Distr.
GENERAL

TD/B/C.3/140
22 July 1977

Original: ENGLISH

United Nations Conference on Trade and Development

TRADE AND DEVELOPMENT BOARD

Committee on Invisibles and
Financing related to Trade
Eighth session
Geneva, 5 December 1977
Item 7 of the provisional agenda

INVISIBLES: INSURANCE

Cargo insurance problems in land-locked developing countries

Study by the UNCTAD secretariat

CONTENTS

GE.77-67466

Introduction

(i) The Committee on Invisibles and Financing related to Trade (CIFT), at its seventh session in November 1975, adopted resolution 9 (VII) on marine cargo insurance which recommended implementation by the developing countries of the conclusions of the study on marine cargo insurance (TD/B/C.3/120) prepared by the secretariat. The study, the purpose of which was to examine means to ensure a greater participation of the insurance markets of developing countries in the cover of the insurance needs generated by their intensive foreign trade, analysed the various problems of developing countries in the role of providers of marine cargo insurance and proposed measures for solving these problems.

(ii) The study on marine cargo insurance (TD/B/C.3/120) and resolution 9 (VII) which endorsed its conclusions and recommended their implementation was a direct follow up of resolution 42 (III) on insurance and reinsurance (adopted at the third session of the Conference in May 1972), which affirmed "that developing countries should take steps to enable their domestic insurance markets to cover in these markets - taking into account their national economic interests as well as the insured interests - the insurance operations generated by their economic activities, including their foreign trade, as far as is technically feasible". The study proved that most developing countries, by taking adequate measures at the domestic insurance industries level, could help their insurance markets to cover locally the bulk of their foreign trade, mainly their imports.

(iii) During the debate on marine cargo insurance which resulted in the adoption of resolution 9 (VII), several countries expressed the opinion that when dealing with transportation insurance land-locked developing countries had some additional specific problems which should be examined and set out in a separate study which would complete the one on marine cargo insurance in general. The secretariat was therefore requested to prepare a study on "Particular problems of land-locked developing countries in the field of transportation insurance" and submit it to the Committee at its next session. 1/ The present document was prepared in compliance with that request.

(iv) In preparing the present study, the secretariat was fully aware of the fact that the basic handicaps of land-locked developing countries, when dealing with insurance of their foreign trade, were of an infrastructural nature, the main constraints of which were beyond the scope of the insurance sector and could not be influenced by taking measures in that sector alone. While referring, where necessary, to the various extraneous factors, the present study tries to remain as pragmatic as possible and to propose solutions which fall directly within the power of the insurance sectors of the land-locked countries concerned and of their neighbouring transit countries.

(v) In order to obtain a realistic picture of the nature and extent of the prevailing problems, the UNCTAD secretariat contacted the authorities of many land-locked developing countries, as well as the secretariat of the Conference of the Insurance Controllers of French-speaking African countries (CICA). The following chapters are based on the valuable data and information received from insurance institutions and governmental insurance supervisors.

1/ See TD/B/590, paras. 133, 135, 136 and 157.

Chapter I

TRANSPORT PROBLEMS OF LAND-LOCKED DEVELOPING COUNTRIES

1. Cargo insurance problems are basically a result of general transport problems and any effort towards improving transport conditions will therefore have a favourable effect on cargo and its insurance. There is very little that the insurance sector, as such, can do to improve the infrastructure which is used by land-locked countries in the transport of their cargo. If such infrastructure (roads, highways, channels, railways, trucks, barges, trains, as well as customs, loading and unloading procedures, warehousing facilities, etc.) were modernized, it could confidently be said that the cargo insurance problem would become minimal.

2. In international trade land-locked countries are at a disadvantage in comparison with their coastal neighbours. This disadvantage stems from the fact that transport by sea is the most commonly used form of transportation of the bulk of the cargo imported and exported by developing countries. However, the goods of the land-locked developing countries have to cross foreign territory before they reach the sea or their destination, which means customs inspection transloadings, delays and frequently damage. Given the port and customs congestion in most developing countries, land-locked countries often have to wait a long time for their cargo to be handled, and this entails extra costs.

3. Each of the 20 land-locked countries has different characteristics, such as distance to the nearest port, topography, type and number of routes available, economic and political conditions, relations with transit neighbour countries, prevailing customs procedures, managerial skills, port and warehousing facilities, and type and volume of goods transported.

