ORDINARY LIVES: INSURANCE AND SAVINGS IN AMERICA, 1861 TO 1941

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Ordinary life insurance was a critical means by which American households saved for retirement prior to the advent of Social Security, but remains understudied. This paper sheds light on the function of life insurance in American households over the late 19th and early 20th centuries, and provides valuable context for understanding the evolution of American old-age savings from private insurance toward nationalized retirement savings programs. It also touches on the distributional implications of this shift, in light of both historical racial disparities in life insurance participation, and early-to-mid-20th century policies differentially affecting Americans' options for old-age savings.

Ordinary Life insurance: A Precursor to Social Security

Social Security is the ordinary way that ordinary individuals save for retirement today, with most elderly Americans getting most of their retirement income from this source. The other principal sources of income for retirees – savings and pensions – accrue more to college educated individuals who have had stable, long, and lucrative careers than to those less educated or fortunate. Social Security/OASDI promises pensions to the elderly, payments to the survivors of workers who paid into the program, and payments to individuals whose disabilities limit or prevent them from working. Given its importance for wealth and well-being, Social Security has broad economic, social, and political impacts. It alleviates poverty among the elderly, disabled, and unfortunate. It influences rates of savings, investment, economic growth, and the distribution of wealth. It can be a pivotal political issue.

Understanding Social Security's impact on society requires an understanding of the institutions it replaced. OASDI was created during the Great Depression and began paying regular benefits in the 1940s. Before then, most retirees earned little from savings in banks, bonds, or stocks. Few had pensions. Few firms, unions, and state or local governments provided retirement assistance. Investment wealth was concentrated at the top of the income distribution. What then did ordinary people do when they retired? How did they care for their dependents or build an estate? What did people do if they were disabled? The current academic literature lacks answers to those questions. The literature does not explain how most families saved for retirement in the two generations before the creation of Social Security, a period spanning the Progressive Era, the Roaring 20s, and the Great Depression.

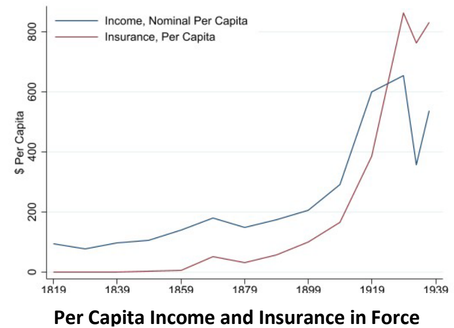
This paper fills that gap by elucidating the main savings method of ordinary households—particularly lower- and middle-class households—prior to the SSA. The savings vehicle was ordinary life insurance. Ordinary life policies, the most common life contract by dollars in force, was a savings vehicle that paid a specified sum to the insured if they survived to a designated age, accumulated value throughout its term which the insured could access whenever they desired, and paid the specified sum to a beneficiary if the insured died before the contract matured. Put simply, ordinary life insurance policies were designed to protect individuals against life's key uncertainty: how long it would last. Dying young limited one's lifetime earnings, preventing heads of households from supporting their dependents, typically a wife and children but often also elderly parents and younger siblings. Dying old increased one's lifetime expenses and risked poverty in old age when the ravages of time prevented people from earning enough to pay for the lifestyles they desired. Ordinary life insurance policies protected individuals against both contingencies by combining insurance and savings in a single financial instrument.

In this paper, we shed light on the popularity of these policies in the pre-SSA era; explain the attractions of these policies to Americans across the income distribution; illustrate some of the attractive features by outlining the contours of a standard policy; offer comparisons to Social Security/OASDI that help contextualize the transition from a

private means of old-age savings toward a nationalized system of retirement savings; and touch on the potential distributional implications of this transition.

Ordinary Life Insurance Was Hugely Popular in the Era Before Social Security

From 1900 to 1940, aggregate savings via legal reserve life insurance in force – which issued all ordinary life policies – rose from 50% to 200% of annual national income. Savings poured into legal reserve companies during the 1920s, when savings via insurance roughly equaled savings via other financial intermediates. Savings via legal reserve companies continued at about this pace during the 1930s, while savings declined substantially at most other financial intermediaries. Insurance in force per capita rose gradually relative to per capita income, surpassing it in the early 1920s. When Social Security began paying regular benefits in 1941, ordinary insurance in force per capita exceeded $800, which was more than 50% larger than annual per capita income which (about $500). Life insurance was popular across all races and socioeconomic strata, and encompassed the vast majority of Americans' household savings. Ordinary life policies in particular dominated. These were taken out primarily by male breadwinners in their prime working years, and were used mainly for old-age savings.



Per Capita Income and Insurance in Force

Ordinary Life Insurance Offered Savers A Range of Attractive Features

Ordinary life policies had many features that made them attractive to late 19th and early 20th century Americans planning their financial futures—particularly their retirement. The policies reduced risks, eliminated uncertainties, raised returns, reduced taxes, circumvented probate, and enabled policyholders to direct funds towards anticipated expenses even if they should die too young to make the payments themselves. Two obvious attractions were protecting one's dependents and saving for retirement. Ordinary life contracts were good at both—and had additional useful features beyond these, explored in the paper.

Implications

- Popular misconceptions stem from a failure to appreciate the popularity and centrality of ordinary life insurance as an old-age savings instrument in the 19th and early 20th centuries.
- Far from being unprepared for retirement, most heads of household in the US had a retirement plan in place that covered contingencies including disability, early demise, and deflationary shocks.
- The Great Depression did not wipe out their life savings and compel the creation of Social Security—rather, the inflation which began during WWII and continues to this day did that.
- This fact helps to clarify the problem that Social Security initially tried to solve. For instance, looking ahead to the period after the advent of peacetime inflation, it is easy to see the attractions of the newly established OASDI over the ordinary life insurance products it came to supplant. Chief among them, it preserved the value of eligible Americans' retirement savings, even in the presence of rising prices.
- Together, both initial occupational carveouts in the SSA that excluded many Black households form participation, and the high levels of Black participation in inflation-impacted ordinary life insurance policies, imply that the transition from ordinary life insurance to Social Security may have produced disparities in old-age savings and in wealth more generally.

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