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Explorations in Economic History 41 (2004) 205–232

Explorations in
Economic History

www.elsevier.com/locate/eeh

Efficiency, competition, and the development of life insurance in France (1870–1939) Or: should we trust pension funds?

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Received 9 August 2002

Available online 11 March 2004

Abstract

French life insurance remained underdeveloped in comparison with other countries of similar financial development during the period between 1870 and 1939. We show that technical peculiarities of the contracts used and their interaction with macroeconomic fluctuations explain the wide fluctuations we observe in insurance operations. Nevertheless, these fluctuations are not sufficient to explain the industry's long-term stagnation. Low returns paid to clients, resulting from very conservative investment strategies, were the main reason for that stagnation, since only those interested by the life-cycle related aspects of insurance contracts continued to put money in these institutions, while most savers invested directly in the market or through State-owned financial institutions. The main reason for such an investment (and then low-growth) strategy is the existence of a set of conservative regulations and a stable oligopoly in the industry from the 1880s onwards. We suggest that established insurance companies were able to impose regulations and barriers to entry blocking the access of competitors to their market, so maintaining a hold on a small but very profitable market.

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Keywords: Government bonds; Mortgages; Real estate; Stocks; Financial innovation; Financial systems; Government capture; Portfolio selection

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1. Introduction

The rapid development of research on financial systems in recent years centered on banks or financial markets, both considered as organizations with differing abilities in savings' collection, investment financing, information gathering, and solving problems of corporate monitoring and control.¹ The role of institutional investors such as mutual funds, trust funds and life-insurance companies, which hold a substantial part of the financial market's capitalization in many countries, has been much less studied. These were part of the quantitative study of financial systems by R. Goldsmith and others in the 1960s, but have not figured much in the recent, more theory-based, revival. Nevertheless, these institutions do have an important role not only in providing a service to savers, but also in channeling funds towards firms and as participants in the market for corporate control. Indeed, a frequent complaint among continental European businessmen is that the underdeveloped size of these institutional investors makes their countries' economies vulnerable to a transfer of their centers of decision to foreign countries through the voting rights of foreign institutional investors in national firms, independently from control resulting from FDI.

It is frequently argued that this underdevelopment results from State intervention in the economy, especially the development of generous pensions systems organized on a pure *pay as you go* basis, since this limits financial savings. The underdevelopment of institutional investors has also been seen as a result of the predominance of fixed-income securities in their portfolios, something imposed by governments in order to sell their own debt and facilitate a potential inflation tax.

One purpose of this paper is to test these ideas by examining the role of institutional investors in France before World War II, in a period of free-market economies, with little social security, state-owned industrial firms or exchange control. A second and more historical motivation is to shed some more light on the question of the efficiency of the French financial market. In comparison with London, the Paris Bourse had less firms listed and was even more focused on fixed income securities: French and foreign government bonds in particular, and bonds with government guarantee, such as those of most railways. This has been related to certain characteristics of the French economy such as the small number of joint stock companies and the small size of firms in general (of which it might be a cause as well as a consequence). Eviction by French government issues has been frequently emphasized

¹ This paper is part of a research project financed by the French Research Ministry on the dynamics of the french financial system since the 19th century. It makes wide use of joint research conducted with P. Verley for the XIIth International economic history congress (Madrid, 1998) (Hautcoeur and Verley, 1998). I thank participants at that congress, at the conference on "Risques financiers et systèmes de crédit en France et en Grèce" (Fondation des Treilles, 1999), at the third conference of the European historical economics society (Lisbon, 1999), at the European economic association meeting (Santiago, 1999), at the French Finance Association (AFFI, Lyon, 2003), and at seminars at DELTA, Université d'Orléans and Université de Paris I for their comments. I also thank the referees and editors of this Journal, and especially A. Straus for his comments and his help in collecting the data.

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