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Government policies for the development of the livestock insurance market. Case of Albania

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Abstract

Through factor analysis, this paper aims to identify government policies that promote the development of the livestock insurance market in Albania. Livestock insurance is key to managing the risks threatening this livestock sector. Given the importance of insurance in developing the rural and national economy, the state has a key role in stimulating the demand and supply of livestock insurance products. Through a questionnaire, 105 experts in the field of insurance expressed their opinions on government policies that they thought would promote the development of the livestock insurance market in Albania. The study results showed that factors such as premium subsidies, government efforts to raise farmers' awareness of the importance of livestock insurance schemes, and facilitating administrative procedures are important in developing the livestock insurance market. The results of the factor analysis help the government design effective policies for the development of this sector.

Keywords: livestock sector, development, problems, government, support.

1. INTRODUCTION

Livestock insurance is a small but important part of agricultural insurance that protects animals such as cows, goats, horses, pigs, calves, sheep, etc. (Iturrioz, 2009). Three models are distinguished based on the level of government involvement in the livestock insurance service: the private insurance model, the public insurance model, and the public-private partnership model (Roberts, 2007; Warner & Alemu, 2018).

In the private insurance model, private insurance companies manage and assume the risks the insured faces. They design livestock insurance products and offer them to farmers. Farmers who decide to purchase insurance contracts pay a certain premium, which, depending on the insurance contract terms, can be annual or monthly. The role of the government in the private insurance model is limited. Through laws, it regulates and supervises the insurance market. Some private insurance models are affected by adverse selection and moral hazard, which leads to low demand for insurance products, low-risk diversification and high premium rates (Hazell, 1992). Private insurance systems play a key role in improving the financial sustainability of farmers, as by reducing financial risk, losses in the event of unexpected events are minimized (Warner & Alemu, 2018). This type of scheme has no fiscal costs, but in order to manage systematic risks, it requires support from the state and reinsurance companies (Hazell, 1992). The public insurance model for the livestock sector functions similarly to other social insurance systems. It provides financial support to farmers in the event of certain losses. The government fully manages the public insurance system. Farmers contribute to the system through periodic payments based on their income from livestock activity. In the event of foreseeable events, the state compensates farmers depending on the level of protection obtained. The insurance product is generally single and unified. The existence of a single state-owned monopolistic insurer causes service problems (Bielz et al., 2008). Since this insurance system is often mandatory, there is a high participation of insured persons and a large diversification of risks.

Public insurance schemes are ineffective because contracts have the same conditions and do not categorize insured persons according to risk classes. The public-private partnership insurance model operates through close cooperation between the government and private insurance companies. Government authorities and private insurance companies cooperate to identify farmers' needs, define risks and design strategies to provide effective protection. Farmers' contributions and government subsidies realize financing. Insurance products are designed and sold by insurance companies, which also use their knowledge of risk management (Paudel, 2012). The government monitors the services provided by insurance companies to ensure high standards and meet the needs of farmers. The public-private partnership system produces diversified portfolios, high farmer participation, adverse selection, and reasonable administration costs (Xing & Lu, 2010). This insurance scheme requires protection from reinsurance companies. The private-public insurance scheme has competition in service and reasonable fiscal costs and has contributed to the creation of innovative livestock insurance products (Chatterjee, 2017). The clear division of tasks across sectors in the livestock insurance model developed through public-private partnerships influences the success of this program (Fava et al., 2021).

2. METHODOLOGY

To achieve the purpose of this paper, data were collected through a questionnaire that was distributed to 105 experts in the livestock insurance market in Albania. These professionals are employees of insurance companies, academics, and employees of the Financial Supervisory Authority. The individuals included in the study have very good knowledge and experience in the insurance market. The questionnaire was distributed physically. Experts were selected randomly, guaranteeing representation of experts working in different financial and academic institutions. The questionnaire was designed to collect data about experts' opinions on the measures that the government should take to stimulate the development of the livestock insurance sector in Albania. The collected data were processed with SPSS. Through quantitative analysis, the mean and standard deviation were calculated for each option, thus providing a result of the most frequently selected options. Each participant was informed about the purpose of the study and about maintaining the confidentiality of the data.

3. LITERATURE REVIEW

3.1 The role of the government in the development of the livestock insurance market

Governments support the development of the livestock sector through direct payments, input and output policies, low-interest loans, tax breaks, disaster relief programs, etc. The development of the livestock insurance market positively affects the development of the livestock sector. Government support plays an important role in increasing the demand for livestock insurance. Systematic risk is the main argument that justifies government intervention in the insurance market (Ibrahim, 2012). The lack of insurance infrastructure in rural areas, the lack of private sector insurance services, the high costs of developing insurance products, limited access to reinsurance markets, the high costs of signing contracts and high farm insurance premiums are other arguments that support state intervention in livestock insurance schemes (World Bank, 2015) In order to develop the supply of livestock insurance products, the government assists insurance companies by drafting and improving the legal framework. It makes available to insurance companies weather data from meteorological services, data collected from surveys directed to farmers, provides education and awareness programs to farmers on the importance of insurance schemes, helps in the distribution of insurance products, subsidizes insurance premium and administration costs, etc. (Mahul & Stutley, 2010).

