

# THE IMPACT OF PUBLIC INSURANCE POLICY ON THE PRIVATE INSURANCE MARKET: THE EXAMPLE OF AZERBAIJAN

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## ABSTRACT

Economic actors, whether individuals or organizations, generate externalities via their economic activities, which may have either positive or negative effects on other economic units that are not directly connected to them. These actions are undertaken with the aim of maximizing their own benefits or profits. The insurance industry, which plays a significant role in economic activity, also generates social externalities.

The insurance business generates significant externalities, resulting in a substantial multiplier impact on the economy. The insurance industry will significantly contribute to the key components required for investment in Azerbaijan's rising economy, including savings, financial possibilities, a trustworthy environment, and risk reduction. Azerbaijan's contribution in the global insurance market is quite small in proportion to its potential. This article aims to analyse the impact of governmental insurance practices on private insurance.

**Keywords:** State Insurance, Private Insurance, Insurance in Azerbaijan, Insurance Market, Global Market, Insurance Policy

## INTRODUCTION

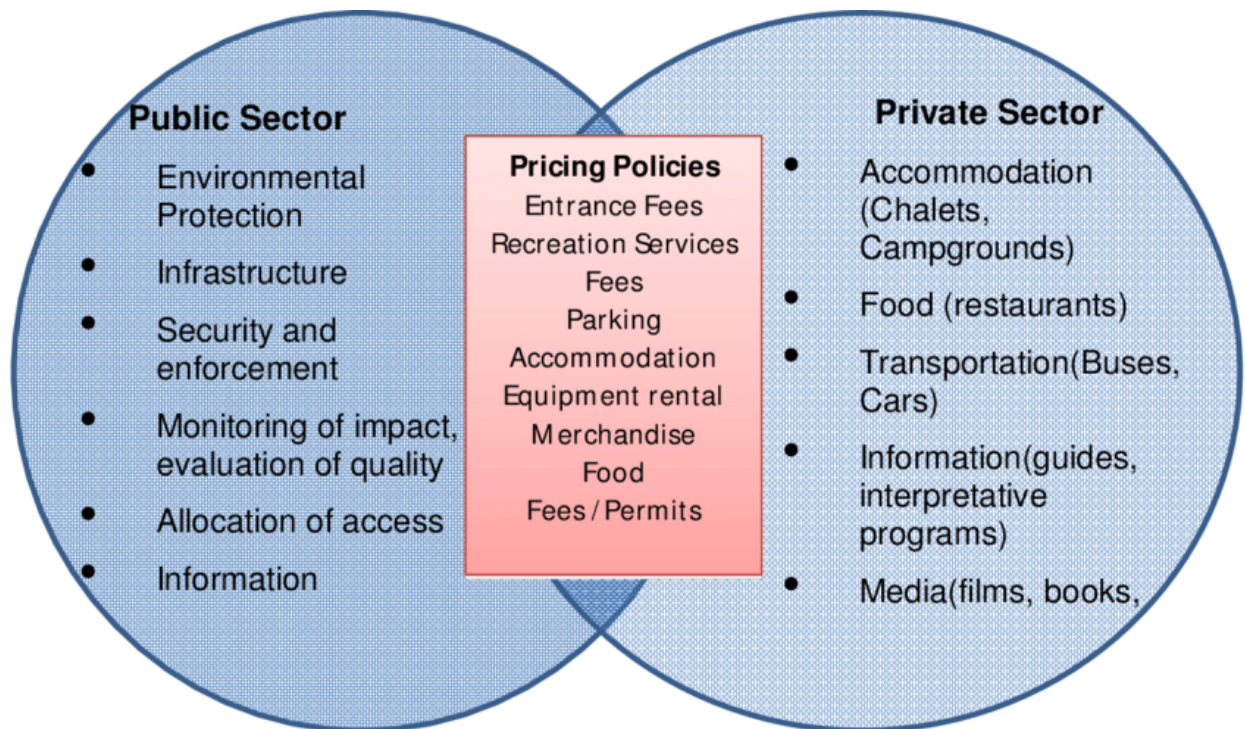
Insurance is often seen as a personal or institutional measure that protects individuals financially from potential hazards in exchange for a specified payment. However, it also functions as a public benefit and has external effects for other parties involved. Throughout one's lifetime, both personal well-being and possessions are susceptible to a multitude of hazards (Acınan, 2005). Insurance practices originated as a mechanism of collaboration among persons who may encounter comparable dangers. Gradually, it has facilitated commerce, provided financial resources for taxation, and offered credit options for entrepreneurs. Insurance practices have not only had favorable impacts on economic development and progress, but they have also actively contributed to the financial system via their function of generating funds. Societies cognizant of this influence have endeavored to use the insurance industry for their advancement and expansion. Upon analyzing global insurance data, it becomes evident that economically advanced nations have a more developed insurance industry in comparison to other countries (Swiss Re, 2020). The growth of insurance knowledge and culture is linked to the rise in per capita income, as well as the increase in social consciousness and the establishment of both internal and external security. Inner security refers to a state of spiritual equilibrium, organization, direction, and assurance. External security refers to the level of financial pleasure and trust that people want in their connections with their surroundings. The security system ensures access for authorized personnel while also prioritizing integrity, orientation, and the maintenance of a secure environment. Among these objectives, the pursuit of spiritual and bodily well-being and the attainment of a sense of peace and security are also taken into account. While the economic literature has extensively examined the idea of externality in relation to public or semi-public goods, there is a notable absence of detailed studies on the externality impact generated by insurance services. Our objective is to become a trailblazing essay in the future in this topic, which has received little attention in the economic literature, and to lead the way in future publications on this subject.