4. The land-locked country closest to the sea is Swaziland (with a minimum transit route of 84 kilometres). Some, like Burundi, Chad and Rwanda have minimum distance transit routes of over one thousand kilometres. Most land-locked countries have a choice of ports in different countries and all, except Bhutan, have at least one international airport. Most have hard-surface roads connecting them with at least one port, and eleven have through railways transit routes to the sea.

5. No two countries are similar in all respects and this makes it very difficult to find general solutions to the problems they face. Case-by-case solutions have to be tried. Any economic solution has to be aimed at specific "bottlenecks" (i.e. where help is most needed). In some cases the most severe constraint arises from inadequate warehousing facilities in the port, while in others the source of delay can be due to unnecessarily complicated administrative customs procedures. Inadequate means of transport, in quantity and/or quality, from the port to the land-locked country may also be a problem. It is not unusual to find all these problems - in varying degrees - affecting one country. The removal of such difficulties is, ultimately, beyond the scope of insurers as such, although the insurance industry in most countries does co-operate actively with port and customs authorities to alleviate some of their consequences. 2/

2/ See A transport strategy for land-locked developing countries: Report of the Expert Group on the Transport Infrastructure for Land-locked Developing Countries (TD/B/453/Add.1/Rev.1), United Nations publication, Sales No. E.74.II.D.5.

Chapter II

SOME PECULIARITIES OF CARGO INSURANCE IN LAND-LOCKED DEVELOPING COUNTRIES

6. Other things being equal, the condition of land-locked countries seems to justify higher premiums for their cargo insurance than for that of their coastal counterparts. Nevertheless, to compare meaningfully the level of such premiums is a difficult task, and requires much more detailed information than the secretariat has at present been able to collect - assuming it is available in the countries concerned, which is doubtful. For such comparisons to be possible it is necessary to standardize the goods concerned (kind, packing, etc.), means of transport, length of voyage and intermediate stopovers, to mention but a few of the factors which influence rates in cargo insurance. Also, the scope of the cover has to be the same. The "Free of Particular Average" (FPA) cover is cheaper than "all risk" cover; open policies usually offer protection at a lower price than specific ones, because there are administrative savings involved in the former but not in the latter. Experience with specific carriers, as far as recoveries are concerned, may also prove to be important where rating is concerned. All in all it is almost impossible to establish how much higher the cargo insurance premiums paid by importers of land-locked countries are in comparison with those of their coastal neighbours.

7. Some land-locked developing countries are known to suffer from the non-availability to them of "warehouse-to-warehouse" covers. This is in some instances due to the fact that foreign cargo insurance cover is designed to end at the port of the coastal country; it is also due to laws or practices in some transit countries which require the goods carried through their territory to be insured locally (at least for the period they are on their territory). It is logical that no insurer wants to carry extensive responsibilities, for damage which may have occurred during the leg insured by another, but which was detected only afterwards. When insurers do provide such cover they charge about the same rate as that for the whole journey with the result that the insured ends up paying a higher aggregate premium.

8. One possible way to avoid such overlap of cover is by having segmented covers through which the seller insures the cargo from the commencement of the voyage until it reaches the port of destination; a local insurer in the coastal country supplies cover from the commencement point until the goods leave his country and an insurer from the land-locked country supplies the cover for the remainder of the journey. Such a solution is used in some cases, but it is highly inefficient First, no insurer is willing to provide all risk cover for the journey because of reasons mentioned in paragraph 7. In order to avoid detecting damage too late, it is necessary to exercise a very detailed (and expensive) inspection of the condition of the goods at intermediate points of their journey. Another drawback in such an arrangement is that even when the cover is restricted (e.g. only FPA) the safety loading of the premium, as well as the loading for administrative expenses accumulate and become unfavourable to the insured. He therefore ends up paying more than if he had to deal with only one insurer. 3/

3/ A hidden cost of this arrangement, which proves sensitive, is that involved in filing claims with more than one insurer.

9. It should be mentioned at this stage that extensive covers such as "all risk" or "warehouse-to-warehouse" covers are not necessarily in all cases preferable to a more limited protection, because the benefits of a larger protection have to be compared with the corresponding extra cost. Since cargo premiums are so directly influenced by the insured's own experience (this influence is much larger in cargo than in most other types of insurance) a more extensive cover (for example, in the form of less exclusions) can only be given at an extra price which includes not only the average value of the losses to be paid, but also administrative expenses, commission and profit. The cost of processing small claims is relatively high and affects the insurer as well as the insured. In fact, for an active importer, FPA cargo policies may be more economical than wider ones. One should not forget that insurance is primarily designed to cover "sensitive" and "infrequent" losses, not small and repetitive ones. This is the only reason why individuals and firms are willing to pay a premium which exceeds the actuarial value of the losses.

