Available online at www.sciencedirect.com
SCIENCE DIRECT®

J. of Multi. Fin. Manag. 14 (2004) 249–260

Journal of
MULTINATIONAL
FINANCIAL
MANAGEMENT

www.elsevier.com/locate/econbase

International investment in insurance services in the US

Donghui Li*, Fariborz Moshirian

School of Banking and Finance, The University of New South Wales, Sydney NSW 2052, Australia

Received 16 May 2002; accepted 10 April 2003

Available online 14 December 2003

Abstract

The purpose of this study is to analyze and discuss the determinants of foreign direct investment (FDI) in insurance services in the US. This study demonstrates that solid economic fundamentals in the host countries are the major factors which attract FDI in insurance services, while the uncertainty of the international exchange market increases the investment risk and reduces foreign investors' willingness to invest. The empirical results of this study indicate that national income (NI), the source countries' insurance market size and financial development (FD) of the host countries contribute to the expansion of FDI in insurance services, while the relatively higher wages and higher cost of capital in the host countries discourage FDI in insurance services. The empirical results also suggest that FDI in insurance services complement FDI in banking as well as total trade in insurance services.

JEL classification: G15; G25

Keywords: FDI in insurance services; Globalization; FDI in banking

1. Introduction

Foreign direct investment (FDI)[1] has been important for the world economy for decades and often functions as the principal vehicle of international capital movement, via which

* Corresponding author. Tel.: +61-2-93855873; fax: +61-2-93856730.
E-mail address: donghui@unsw.edu.au (D. Li).

[1] According to WTO (1996), FDI occurs when an investor based in the home country acquires an asset in the host country with the intent to manage that asset. There are three main categories of FDI: (1) equity capital (the value of the MNC's investment in shares of an enterprise in a foreign country). Ten per cent or more of the ordinary shares or voting power of an equity capital stake in an incorporated enterprise, or its equivalent in an

1042-444X/$ – see front matter
doi:10.1016/j.mulfin.2003.04.001

the integration of the global economy, or what is popularly known as "globalization", is promoted (see for instance, Helpman and Krugman, 1989; Ma et al., 2000). This is evidenced by the increased importance of foreign-owned production and distribution facilities in most countries. The annual global total FDI inflows and outflows were around US$ 2421 billion in 2000, compared to US$ 94 billion in 1982 (UNCTAD, 2001). Stocks of FDI have been growing faster and estimates suggest that the sales of foreign affiliates of multinational corporations (MNCs) exceed the value of world trade in goods and services (WTO, 1999). The annual average growth rate of world FDI (24%) for the last decade has far exceeded that of world merchandise imports (8.4%) and world nominal GDP (2.5%). Developed countries accounted for more than 75% of global investment inflows in 2000 because of intense cross-border Merger and Acquisition activity (UNCTAD, 2001). FDI could also increase the efficiency with which the world's scarce resources are used. Particularly, new technology and intangibles such as organizational and management skills, and marketing networks, could be transferred through FDI. Job creation and economic growth could also be achieved through FDI stimulus effects, such as competition, innovation, savings and capital formation. According to OECD Insurance Statistics Yearbook, the share of foreign life insurance companies' in Canada, Germany, Netherlands, Spain, the UK and the US were 31.02, 17.21, 32.08, 15.75, 26.06, and 19.79, respectively, in 1999. The share of foreign non-life insurance companies in Canada, Germany, The Netherlands, Spain, the UK and the US were 22.61, 13.60, 35.81, 25.18, 44.45, and 10.38%, respectively, in 1999. Both the life and non-life foreign market share in Japan were small due to tight Japanese regulation on foreign entries.

There are several categories of FDI in the US,[2] one of which is the FDI in insurance services, as opposed to FDI in manufacturing or banking. On a historical basis, the FDI in insurance services in the US was US$ 80.38 billion in 1998, which was an increase of more than four times, compared to US$ 18.99 billion in 1988.[3] The seven major countries which invest in the insurance industry in the US are Canada, France, Germany, The Netherlands, the UK, Switzerland, and Japan. In 1998, almost 21.30% of FDI in insurance services was from Switzerland, 20.96% from The Netherlands, 17.75% from the UK, 12.01% from Germany, 9.78% from Canada, 6.08% from France, and 1.23% from Japan. Under NAFTA, the US market becomes a base for market penetration into Mexico and Latin America, thus it is expected FDI in insurance services in the US will increase. Moreover, the EU's single insurance market directive brought into effect since July 1994, which allows the European-based insurance companies to operate throughout Europe on the principle of a single license, is expected to encourage European insurance companies to invest more in the US market, as they become stronger and hence more competitive against the US insurance companies.

---

unincorporated enterprise, is normally considered as a threshold for the control of assets. Mergers and acquisitions (M&A) and the creation of new facilities fall in this category; (2) reinvested earnings (the MNC's share of affiliate earnings not distributed as dividends or remitted to the MNC); (3) other capital (short or long-term borrowing and lending of funds between the MNC and the affiliate).

[2] According to the US Department of Commerce, FDI in the US is defined as the ownership by a single foreign person (or an associated group of foreign persons) of at least 10% of the voting stock of an incorporated US business enterprise or an equivalent interest in an unincorporated US business enterprise.

[3] From Survey of Current Business, various issues, Department of Commerce, US.