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Protectionism in International Insurance Transactions

by Richard Senti, Zurich*

Efforts have been in progress for a number of years now to conclude an agreement on the regulation of international trade in services, including international insurance activities. The proposals put forward by the OECD, UNCTAD and GATT differ considerably from one another, as do those put forward by individual countries. How important is international insurance? What trade barriers exist today? What reforms have been proposed and what is the likelihood of their being realized?

When talking about the international business of insurance companies we must differentiate between foreign branches, subsidiaries and agents on the one hand and genuine foreign business in the sense of contracts with a foreign company on the other. The premiums received by branches abroad are not, as a rule, transferred to the main office, or only on the level of the distribution of profits. The branches use their receipts for extending the local organisation, covering current running costs and claims, or for building up reserves. The foreign activities of a concern therefore scarcely show in the balance of payments of the countries concerned or in any other statistically measurable transaction.

Insurance companies are, however, very much internationally oriented and there is considerable interpenetration between countries. The USA and Great Britain are both active in over 40 countries with about 600 agencies each in the life insurance field. France, Switzerland, the Federal Republic of Germany and Canada have 100 to 160 foreign agencies and Italy, the Netherlands and Japan 60 to 70. Most countries concentrate their foreign activities on certain areas for reasons of market proximity or because of tax or other advantages: more than half of the USA's foreign agencies are in Canada and Puerto Rico; Canada, on its part, concentrates on the US market, the Federal Republic of Germany on France, Belgium and the Netherlands, and Britain on the EC member countries. Swiss foreign agencies are markedly widely spread.

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In contrast to the usual definition of protectionism the following remarks speak of protectionism when two conditions are fulfilled:

- It necessarily involves *state* intervention in the economy. Decisions taken by individual companies, even if they affect foreign competition, do not fall within the scope of this paper.
- State intervention can be deemed protectionist if, by diverting factors of production, the result is a reduction in worldwide real income or an international redistribution of income.

Consequently, protectionism consists of the protective measures ordered or allowed by the state for the benefit of individual economic groups to the detriment of other economic groups, such as domestic consumers, foreign industries or service industries.

Trade barriers can be subdivided according to various criteria. The OECD distinguishes between trade barriers with reference to foreign branches and transactions on the one hand, and the nature of these trade barriers and their application in different countries on the other.¹ The UNCTAD considers the country's stage of development as an important factor: which trade barriers are applied by industrialised countries and which by developing countries?² Finally, from the point of view of economics the following questions are of interest: which trade

¹ OECD: International Trade in Services, Insurance, Paris 1983, pp. 39 ff.

² UNCTAD: Third world insurance at the end of the 1970s, TD/B/C.3/169/Add. 1/Rev. 1, New York 1981, pp. 4 ff.

barriers can be justified on the grounds of economic policy? Which are based on social policy considerations and which are of a national policy nature?

Trade Barriers as Instruments of Economic Policy

The following trade barriers are usually based on economic policy arguments:

- Almost all developing countries create state monopolies and partially state-controlled insurance concerns, whereby parties taking out insurance are obliged to use the services of these institutions. In the industrialized countries, government-run insurance companies (except for social insurance) are less common.
- In almost all countries where trade is government-controlled, and in developing countries, imported and exported goods must be insured with a domestic company. Similar regulations also apply in France and Italy: imported and exported goods may only be insured with national companies. Austria imposes a supplementary tax on imported and exported goods which have foreign insurance cover.
- A typical characteristic of insurance activities in the developing countries is that most insurance transactions are either wholly or partially subject to compulsory reinsurance with state-owned companies. Compulsory cession is relatively rare in the industrialized countries; Italy has a partial compulsory cession for life insurance, as do Japan and Norway for personal liability insurance.
- Many developing countries and many industrialized countries prohibit the transfer of capital abroad. This applies in Denmark and Sweden to life insurance, in Australia, the Republic of Ireland, New Zealand, Norway, Poland and Spain to all categories except transport insurance, and in Belgium, France, Italy and Austria to individual insurance fields.
- In countries where insurance is government-controlled, bans on advertising are irrelevant. However, in 15 out of the total of 24 OECD countries there are also total or partial bans on advertising for insurance companies which do not have a business license. Thus no advertising for foreign firms is allowed in Austria, Canada, France, Greece, Italy, Spain and Sweden. The same applies in Belgium and Switzerland with the exception of transport insurance. In Denmark, foreign advertising is allowed only in the local press, in Japan foreign advertising is permitted only for transport and travel insurance, and in the Netherlands only for life insurance.