10. Thus, what is wrong with the present situation in some land-locked developing countries, as far as cargo insurance is concerned, is not that local importers do not take out "all risk" and "warehouse-to-warehouse" covers, but the fact that they are not given the option of obtaining them in those cases where it is more advantageous.

Chapter III

SOME POSSIBLE ARRANGEMENTS AT THE BILATERAL LEVEL

11. It is therefore better for the importers to have their goods insured under only one policy than under segmented ones. Since the cost of the insurance is always covered by the buyer - no matter what the terms of sale are - it is only reasonable to allow the importing country to decide who insures its goods. Transit countries should be requested to withdraw regulations and/or practices which require that one part of the marine or overland transport of goods in transit to the land-locked country be insured in the transit country. As far as technically and economically possible, the cargo cover for goods destined for a land-locked country should be provided by insurers domiciled in it. This solution favours the balance of payments position of land-locked countries, promotes financial stability and growth of the local insurance market and allows importers in land-locked countries to obtain cover not only suited to the needs of international trade, but also tailored to fit their particular requirements. Such types of cover should be devised specifically for land-locked countries and receive international recognition.

12. By far the most important measures which could be taken in order to lower the cost of cargo insurance are in the field of loss prevention. This is generally encouraged through experience rating and where possible, through the use of franchise clauses in the insurance contract. The logic behind this is that the importer can contribute to a significant reduction in losses (by, for instance, requiring better packing, executing a proper clearance of his merchandise, more careful selection of carriers) and thus should be encouraged to participate in the losses and profits from the benefits of improved handling of his goods; the above actions are desirable irrespective of who insured the cargo.

13. The problem faced by importers as well as insurers in land-locked countries is that they do not usually have all the means of expediting formalities at the port, and therefore franchise and experience rating do not play a very significant role in the reduction of losses. Their goods are usually subject to inspection at the port, and have frequently to wait in congested, unprotected and inadequate premises and to be reloaded before they can continue on their inland journey - factors which often increase the risk. The risk is higher for goods that are perishable and consumer-oriented and for those that have a high value in respect to bulk (e.g. cameras, portable radios, etc.). When capital goods are being imported 4/ (e.g. industrial machinery, tractors etc.), there is no reason to expect the risk of theft or breakage to be significantly increased by the mere passage of time. Water damage risk is, however, increased if the goods are left in inadequate premises. In those cases where the stopover at the transit country's port is too risky, it may pay to take risk prevention measures there, and this can be done by the insurance sector in several ways. One way would be to have insurers of the transit countries participate in the insurance of cargo to (and maybe from) their landlocked neighbours. Another possibility would be to enter into an agreement with specialized firms which exercise risk prevention at ports and other points on behalf of the insurers of the land-locked country. A third way would be to increase the use of experience-rating in cargo insurance and induce those who are insured to do all they can themselves to reduce losses. The advantages and limitations of each of these arrangements are considered below.

4/ Goods exported by developing countries - land-locked included - mainly consist of raw materials which are not subject to theft while at the port, but in some cases their quality may deteriorate if they are left unprotected for long periods of time.

(a) Sharing of business among insurers

14. This first approach, in principle, could take the form of coinsurance or quota-share reinsurance arranged between the insurers in the land-locked and transit countries. The percentage of participation would have to be negotiated but steps should be taken to ensure that incentives for the insurers or reinsurers in the coastal countries are high enough to induce them to reduce the amount of losses. If their participation is too small, they may be reluctant to incur the costs that loss prevention entails. The cost of loss prevention at ports and at other strategic points (e.g. points of transloading) should be shared in the same proportion as the premiums. This should apply to all other costs of running the common business, such as agents' commissions.

15. Besides helping reduce the aggregate volume of losses per unit insured, these arrangements offer two advantages. First, they render unnecessary the expensive checking of cargo at intermediate points of the voyage, required by other kinds of arrangements (e.g. by segmented coverages) and they make it possible to apply warehouse-to-warehouse coverage at reasonable prices. Second, they serve to keep cargo insurance premiums within the regions concerned, which is also important if it is borne in mind that an easy alternative to local or regional cargo insurance is import on c.i.f. terms.

