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Seminar

Addressing Information Gaps in Business and Macro-Economic Accounts to Better Explain Economic Performance

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Non-life insurance
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<u>Insurance Presents Special Challenges for National Accounts:</u>

1. Treating premiums as "final sales" as the sole indicator of output would cause double counting
   a. Car insurance premium plus the purchases of car repair services paid for by out of proceeds from insurance claim.
   b. If auto insurance companies directly paid for car repair services then we could treat them (the claims) as intermediate inputs that we subtract from the insurance premiums to get the industries value-added, as we do with other industries.[1]
   c. Since that is not the case, we deduct claims from premiums to measure final expenditures by consumers and business on (or production by) the industry. (We also net out the investment income that represents a claim of the policyholders).
      i. Conceptually these net premiums represent, the insurance industries provision of:
         1. Financial protection through the pooling of risk
         2. financial intermediation services through the investment of reserves to help cover current and extraordinary claims
         3. Administrative services such as loss settlements, risk surveys, and loss-prevention plans.
   d. To illustrate the importance of the use of net claims in avoiding double -counting in GDP, in 2007 premiums paid by consumers were $205 billion, but net of claims returned to policy-holders (and indistinguishably spent on other goods and services) spending on insurance was $83 billion.
2. Insurance claims can be volatile:
   a. As a result net premiums can give a distorted view of economic activity when unusual events occur.
   b. In the past, during major catastrophes when insurance companies were probably most productive, their output (as measured by premiums net of claims) fell; the trade balance improved (as reinsurance payments/claims rose, lowering net import payments); GDP could either increase or decrease (because both household expenditures and imports were reduced); and household gross saving increased (because household expenditures for insurance—as measured by premiums net of claims—fell).
   c. To address this problem BEA moved to:
      i. The use of expected claims (and expected investment income) in calculating net premiums and;
      ii. In accordance with the updated SNA, we plan to treat most of the impact of catastrophes as capital losses or "capital transfers (current period losses are used in estimating expected claims)."
3. The real – inflation-adjusted -- output of the industry is not adjusted for risk.
   a. Neither PPI nor CPI address portion of changes in premiums associated with changes in risk (post 9-11).
   b. If risk increases, the whole increase in premiums is treated as a price increase, thereby overstating inflation and understating industry's real output and productivity.
4. In addition to the problems of risk in deflating premiums, there are significant problems in deflating intermediate costs (claims).
   a. Increasing cost of construction

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[1] For simplicity, this discussion ignores of intermediate inputs by the insurance industry; it also does not discuss differences between the value-added and final expenditures approaches to measure industry output, products, and GDP