□ Tax penalties are often imposed on foreign insurance companies. Australia, Canada, New Zealand, Austria and individual American States impose additional taxes on the premiums of insurance cover taken out with companies which are not established or authorized to do business in the country, and these practices are highly differentiated. Discriminatory fiscal measures are also practised in Belgium, the Federal Republic of Germany, Great Britain, Luxembourg, Austria and the Netherlands, where the premiums on insurance taken out with foreign companies are not deductible from taxed income or profits.

The trade barriers listed above have in common that they are usually based – rightly or wrongly – on economic policy arguments. It is evident that countries with low income impose far harder and broader protective measures than the industrialised countries of North America or Europe. This correlation between poverty and protectionism in foreign trade may be due to the fact that an insurance company must make sure that risks are adequately spread and must have a sufficient volume of transactions to cover itself against losses and ensure efficient administration. These countries would usually be too small to be competitive in the insurance business in an open market. Furthermore, the countries of the Third World have high capital requirements and must therefore take measures to prevent the outflow of capital.³

Trade Barriers as Instruments of Social and National Policy

Under the heading of social policy protectionist measures are demanded to increase the collective satisfaction of needs and also to improve the employment situation. The state is also held responsible for public law, order and security. The legislature, therefore, must put limits on certain types of economic activities which could be damaging to the general public or lead to a breach of faith in business.

It is extremely difficult to say which trade barriers fall under the heading of social policy. It is, namely, perfectly possible that the initiative to erect trade barriers comes from companies established in the country. The protection of policy holders is in this case a pretext for a policy on insurance business which is in the interest of the companies.⁴ The section below attempts to

³ Ibid., pp. 11 ff.

⁴ Cf. the criticism of the Swiss Insurance Supervisory Council and of the restrictions on competition practised by insurance companies in Switzerland, in: Gerhard Schmid: Staatsaufsicht, Kartelle, Obligationen und Pools im Bereich der Privatversicherung, in: Juristische Fakultät der Universität Basel (ed.): Festgabe zum Schweizerischen Juristentag 1985, p. 327 f.

summarize the trade barriers to insurance activities founded on social policy.

□ In many countries insurance companies have been either completely or partially nationalized with the aim of maintaining jobs and employment levels within the country. In this context the economic policy measures mentioned above can also fall under the heading of social policy.

□ The regulation whereby a foreign company setting up in a country must employ nationals also falls under the heading of social policy. This condition is sometimes limited to senior management. In many developing countries foreigners do not receive work permits for insurance activities. This can make the setting-up of a subsidiary or agency impossible, particularly in the case of specialised insurance demanding a high degree of specialised knowledge.

□ Almost all European countries and many developing countries demand that foreign companies established in the country hold additional reserve and guarantee funds and high equity-to-debt ratios. These requirements are often coupled with the condition that these reserves must be invested in the country itself. An EC insurance company with its head office in an EC member country can calculate its reserves in proportion to its overall volume of business (national and foreign) and hold them in the country in which it has its head office. A non-EC company with its head office outside the EC must, on the other hand, calculate its reserves according to the volume of business within each EC country separately and hold them in that particular country. In addition, a non-EC company must pay a deposit in each EC country in which it is active. EC insurance companies are not subject to this obligation.⁵ This is intended to

⁵ OECD, *op. cit.*, p. 15.

afford additional protection to holders of foreign insurance policies.

□ For the protection of the insured parties, many countries decree that domestic risks can only be insured against by companies with a registered office in the country or a business license. This is the case, for example, in France, Greece, the Republic of Ireland, Italy, New Zealand, Poland, Spain and Switzerland.

