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Ordinary Lives:
Insurance and Savings in America, 1861
to 1941

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Abstract

Life insurance was the principal method of old-age savings for American households from the mid-nineteenth to the mid-twentieth centuries, a period prior to the advent of OASDI and the popularization of employer-sponsored retirement or pension programs. Despite its historical importance both as a precursor to Social Security and as households' primary mechanism for savings and investment throughout much of American history, life insurance has been overlooked in the literature. This paper sheds light on the function of life insurance in American households, and provides valuable context for understanding the evolution of American old-age savings from private insurance toward nationalized retirement savings programs such as Social Security. To do so, this paper focuses on ordinary life insurance, the most popular of these life insurance products. It first describes the properties of standard policies, which, though complex, offered customers a range of lucrative and useful options that could be tailored to their particular needs. It then establishes why life insurance was such an attractive option to nineteenth- and early twentieth-century Americans, relative to other savings vehicles, in the low-peacetime-inflation environment of the pre-WWII period and in the absence of formal retirement plans of the kind most Americans rely on today.

Keywords: retirement savings, old age savings, life course savings, life insurance, household saving and investment

JEL codes: N21, N22, N31, N32, G22, G51, G52, J32

“In the United States more than half a million persons chiefly men, have their lives insured for the benefit of those who will survive them, or, in many cases, for their own benefit, if they survive a designated age.”

Elizur Wright, 1873.

“The dominant life insurance pattern in the United States achieves protection by a combination of pure insurance and savings.”

Paul Geren, 1943.

Introduction

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.¹ 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. Technically termed Old Age, Survivors, and Disability Insurance (OASDI), Social Security promises pensions to the elderly, payments to their survivors (spouses, children, and dependent parents) of workers who paid into the program, and payments to individuals whose disabilities limit or prevent them from working.² Given its importance for the wealth and well-being of the preponderance of the population, Social Security has broad economic, social, and

¹ In 2013, over 90 percent of Americans over age 60 and working fewer than 30 hours per week received income from Social Security. For over 40 percent of those Americans, Social Security was the sole source of retirement income (Bond and Porell 2020). In 2015, half of Americans aged 65 or older lived in households receiving at least half of their income from Social Security. From 1976 to 2006, “the average share of income that elderly received from Social Security was always substantial (between 66 percent and 84 percent in any given year), particularly for households in the bottom half of the income distribution (Dushi, Iams, and Trenkamp 2017).”

² In 2023, the Social Security Administration reported that payments to survivors amounted to 11.2 percent of total benefits, payments to disabled amounted to 11.0 percent of benefits, and payments to retired workers and their dependents amounted to 77.2 percent of total benefits (Social Security Administration 2024).

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.³

Understanding Social Security's impact on society requires an understanding of the institutions it replaced. OASDI was created during the Great Depression of the 1930s 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 (Ezekiel 1937). 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 from about 1895 to 1940, spanning the Progressive Era, the Roaring Twenties, and the Great Depression.

This essay fills that gap by elucidating the main savings method of ordinary households—particularly lower- and middle-class households—during the first half of the twentieth century. The savings vehicle was ordinary life insurance.⁴ Ordinary life policies, the most common life contract (measured in dollars of insurance 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.

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

³ Since the inception of the program during the Great Depression, political parties and candidates, particularly those seeking federal office, must take positions that satisfy their constituents' interests concerning the existence of, taxes for, and payments from the Social Security Administration.

⁴ Scholars seem to have forgotten this fact because ordinary life differs from term and group life insurance, the most common life contracts today, which pay off only if the insured person perishes, but not if they survive.

they desired. Ordinary life insurance policies protected individuals against both contingencies by combining insurance and savings in a single financial instrument (Geren 1943 p. 33).