**LITERATURE REVIEW**

The insurance system generates externalities that permeate society when individuals buy risks in advance. Insurance ensures societal tranquility and safety by mitigating potential damages resulting from many risks, including death, disease, disability, natural catastrophes, fire, and theft. It affords individuals the freedom to live without apprehension of future uncertainties. By adopting this approach, both organizations and people may have a sense of security in their social and economic endeavors. Insurance is a mechanism where firms and people facing similar risks pool their resources to mitigate financial losses that exceed their individual capacity to bear. Insurance firms construct and operate the system, which is founded on the notion of solidarity. Insurance policyholders pay their premiums in advance to cover any losses caused by risks, so removing the uncertainty of future costs in the open market and facilitating transactions. The damage premium balance is a crucial determinant of insurance demand, and it is the duty of the insurance firm (Seyfullahogulları and Başoğlu, 2018).

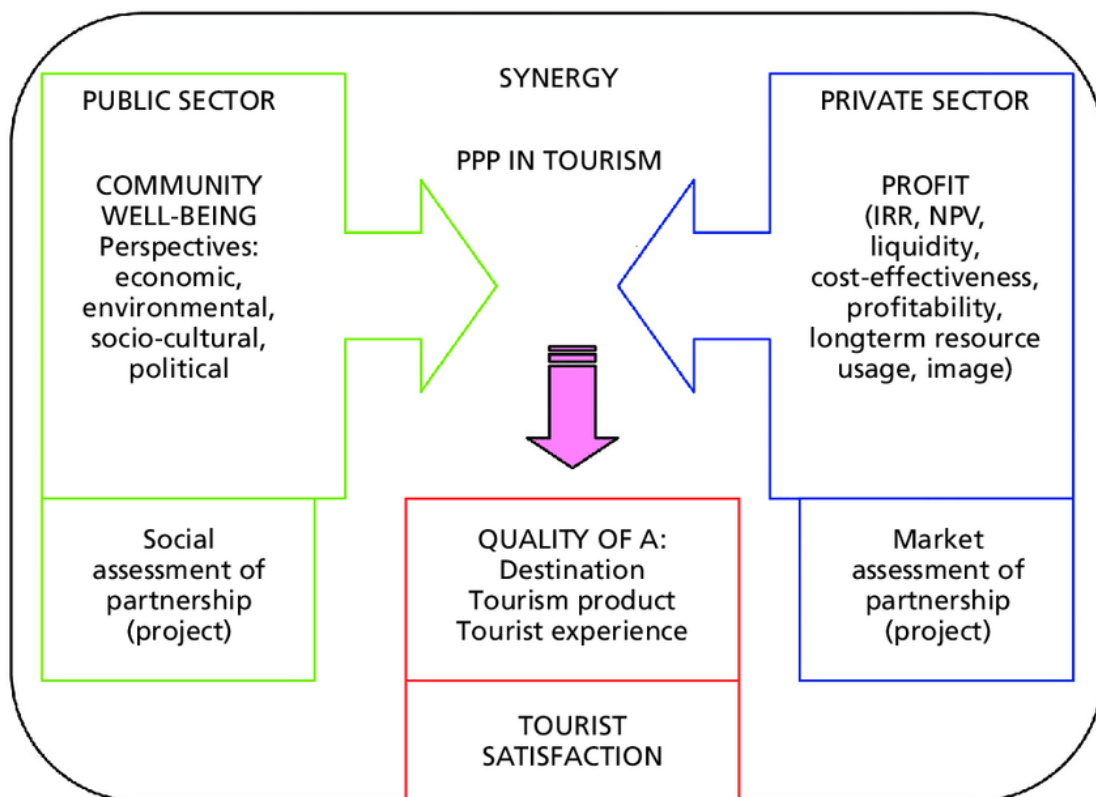
Neo-Classical growth theory posits that technology plays a crucial role in development, and nations without technical advancements can only experience growth under stable conditions. The presence of this circumstance hinders governments to some extent from using the incentive system to promote economic development (Hussel, 2005). Endogenous growth theory has enhanced the existing body of knowledge by elucidating the underlying factors that drive economic growth in situations when technical advancement is absent. This is achieved by including externalities into the theory, an aspect that is missing in Neo-Classical growth theory. Endogenous growth theory posits that growth and investments in one area generate positive externalities in other industries. In endogenous growth theory, it is anticipated that economic growth would rise in the remaining sectors of the economy due to the presence of favorable externalities under stable conditions. The financial industries, including banking and insurance, have significant influence in disseminating positive externalities. The influence of financial innovations in economic growth is evident in economic assessments. Financial institutions contribute to economic progress by promoting savings, efficiently allocating and forming capital. In order to generate capital, it is necessary to acquire resources that grow via savings, which in turn come from consumption. Capital allocation is the transfer of funds from savers to investors for the purpose of producing products and services. To ensure the complete functioning of the economic system, it is necessary to assess insurance funds in capital markets. Financial markets and intermediaries play a crucial role in efficiently allocating resources to investors. Research has shown a direct correlation between financial development and economic growth. Insurance is widely acknowledged as a significant measure for assessing the degree of development in societies, since its prevalence and growth are closely linked to economic progress. The proportion of insurance premiums in the national income of industrialized nations is one of the highest and has a significant capability for generating funds. Despite facing competition, insurance firms in these nations engage in investment activities similar to other financial institutions, thanks to their growing financial earnings. The link between economic growth and the insurance industry is influenced by factors such as the economic system, regulation, and culture, which may vary across different countries. According to the prevailing economic perspective, advancements in financial systems provide advantages to the national economy, particularly in terms of efficiency (Hartmann et al., 2007). The belief that technology advancement would not only take place in the tangible sector but also in the financial sector further emphasizes the significance of the externality impact of insurance. While insured individuals may sometimes encounter issues relating to the system, the use of insurance has a significant influence on economic performance, equitable allocation of resources, and progress. As insurance practices become more prevalent, the effectiveness of financial activities improves, and it becomes a driving factor for growth and economic development.