The government encourages the development of the farm insurance market through active participation and incentives (World Bank, 2015). Through active participation, the state designs and implements continuous policies to stimulate the demand growth for insurance products. In contrast, the state indirectly supports selling insurance products through the incentive model. According to (Qingshui & Xuewei, 2010), increasing farmers' incomes, drafting legislation by appropriate standards, subsidizing, training insurance company employees, promoting the importance of farm insurance, and establishing mechanisms to prevent the spread of systemic risk are some steps that the government should take to develop the livestock insurance market.

Without subsidies, livestock insurance markets would not develop (Smith & Glauber, 2012). They help increase participation in the insurance market and make insurance more affordable for farmers by stimulating the development and effective functioning of insurance markets (Chatterjee, 2017). The level of subsidy depends on the policies followed by each country. According to (Nash, 2018), although subsidies make insurance more affordable, they are not the only means encouraging farmers to participate in farm insurance. (Ibrahim, 2012) speaks out against state intervention in farm insurance schemes. According to him, premium subsidies encourage farmers to take less care of their animals and distort other sectors of the economy since citizens' taxes pay for them.

Suppose livestock insurance is not supported by the government and by reinsurance companies. In that case, insurance companies must maintain high capital reserves, which increases the cost of capital and the cost of the premium. Thus, state support is necessary for the insurance premium to be affordable for farmers (Mateos-Ronco & Server Izquierdo, 2011). According to (Nshakira-Rukundo et al., 2021), government cooperation with risk transfer institutions increases the supply of insurance and strengthens the reinsurance service. Livestock insurance markets are established, improved and developed only if the laws and regulations set by the state are implemented. The government should establish farm insurance as one of the main points of protecting farms and the quality of their production (Baskaran & Maher, 2021). Governments should cooperate with private insurance companies, banks and international organizations to implement farm insurance programs (Zeng & Mu, 2010). The government should guide insurance companies in supporting a sustainable insurance system (Yanli, 2009). Creating government policies for risk management that guarantee the safety of farmers is essential for the successful development of the livestock insurance market (Covarrubias & Arias, 2006). Given that most farmers in developing countries do not know about the functioning of insurance schemes, governments should assist in effectively disseminating information among farmers. In developing countries like Albania, the state must undertake reforms to develop the livestock insurance industry, which require insurance companies to expand the offer of livestock insurance products, increase the number of distribution channels, and promote insurance products.

3.2 The Problem of the Supply for Livestock Insurance Products

Insurance companies are often unwilling to sell livestock insurance products due to this sector's risks. Some of the main challenges that insurance companies encounter in providing livestock insurance products are:

Systematic risk

"Systemic risk refers to the risk or probability of the destruction of an entire system, rather than the destruction of a part of the system" (Kaufman & Scott, 2003). Epidemic livestock diseases that spread rapidly and affect many animals are considered systemic risks. Systematic risks bring large and unaffordable losses to insurance companies, since as a result of large claims, they face a lack of liquidity and are difficult to diversify.

Adverse selection and moral hazard

The causes of the failure of farm insurance markets have resulted mainly from adverse selection and moral hazard (Miranda & Glauber, 1997). Adverse selection is related to asymmetric information whereby insurance companies are not made available to all information from policyholders. This affects the incorrect determination of the premium. Moral hazard refers to changes in farmers' behavior due to insurance. When farmers feel protected from risks as a result of insurance they can change their work strategies (Roll, 2019).

Limited access to international reinsurance markets

International reinsurance markets play an important role in insurance companies' financial stability. Through reinsurance, insurance companies can transfer a part of the risk. Reinsurance is the provision of insurance that has the function of reducing the exposure of insurance companies to individual risks by limiting losses and increasing the solvency margin (Mahul & Stutley, 2010). This allows insurance companies to diversify their portfolio and make the product offering to their customers more affordable. For many developing countries, entry into these markets is limited or impossible due to various factors such as lack of capacity, lack of experience, difficulty adapting to the criteria and standards of international reinsurance markets, etc.

Lack of rural infrastructure

The main market in which livestock insurance services are offered is rural areas. Insurance companies face a lack of infrastructure in these areas for the distribution of insurance products. Lack of infrastructure includes not only bad roads, but lack of electricity, limitations in technology, limited access of farmers to information about livestock insurance products, difficulties in accessing veterinary services, lack of laboratories for determining animal diseases , lack of risk assessment equipment, etc. (Fava et al., 2021; Singh et al., 2020).