16. By means of coinsurance two or more insurers of the land-locked and transit countries could participate in the insurance of cargoes to (and perhaps from) the land-locked country. From an operational point of view the type of coinsurance recommended here is a little different from the way coinsurance is known to work in most cases and it may help to clarify the variation being proposed. Coinsurance simply means that various "insurers" assume a given proportion of a risk and, therefore, of every loss. In the most obvious situation this happens when an insured places the insurance of a given risk with two or more specialized insurers of his choice, each assuming a certain percentage of it, and the total amounting to one hundred per cent. The slight variation of this principle is that the insured himself can be regarded as an "insurer". This happens when the insurance purchased from the specialized insurer(s) is smaller than the total value of the risk. In cargo insurance, for instance, it is customary for the insured to participate in every loss in proportion to the amount that is underinsured. This coinsurance is reasonable, for if the insurer only insures 50 per cent of the value of his cargo, he is in fact assuming the other half of every loss himself. 5/

17. The coinsurance arrangement described here involves professional insurers operating in more than one country. Since as a rule, the importer were not known insurers in the neighbouring countries the arrangement would have to be concluded between the local insurer and his counterpart in the transit country - a factor absent in the types mentioned in paragraph 16. Insurers in the land-locked countries would act as leading underwriters and would operate in their own name and on behalf of the other coinsurers. Insurance contracts covered by such agreements would have to indicate the name and domicile of the insurers who share the risks and the proportion carried by each of them. Every coinsurer would act as an agent of the other in his territory. The leading underwriter would be in

5/ In principle, nothing prevents an insurer from supplying insurance on a first-loss basis by means of which the total value of every loss is paid to the insured even if he has not insured for the full value of the cargo. This is possible by charging a premium over-proportional to the underinsurance. (This is so because small losses are much more likely to occur than large ones: a large loss implies a small one, but not vice-versa). This possibility, however, does not affect in any respect the validity of the above arguments.

direct contact with the importers and would have to be given enough power to accept risks and to pay claims on behalf of the whole group. Failure to do so would mean an unnecessary burden for local importers.

18. Two facts should be mentioned on the cost side of the above argument. One is that coinsurance is difficult to implement when too many insurers are involved. In fact, information available to the UNCTAD secretariat shows that cargo to and from a land-locked developing country has to go through an average of two transit countries, and in general many insurers operate in these countries. Thus, in order for such coinsurance arrangements to be practical and economical, they would have to be entered into by a small group of insurers. 6/ Also, since coinsurance affects only cargo transported through the coastal countries (by road, rail or water) but not that carried by air, a separation of accounts would be necessary for this purpose; furthermore, an efficient communications network would have to be established between the parties so that effective risk-preventive action could be taken wherever required. The latter might prove difficult for insurers who are not used to such sophisticated methods.

19. Finally, probably the most important fact is that the coinsurers (the leaders included) are legally responsible for losses only up to their respective share of the risks, as stated in the policy. Should any of them go insolvent, nothing obliges the others to cover the insolvent's share. Importers may consider this as an unfortunate feature of the arrangement, especially as they usually have either insufficient or no knowledge at all of the foreign coinsurers taking part in the coverage; thus they can argue that they have no proper means to make the right choice. 7/

20. Land-locked developing countries which require insurance of their imports to be issued only by admitted insurers would have to relax their insurance laws to allow for coinsurance with insurers operating in the transit countries. This may make rating of cargo insurance business a regional matter rather than an entirely national one. Also, the arrangement implies a cession to the region of part of the cargo insurance business of the land-locked developing country, which would run counter to the idea, contained in paragraph (ii) of the introduction of retaining in the domestic market the largest volume of premiums technically feasible.

21. In view of the problems inherent in coinsurance, quota-share reinsurance represents a better alternative. In fact, regional quota-share cargo reinsurance offers the advantages mentioned in paragraph 15 without the disadvantages referred to in paragraphs 18 to 20. If regional reinsurance is the method chosen, local importers would only have to deal with local insurers, who would be fully responsible for all losses under the policies.

6/ Accepting cargo business from the land-locked neighbours may imply more concentration of risks for the insurers in coastal countries, therefore only those who have enough capacity are expected to participate in such a venture.

7/ This is certainly a risk, but since the insolvent coinsurer could have been a local insurer, it could still be prudent to divide the risks.