Many barriers to international trade in services cannot be explained conclusively unless national policy is taken into account. Politically based trade barriers are the expression of a country's dependence on, or its desire for independence from, other countries. Examples of trade barriers resulting from national policy are:

□ The principle of reciprocity. Thus, for example, Denmark and Spain both practise reciprocity in the issuing of licenses to foreign insurance companies: foreign insurance companies should not receive better treatment in Denmark or Spain than Danish or Spanish companies in the country concerned.

□ Arbitrary issuing of licenses. For example, Finland, the Republic of Ireland and Italy issue business licenses according to market needs, which opens the door to arbitrary practices.

□ Discrimination against countries where trade is government-controlled. Many American states refuse to allow insurance companies from such countries to set up branches.

Quantifying Protectionism

Quantifying protectionism in insurance is difficult because insurance covers an extremely wide range of services as risk cover and payment of damages varies with each individual contract.

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V E R L A G W E L T A R C H I V G M B H – H A M B U R G

Our attempt to quantify protectionism covers three basic questions:

- To what extent does protectionism lead to worldwide economic losses?
- What is the extent of the cost disadvantage to foreign competitors as a result of protectionism?
- To what extent does protectionism simply produce a redistribution of income between domestic and foreign insurance companies?

Economic Losses

Losses to the national economy can be determined above all in the field of transport insurance. The restrictions currently imposed in most state-trading countries and in developing countries, where imports and exports must be insured with domestic companies, means a high degree of inconvenience and uncertainty for trade. It is, as a rule, extremely difficult for Western importers and exporters to defend their rights in state-trading or developing countries.

The general worldwide practice is therefore that Western firms, in addition to the policy taken out with the "compulsory insurer", also cover themselves with their own domestic insurers for the differences in protection and/or conditions, and take out extra import or export risk insurance. This practice has resulted in a part of trade flows to and from developing countries and those with state-controlled trade being doubly insured, which to a certain extent represents an effective macroeconomic loss, because the use of means of production for double insurance purposes would have been unnecessary if the party seeking insurance had had a free choice.

Approximately half the trade with developing countries and countries where trade is government-controlled is in effect doubly insured. For transport insurance this means that approximately 3.7 billion dollars are paid out for double insurance. The premiums amounting to 3.7 billion dollars represent additional costs to the traders with double insurance in the region of 0.6% of the commercial value. The Swiss Insurance Union estimates that inadequate insurance coverage in developing countries accounts for between 1/2 and 1% of Swiss export volumes to these countries. Assuming

that operational costs account for between 25 and 30% of insurance companies' premiums, the final effective worldwide economic loss amounts to almost 1 billion dollars per annum. Labour and other factors of production are employed to this extent for services that would be unnecessary under conditions of free trade.

Cost Disadvantages

Competitors are subject to cost disadvantages attributable to protectionism if foreign companies have to pay higher taxes (as in France) or are obliged to maintain higher levels of reserves and solvency margins than domestic insurance companies.

The cost effects of higher technical reserves and solvency margins cannot be accurately estimated. Dieter Zoelly presented an estimate in 1982 according to which discrimination against foreign companies in the EC by means of higher reserves and stricter regulations on solvency amounted to 10%.⁶

During a recent debate in the British House of Commons it was pointed out that discrimination against British insurance concerns in the EC member countries (with the exception of the Netherlands) meant that premiums had increased by 5%.

José Ripoll, a member of the UNCTAD secretariat, points out that in the early 1970's France, under the French-Franc-Union, had a surplus on its balance of trade in insurance over a number of years amounting, for example, to about 176 million FF_r in 1973 (as against 43 million FF_r in 1970). As he says, this may seem insignificant given the size of France, but in fact represents a very considerable amount for the African states involved.⁷ More precise figures are not available for balances of trade in insurance. Nevertheless, Third World countries are especially concerned about this trend, and in part nationalize insurance companies precisely because of the capital outflow they entail, whilst simultaneously prohibiting the export of capital.