Our elucidation begins by demonstrating the popularity of ordinary life insurance. From 1900 to 1940, aggregate savings via legal reserve life insurance in force, which issued all ordinary life policies, rose from 50 percent to 200 percent of annual national income. Savings poured into legal reserve companies during the 1920s, when savings via insurance roughly equaled savings via other financial intermediates including holdings of equity and bonds, deposits in commercial banks, and shares in savings banks and building and loans. 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 percent larger than annual per capita income at the time, which was about \$500.

Our elucidation continues by describing features common to all ordinary life contracts and scrutinizing an example. Key features included: (a) fixed periodic premia, (b) payout of a fixed sum to the insured if the insured survives to a specified age or to beneficiaries if the insured dies before that age, (c) accumulation of equity value to which the insured retained ownership even if their payments of premia lapsed, and (d) ability to borrow up to the contracts' equity value at a specified low interest rate. The example is Metropolitan Life's ordinary life insurance policy. This was the most popular ordinary life contract issued by the most popular legal reserve insurer in the first half of the twentieth century. It may have been one of the most popular investment contracts of all times, since each year during the 1930s about one percent of the national income of the United States was invested via this policy issued by this intermediary.

We then describe the attractions of ordinary life policies to ordinary households during their heyday in the two generations before the creation of Social Security. When compared to other forms of savings that lower- and middle-income households could access, ordinary life policies had good returns with low variance. Accordingly, they were especially popular with these socioeconomically vulnerable groups.⁵ Ordinary life policies protected households against a range

⁵ Indeed, life insurance was historically particularly popular among Black households, who tended to have lower incomes and face greater barriers to financial access (see, e.g., Arthi et al. 2024). To the extent that Black households

of risks. The most pressing was uncertain longevity. The policies protected against the early demise of a family's breadwinner or longevity that might lead to poverty after retirement. The policies protected against a range of other risks including: (i) deflation, a perennial problem afflicting America's farmers and laborers; (ii) taxation, including both estate and income taxes, which rose rapidly during the Progressive Era; and (iii) overinvestment in specific assets, since insurance companies provided ordinary families with their only opportunity to invest in a wide array of bonds, both corporate and government, and mortgages, both residential and commercial. In this discussion, we highlight the role that race-specific differences in ordinary life insurance participation, in tandem with the broader economic and policy environment of the early to mid-20th century, may play in racial wealth disparities.

Popularity of Ordinary Life

Underwriters issue insurance. The verb “to underwrite” comes from Old English “underwritan,” which means “to write at the foot of.” Its modern sense of issuing insurance comes from the practice of signing marine insurance contracts at the foot of the document. Since at least the 1620s, the term underwriter has meant someone issuing an insurance contract.

Between the Civil War and the Second World War, four principal types of life-insurance underwriters operated in the United States. Figure 1 depicts insurance underwritten by those organizations over time. Legal reserve underwriters insured individuals by issuing contracts and accumulating reserves that they used to pay obligations to the people they insured. Legal reserve corporations issued all life insurance in the United States before the 1860s. In the latter half of the nineteenth century, fraternal and assessment underwriters began operations. Fraternal underwriters—like the Masons or the Oddfellows—provided death and burial benefits as part of a package of services provided to members of their fraternal organizations. Assessment organizations paid death and burial benefits by assessing members of the organization a fee to pay benefits to members who perished at any point in time. Neither fraternal nor assessment underwriters accumulated reserves sufficient to cover their obligations. Their popularity peaked

tended to hold a greater share of their savings in life insurance than the average household, they were also more exposed to phenomena—such as inflation—that eroded nominal returns.

near the end of the nineteenth century when they issued nearly half of all life insurance underwritten in the United States (see Figure 2). Their popularity waned rapidly, however, as their members aged and the costs of their insurance increased, which impeded the recruitment of new members and prevented them from covering the policies that they issued. While many men joined these organizations in the decades after the Civil War, most, in the end, did not get the benefits they anticipated.

The United States government began underwriting life insurance after the US declared war on Germany in 1917. Most private life-insurance contracts did not cover deaths of military members serving during war. The federal government filled this void, issuing over 4 million policies to eligible individuals through the War Risk Insurance program. Individuals could renew these policies even after completing military service. The whole life policies remained in force as long as the insured paid premiums and annuitants remained alive. So, the federal government continued to serve a small number of these policies throughout the twentieth century.