22. Regional quota-share reinsurance presents an additional advantage. Once reinsurance agreements have been successfully contracted, nothing prevents the parties from reciprocating. The smaller the intra-regional co-operation is, the larger becomes the cession of regional business abroad. Reciprocal exchange of business enhances the risk-bearing capacity of all parties participating in the exchange. This means that for a given "risk" the volume of premiums kept in each of the countries concerned would be larger. 8/ One of the main reasons why regional exchange of business is not practiced on any significant scale in developing countries is the lack of joint ventures between the potential beneficiaries. If a start were to be made and insurers of the region got to know each other through the proposed scheme for cargo insurance, mutually beneficial exchanges of business in other branches would be more likely to follow. The benefits of exchange are larger the more independent the risks exchanged, therefore fire, life or motor insurance, constitute good branches for additional reciprocities.

(b) Purchase of risk-prevention services

23. A type of arrangement, which seems much easier to implement than those mentioned above, would consist of entering into an agreement between the insurer(s) of land-locked countries and specialized firms which would work in the coastal country (for a fee) supervising the storing and handling of the goods insured by the former. The fee could be a fixed one, or based on the volume of cargo passing through the ports where supervision would be required. 9/ Many activities may be included under the heading of risk-prevention, e.g. disposal of goods when such action is required to minimize losses; mediation to obtain prompt dispatch of goods insured; identification of non-delivered cargo; preparation of surveys, etc. Since these services are similar to those entrusted to an agency of the insurers, the coastal country may require the specialized firm to operate under a licence. In countries where cargo risk prevention bureaux already operate the best course of action for insurers in land-locked countries would be to apply for membership of them.

(c) Experience-rating

24. If cargo insurers decided that these arrangements involved excessive administrative and/or financial complications, they might simply elect to translate the cost of any adverse loss experience into higher cargo insurance rates. In this case the insureds themselves would be the best equipped party to reduce cargo losses (requiring better packing, a prompt dispatch of goods, etc.), so that experience-rating would prove to be the most economical way to cope with the problem. It is important to bear in mind the factor of the cost of every human enterprise. Insurance itself exists only because loss prevention beyond a point is a much more expensive solution than ex-post sharing of losses among the members of a group of individuals. In fact, practice may very well prove that the risk-prevention arrangements mentioned above are too expensive. This is why they should be understood as possibilities and none of them should be made compulsory.

8/ For reciprocal exchange to be facilitated, the insurance conditions in the participating countries should be analogous.

9/ These modes of payment are the most practical ones, but involve the inconvenience of not having any built-in incentive to reduce losses, which is the ultimate purpose of the activity.

Chapter IV

CONCLUSIONS

25. Cargo insurance problems of land-locked developing countries are mostly a direct consequence of problems of general transport for which the solution falls outside the field of insurance. The insurance sector of land-locked developing countries, however, acting more at the national level than as individual insurers, should help in negotiations aimed at solving these problems.

26. Transit countries which have regulations or practices that require the insurance of goods in transit through their territory to be effected by insurers domiciled therein, should be requested to withdraw the said regulations.

27. Insurance of goods imported by land-locked developing countries should be effected by insurers from those countries who can act on their own behalf, or as members of regional groups of cargo insurance.

28. The conditions of cargo insurance offered in land-locked countries should be the standard ones obtainable in the international markets; in particular, importers should have the option (but not be forced) to take all-risk and warehouse-to-warehouse covers. Notwithstanding this, the coverage of policies for cargo from and to land-locked developing countries should be tailored to meet in a satisfactory manner the specific needs of those countries, as far as length and time of voyage, means of conveyance, intermediate custom clearances, etc., are concerned. International recognition should be given to such types of cover.

29. In rating of cargo insurance, due consideration should be given to the insured's own loss experience, as far as is technically feasible.

30. Insurers in land-locked countries should be given the legal possibility (but not be forced) to:

(a) enter into coinsurance and reinsurance agreements with insurers in their coastal neighbour countries, aimed at providing more economical cargo insurance coverage for their international trade;

(b) enter into agreements over prevention of losses with specialized firms or national bureaux of the coastal countries. Coastal countries should give these entities reasonable means to do their job properly.

31. Since local possibilities and limitations, which seem to vary significantly from one country to another, play a relevant role in the selection of viable and efficient arrangements, the situations of different countries and regions should be analysed and solutions tailored to each specific situation. This approach is justified because most of the difficulties involved in finding adequate solutions to cargo insurance problems of land-locked developing countries are of a practical, rather than a conceptual nature.