Economic growth refers to the increase in the value of goods and services produced in an economy over time. Its impact on society is not immediate and requires a certain amount of time to manifest. Enhancing human rights, democracy, fairness, economic distribution, and quality of life is the only way to attain a higher level of social welfare. Economic growth is a necessary condition for attaining human development, but, it is not enough on its own (Özcan, H., Ökten, N. Z., Uzpeder, İ., 2021). The insurance industry contributes to economic development and, in turn, the growth of the insurance sector has a positive impact on society, establishing an interdependent relationship. As the standard of living improves in emerging nations, there will be a growing recognition of the significance of insurance. Insurance will no longer be seen as an additional cost, but rather as a fundamental need that instills confidence in the future and establishes a sense of security. Insurance, being a field responsible for protecting material assets and preserving wealth, naturally has a connection with human growth (Zortuk & Ebeoğlu, 2016). The primary determinant of a society's degree of social wellbeing is the progressive growth of per capita income over time. In order to augment revenue, it is vital to enhance both investments and output value. Savings may be used to accomplish the capital accumulation necessary for investments. Insurance incentivizes people and organizations to engage in actions that enhance the overall well-being of society (Kunreuther et al., 2013). By taking measures to mitigate risks, both people and organizations generate positive economic externalities that contribute to the overall societal savings.



**Figure 1:** Comparison of Pricing Policies in the Public and Private Sectors

Source: Ismail, S., A Rahman, A. 2009



**Figure 2:** Criteria for the public and private sectors

Source: Peric, M., 2009

The Center for the Development of State-Entrepreneurship Partnership aims to enhance the involvement of the private sector in economic development by utilizing public-private sector partnership (PPP)