Legal reserve underwriters issued the preponderance of the life insurance policies issued over the entire period. Figure 3 illustrates their expansion. They underwrote a few billion dollars in policies in the nineteenth century but over \$100 billion in policies by the end of the 1930s. Legal reserve companies wrote three types of insurance. The preponderance of their policies by value were ordinary life, which is the focus of this paper. The majority by number (but not value since their average face value was smaller) were industrial life, which we discuss in separate essay. A small fraction was group life. Figure 4 illustrates the share of these types by dollar value over time. The preponderance was ordinary life. The popularity of industrial life, introduced in the 1870s, grew gradually over the next seventy years. Group life, which was introduced in 1911, spread slowly and remained rare in the era that we analyze. Now, it is the dominant form of life insurance in the United States.

The growth of insurance in force in nominal dollars represents a real increase in insurance spending. The US operated on a gold standard for much of the nineteenth century. The money supply grew slowly. Prices gradually declined during peacetime. Prices rose during wars. In the long run, the price level changed little. So, nominal increases were real increases.

National income rose as America expanded across the continent and the economy industrialized, but insurance grew quicker than the income (see Figure 5). Insurance in force

surpassed one-quarter of national income around the time of the Civil War (1861–5). It surpassed one-half of national income around the time of the Spanish-American War (1898). It surpassed national income a few years after the First World War (1914–1918). It grew rapidly during the 1920s when households invested increasingly large sums in life insurance and continued to grow relative to the economy during the Great Depression when national income declined dramatically.

Income in the US not only grew on aggregate but also per person. Figure 6 depicts the rise in life insurance in force per capita. During the nineteenth century, life insurance per capita increased at a rate slightly higher than per capita income. During the twentieth century, it grew at a much more rapid rate. Life insurance per capita exceeded income per capita in the 1920s and was nearly double income per capita in the depths of the Great Depression.

The stock of life insurance in force is a potential measure of savings via insurance, but individuals' payments for insurance were spread over many years and often their entire adult lives. So, a better measure is payments for these policies. Figure 7 depicts these flows by plotting the sum of all premia collected by legal reserve insurers for life insurance. These payments rose immediately after the Civil War, shrank during the 1870s (when fraternal and assessment insurance initially expanded), rose steadily through the late nineteenth century, and increased exponentially in the twentieth century. Savings via insurance more than tripled during the Roaring Twenties, jumping from about \$1 billion per year around 1919 to over \$3 billion per year in 1929, and plateaued during the Great Depression.

Dividing annual aggregate premium payments by annual national income yields the aggregate rate of savings rate via legal life insurance corporations, which is plotted in Figure 8. Households saved about 1 percent of national income each year via insurance in the mid-nineteenth century. Insurance savings doubled to 2 percent of national income by the turn of the twentieth century, rose rapidly during the Roaring Twenties, surpassed 6 percent by the end of the decade, and peaked at 7 percent during the depths of the Great Depression.

During the Depression, the federal government conducted the Consumer Purchases Study, which provides clear evidence as to who saved via which institutions. Geren (1943) distilled this information, which is depicted by Figure 9. The solid line indicates the fraction of incomes that households at each income level saved each year via insurance. Households at all income levels, on average, saved via insurance. Incomes below median (~\$1,100 per year) saved 2 to 3 percent

of their income in life insurance policies. Income above median saved 4 to 5 percent of their income via life insurance. The fraction of income saved via insurance peaked at annual incomes around \$10,000 per year and diminished at higher incomes. Very high-income earners saved a “minute percentage” of their income via insurance since their accumulated wealth secured “to him the purpose for which the small income receiver seeks to secure through life insurance” (Geren 1943 p. 38). The dashed line indicates the fraction of incomes that households saved in all ways (i.e., insurance, bank accounts, building and loan shares, bond purchases, stock purchases, etc.). The difference between these two lines indicates savings via all sources other than insurance. Savings were negative on average for individuals with annual incomes under \$2,500 because households with incomes below that amount need to consume their savings or borrow if possible during the depths of the Depression.