US Proposals

American proposals for the international regulation of trade in services are essentially based on the following points:

- The future regulation of international trade in services should be conducted within the framework provided by already existing international organizations such as the GATT.
- Multinational agreements must take account of the principle of residency, most-favoured-nation and non-discrimination principles, competition between public

⁶ Dieter Zoelly: Versicherungsabkommen – Testfall Schweiz/EG, in: Staatsbürger, 1982, No. 4, p. 31; on the EC-regulations cf. Marcel Grossmann: Die Versicherungs-Regelung in der EG, in: Schweizerische Versicherungs-Zeitschrift, 1981, No. 1, pp. 10 ff.

⁷ José Ripoll: UNCTAD and Insurance, in: Journal of World Trade Law, 1974, Vol. 8, No. 1, p. 78.

and private sectors, right of ownership, the principle of unhindered market access, mutual information and the settlement of disputes.

□ Under this “umbrella of principles”, bilateral agreements for individual service sectors would have to be allowed in order to give due consideration to specific national peculiarities and needs. The proposed restriction to limit participation in agreements to partners of more or less equal economic strength considerably narrows down the American suggestions and gives rise to the suspicion that the American proposals are following the model of the Multi-fibre Arrangement which, beneath the shelter of general recommendations, promotes national trade interests.

Third World Proposals

UNCTAD has paid great attention to services, and especially insurance, in recent years. Its criticism of industrialized countries' proposals and also its own efforts can be summarized in three points:

□ The industrialized countries fail to take sufficient account of the development policy aspects of the Third World.

□ The discussion to date has not distinguished between market access and the freedom to set up a company. The problem of labour mobility and access to capital and technology should be included in the proposals.

□ A world trade agreement on services should take into consideration the questions of education, research, external financing, technology transfer, technical assistance and the free movement of labour.⁸

The Difficulties of Finding a Solution

The proposals forwarded in recent years and the discussion to which they have given rise concerning the regulation of international trade in services have so far failed to make much headway. There are three main reasons which explain why the worldwide opening-up of services markets is proving difficult or impossible: the submission of proposals based solely on national interests; the lack of information as to the real need for protection in individual countries; the lack of an independent policy for services amongst trading partners.

□ The reforms proposed by individual countries and groups of countries are heavily geared to self-interest, and in their present form have no common denominator.

The industrialized countries favour the option of negotiating bilateral agreements, thereby favouring strong trading partners. Developing countries, on the other hand, are calling for the free international movement of labour, which is unacceptable to the industrialized countries for reasons of employment policy.

□ The current proposals are based on the idea of a general liberalization of trade in services similar to the opening-up of markets to manufactured goods. However, nobody, neither in the OECD nor in conjunction with the latest round of trade talks at the GATT, has considered the real needs for protection in individual countries. The current widespread preoccupation with compiling as accurate a list as possible of the trade barriers at present in force, systemizing and categorizing on a country-by-country, product-by-product basis, clearly overlooks the fact that mere knowledge of existing trade barriers does not help to dismantle them; the important point is rather that no new trade barriers should be permitted where the protection needs of individual countries are already covered. In other words, in place of list-making, what is needed is an analysis of the protection needs, completed by some system of indicators which clearly shows how the existing risks in individual countries can be covered with the minimum of protection.

□ The lack of results of efforts made to date is due in the final analysis to individual countries' lack of an independent policy for services.⁹ Only when individual countries and governments know which services contribute the most to a country's economy, which trade barriers have which effect, the effects of free trade etc., can they enter into corresponding agreements.

The effort to open up markets for international trade in services results in the necessity of subordinating short-term national interests to a certain extent to long-term common interests, of analysing individual countries' needs for protection and reducing trade barriers to a necessary minimum, as well as of working out and formulating between trading partners an appropriate policy for services. This is the only way to break out of the current deadlock situation and, in the sense of the GATT preamble, to contribute to the worldwide rise in living standards, to the attainment of full employment, to high and constantly increasing levels of real income, to the best use of the world's aid resources as well as to growth in the production, and expansion in the exchange, of goods and services.

⁸ Cf. UNCTAD: Services and the development process, TD/B/1008, 2. 8. 1984, pp. 64 f.

⁹ Murray G i b b s : Continuing the International Debate on Services, in: Journal of World Trade Law, 1983, Vol. 19, No. 3, p. 217.