mechanisms. This objective is outlined in the strategic roadmaps approved by the President of the Republic of Azerbaijan, as well as in the conceptual documents focused on the social and economic development of Azerbaijan. To guarantee systematic action in promoting and supporting important infrastructure projects, the State-Entrepreneur Partnership Development Center was formed under the Small and Medium Business Development Agency of the Republic of Azerbaijan. The model statute of the Center was authorized by the Decision of the Board of the Ministry of Economy of the Republic of Azerbaijan on 16.07.2019. The State-Entrepreneurial Partnership Development Center currently engages in the following activities: - Proposing improvements to the legislative framework and institutional infrastructure for state-entrepreneurial partnership. - Planning, executing, and coordinating programs and projects related to state-entrepreneurial partnership. - Increasing the involvement of small and medium-sized enterprises (SMEs) in state-entrepreneurial partnership initiatives. - Providing education and support to all interested parties in the field of state-entrepreneurial partnership. - Analyzing and researching projects based on state-entrepreneurial partnership criteria and facilitating their implementation.

The DOST environment in Azerbaijan is established through the implementation of the Law of the Republic of Azerbaijan dated 15.03.2016, which focuses on investment projects related to construction and infrastructure facilities and is supported by special financing. Additionally, the Decree of the President of the Republic of Azerbaijan dated 07.12.2016 further supports the implementation of investment projects related to construction and infrastructure facilities. The conditions for implementing investment projects under the "Build-Manage-Deliver" model by investors are regulated by the "Rule on the methodology for calculating the amount of cooperation assistance and guarantee obligations for contracts concluded within the framework of the "build-manage-deliver" model, approved by Decision No. Q-06 dated 22.05.2017 of the Ministry of Finance board. This rule sets requirements for investors based on the types of construction and infrastructure projects, as well as the characteristics and conditions of the contracts. It also determines the value of goods and services that will be obtained as a result of the investment. As of December 27, 2022, the new Law of the Republic of Azerbaijan titled "On Public-Private Partnership" became effective. With the implementation of this law, the previously mentioned regulatory laws were invalidated, and the contracts will now be governed by the provisions of the Civil Code and the Law "On Investment Activities".

The new legislation defines public-private partnership as a collaborative endeavor between a public entity and a private entity, governed by a contractual agreement, to provide public services and develop and oversee the associated infrastructure. The Cabinet of Ministers of the Republic of Azerbaijan will establish the guidelines for public-private cooperation, which will govern the execution of the legislation. The Ministry of Economy of the Republic of Azerbaijan has been designated as the authoritative entity responsible for overseeing public-private partnerships, including those in the sphere of public-private partnership.

Contribute to the development and implementation of government policies; · Draft tender documents and contracts, or the key terms of contracts, for project implementation; · Arrange competitions or direct negotiations to select a private partner; · Evaluate project proposals and maintain a comprehensive database; · Coordinate the preparation of competition terms and agreement with the government partner, either through a competition or direct negotiations, and make amendments to the contract. Public-private partnership initiatives in the Republic of Azerbaijan are funded by sources that are not forbidden by the country's legislation. The Ministry of Economy determines the form and methods of state involvement in projects based on the project's technical and economic rationale. These details are then recorded in the competition's set of requirements (<https://www.pppdc.gov.az/az/page/azerbaycanda-dovlet-ozel-terefdasligi-muhiti> ).

## **METHODOLOGY**

In this study, we analyzed the benefits of the insurance sector in Azerbaijan in the example of public and private partnerships by conducting a comparative analysis from various sources.

## **DISCUSSION**

Our research focused on the significance of insurance. It is important to prioritize the growth of the insurance industry as it has a direct impact on the matter of entrepreneurship. In Azerbaijan, the establishment of public and private insurance cooperation is presently regulated by state regulations. An effective implementation of the insurance sector, for instance, promotes the stimulation of entrepreneurship.



### CONCLUSION AND RECOMMENDATION

The significance of the insurance system in Azerbaijan is quite significant. This system plays a crucial role in the service industry of Azerbaijan. However, the current insurance system in Azerbaijan is unsatisfactory. There are several issues present in the insurance industry. The primary obstacles hindering the growth of the insurance system in Azerbaijan are the low level of public awareness about insurance services, the presence of a monopoly in the insurance industry, an insufficient legal framework regarding insurance, and the provision of poor quality insurance services. These issues pose significant challenges for the insurance sector in Azerbaijan. These kind of difficulties engender mistrust among individuals. They have a lack of faith in insurance providers and are unwilling to use insurance goods.

Despite the presence of these challenges, the prospects for the insurance system are quite promising in the near future. The primary anticipated prospects in the insurance industry are the advancement of life insurance, the establishment of mandatory insurance, the enhancement of insurance culture, and the augmentation of insurance businesses' capitalization. The following procedures are crucial for establishing a comprehensive insurance system in Azerbaijan.

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