The trajectories of savings via the principal financial intermediaries in the 1920s and 1930s are illustrated in Figure 10 and Table 1. During the Roaring Twenties, savings accumulated in three principal repositories: (a) depositories, including commercial banks and building and loans, (b) legal reserve life insurance corporations, and (c) non-financial corporations. Savings in each of these groups equaled about \$15 billion during the decade. These end-of-year figures obscure the equity boom in the late 1920s since the rapid rise in corporate wealth in 1928 and early the next year was offset by the stock market crash in the fall and dramatically decline in equity values by the end of 1929. During the 1930s, savings via life insurance accelerated, while savings via other sources declined. Most B&Ls became frozen with members unable to convert shares to cash and market values for the shares falling by 50 percent. Many banks failed, and depositors drew down balances in banks that remained open. Stock price (as measured by the Dow Jones Average) declined by more than 95 percent. Thousands of firms failed, and the value of their shares evaporated. Life insurers, however, remained liquid, solvent, and safe and continued to pay interest typically of 3.5 percent. So, individuals increased savings in life insurers by large amounts.

The patterns reveal the importance of life insurance as means of savings. Ordinary life insurance policies were the principal savings mechanism for American households in the early twentieth century. Their popularity increased during the Depression of the 1890s and peaked during the Depression of the 1930s. Savings via life insurance were particularly important for households near and below median income, who saved more via insurance than through other

means. Understanding the reasons for these patterns requires us to understand the nature of ordinary life insurance policies.

What Was Ordinary Life?

Ordinary life policies had several salient features. The first was an irrevocable and incontestable promise by an insurance company to pay a specified sum upon death of the insured to a named beneficiary in consideration of an application and periodic payments of premia. This sum was called the face value of the policy because it was prominently printed on the first page of the application and the contract documents. The promise was an absolute obligation of the corporation. As long as the insured paid premia on time, the corporation reserved no rights to cancel, contest, or exit the agreement after accepting the application and verifying the information in it. The contract gave the company a span of time, typically one but sometimes two years, after it issued the policy to verify information supplied by the applicant. If the corporation could prove that information was false and material to the terms of the agreement, it could cancel the contract and return the premia paid. The key pieces of information the company would seek to verify were the age and occupation of the insured since prices were conditioned on this information. After the verification period, the policy became incontestable. The corporation had no legal right to contest the contract for any reason including misinformation supplied by the applicant. Upon receiving documentation of the death of the insured, the corporation had to promptly pay as promised.

The death could occur anywhere, anytime, for any reason, and in any circumstance with two potential exceptions that had to be explicitly and prominently stated in the application. The promise might not cover death by suicide if it occurred before the policy became incontestable, but in this case, most policies called for premia paid to be returned in full. The promise might also not cover death due to military service in time of war. Most policies excluded this coverage; a small set of policies covered these deaths if an applicant requested this provision and paid additional (usually substantial) fees.

The person who purchased an ordinary life policy had to have an insurable interest (Owen 1942 p. 306). According to insurance laws of all states, individuals had insurable interests in their own lives and the lives of their family members whom they supported or who depended upon them for support. Business had insurable interests in the lives of key employees but only up to the value

of the income that might be lost by their demise. Creditors had an insurable interest in the lives of debtors but only up to the value of their outstanding debts. Rules concerning insurable interests ensured that purchasers of policies had a stake in the survival of the insured. Policyholders did not gamble on the lives of individuals with whom they had no familial or financial connection.