Low awareness

In the development of the livestock insurance market, one of the main challenges is the lack of farmers' awareness of the importance that livestock insurance schemes have in stabilizing the volatility of profit. Farmers are often unaware of the risks they may face, and the role insurance schemes can have in mitigating these risks. They do not have enough information about insurance schemes and the benefits they offer (John, 2023).

Lack of affordability

Insurance premiums are often not affordable for low-income farmers (Ibrahim, 2012; Singh et al., 2020). Farmers with low incomes often cannot become part of livestock insurance schemes due to limited liquidity.

Lack of legal framework

The lack of a clear and complete legal framework in order to support the expansion and operation of the livestock insurance market, especially in underdeveloped countries and in developing countries, hinders the increase in the supply of insurance products, increases delays in the payment of compensations, prevents the development of new insurance products, increases the mistrust of farmers towards insurance schemes, etc.

Information asymmetry

Asymmetric information occurs when one party to the transaction has more information than the other party (Herbold, 2014; Mahul & Stutley, 2010). The information asymmetry between the insurer and the farmer leads to the vulnerability of the insurance contract. Insurance companies have less information on the risks to which the insured are exposed.

4. RESULTS

The study conducted an exploratory factor analysis on six main variables related to the development of the livestock insurance market: partial subsidy of the premium, government efforts to raise farmers' awareness of the importance of livestock insurance, facilitation of administrative procedures; the government should increase cooperation with insurance companies in developing new insurance products for livestock, insurance promotion, etc., fiscal incentives for insurance companies offering livestock insurance products, creation of a favorable legal environment for insurance companies in order to stimulate livestock insurance. 51.4% of experts surveyed were male. The objective was to identify government incentive policies that affect the development of the livestock sector. The table below shows the results of the analyses conducted. According to the experts surveyed, the most important factor that will stimulate Albanian insurance is livestock, shown in the partial subsidy of the premium. The high average indicates the importance of the factor. The standard deviation of this factor is low, which indicates that the experts surveyed have high agreement on assessing this factor as key in assessing the value of livestock insurance. Based on the interpretation of the mean and standard deviation, the government's efforts to increase farmers' awareness of the importance of livestock insurance schemes are also important in promoting livestock insurance development. The low standard deviation for this factor indicates agreement of opinions among experts. The third factor experts selected as important in insurance is the facilitation of administrative procedures. This factor has a high standard deviation, which indicates the variability of experts' opinions on the importance of this measure in their livestock insurance explanations.

Table 1: Exploratory factor analysis

	Mean	Std. Deviation	Analysis N
Partial subsidy of the premium	1.8135	.14730	105
Government efforts to increase farmers' awareness of the importance of livestock insurance	1.6254	.27874	105
Facilitation of administrative procedures	1.4038	1.10772	105
The government should increase cooperation with the insurance companies in the development of new insurance products for livestock, promotion of insurance, etc.	1.0653	1.29495	105
Fiscal incentives for insurance companies that offer livestock insurance products	1.1762	1.37429	105
Creation of a favorable legal environment for insurance companies with the aim of stimulating livestock insurance.	1.2095	.40892	105

Fiscal incentives for insurance companies that offer livestock insurance products and the creation of a favourable legal environment for insurance companies to stimulate livestock insurance are considered by experts to be important factors in the development of the livestock insurance market. However, the high deviation of these factors indicates disagreement among experts. The least important factor selected in the development of the livestock insurance market is that the government should increase cooperation with the insurance companies in developing new insurance products for livestock, promotion of insurance, etc. It is worth noting that the standard deviation of this factor is high, which indicates different opinions among experts. The analysis results show that most experts select some measures, while others require further discussion to achieve a more accurate result.

CONCLUSIONS

The livestock insurance market in Albania is non-existent. This paper studies the policies and measures the Albanian government should take to develop the livestock insurance market. From theoretical and factorial analysis, it was concluded that our country lacks the legal framework for regulating this market. Many farmers are not aware or informed about the benefits of livestock insurance schemes. Therefore, it is necessary for the government to educate and inform farmers about livestock insurance schemes to increase their awareness of the importance of these schemes. According to the experts studied, premium subsidies are the main factor that would increase the supply and demand for livestock insurance products. The state should stimulate the supply of insurance by drafting government policies that encourage insurance companies to offer products that cover various livestock risks, such as livestock diseases and natural disasters. Promoting livestock products is an important step towards the insurance market's success. One of the main challenges that farmers face when purchasing insurance products is the various administrative procedures. Simplifying these procedures and increasing transparency is an important step in stimulating farmers' demand for insurance. It is necessary to draft regulations related to compensation for farmers after a disaster. Delays in paying compensation should be avoided, and the procedures for claiming compensation should be simplified to increase farmers' trust in insurance institutions. The government's commitment and investment in the livestock insurance sector would positively impact the development of the livestock sector by protecting farmers in the event of natural disasters.

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