The second key feature of an ordinary life policy was a fixed premium payable on a set schedule. The initial premium was due when the contract was signed. Future premia were due annually on the anniversary of the signing or more frequently if the insured selected quarterly or monthly payment options. Standard policies called for equal payments spread over the life of the contract. Options allowed individuals to increase the size of their payments and complete them over an interval such as 10 or 20 years. This option allowed individuals to complete payments during peak earning years and not be burdened with making payments as they advanced in age. A period of grace (usually one month) kept the contract in force if payment was not received on the date due. After that, the contract would lapse but could be reinstated if the insured individual paid all past due premia with interest.⁶

While the corporations' obligations under the contract were contingent on receipt of premia, an insurance corporation had no claim to payments from the insured. Insurance corporations could not sue individuals who fell behind on payments to compel them to pay. Insurance contracts were one-sided absolute obligations. Individuals entered the agreements voluntarily and could exit them at any time. Insurance companies could not.

Since the premium was fixed and prominently stated on the contract, insured individuals knew the maximum price that they would pay over the life of the contract. The maximum was the stipulated stream of premium payments. The price could be lower for two reasons. All insurance companies offered participating policies which paid dividends based on corporations' profits. Dividend payments were typically a function of the firm's profits and past premia paid by the

⁶ Subsequent payments were on a schedule determined at the date of signing. The most common arrangement was premia due annually on the anniversary of the signing. Other possibilities included bi-annual, quarterly, or monthly payments. Payments were typically due at the headquarters of the insurance company and submitted via check, wire transfer, or in person. Individuals could also choose to make a limited number of payments, such as ten, twenty, or thirty annual payments. This arrangement was often chosen by individuals who wanted to complete payments during their peak earning years. The insured chose the structure of payments before commencing the contract. The company typically structured payment plans so that their present values (determined using the company's expected return on investments) were identical. This equality left companies indifferent over individuals' payment choices.

insured individual. Individuals could use the dividend to lower their premium due or accept the dividend as cash. Individuals could also use the dividend to purchase additional insurance or leave it invested with the company with its value compounding at a guaranteed rate (typically 3.5 percent per year in the late nineteenth and early twentieth centuries). Dividend payments rose if an insurers' investments yielded returns higher than anticipated or if the insurers' costs were lower than expected. Dividend payments could be substantial. In typical years, for example, Aetna Life's dividend payments to participating policy holders exceeded 3 percent of premium payments.⁷

The price could also be lower if an insured individual received a rebate from their insurance agent. Agents received commissions for selling new policies to clients, for servicing existing policies, and for renewing older policies that matured. Agents could rebate portions of their commissions to clients and may have done so often, although data on this issue is limited. The extent of the practice was difficult for firms to determine at the time. So, the frequency and size of rebates remains elusive today.

A third key feature of an ordinary life policy was a maturity date when the insurer paid the death benefit in full to the insured rather than their beneficiary. The contract ended. The insurance was no longer in force. The standard maturity date was the first anniversary of the policy after the insured's ninety-fifth birthday. Individuals could choose to have their policies mature at earlier ages. Policies with maturity dates before 95 were termed endowment policies. Popular choices were endowment at age 65 or 75. These contracts would typically be referred to as endowment at that specified age. Individuals could also choose contracts that matured after specified intervals. Popular choices were maturity after 10 and 20 years. These policies would typically be termed endowment after the stated number of years. Features of endowment policies were identical to those of other ordinary life policies. The contracts had the same provisions. The principal difference was the cost. Since endowments matured earlier, their premia were higher.

The standard maturity age of 95 originated with the actuarial calculations underlying ordinary life policies in the mid-nineteenth century. Before 1858, American insurance companies based their calculations on mortality tables created by English life insurers. These tables,

⁷ In 1922, for example, Aetna Life collected \$55,934,645.05 in premiums and paid \$1,856,141.57 in dividends to participating policyholders. In other words, 3.32 percent ($=1,856,141/55,934,645$) of premiums in that year were returned as dividends (Aetna Life 1923).

obviously, reflected death rates of Englishmen and not those of healthier and longer-lived Americans. In 1858, the actuary for Mutual Life, Sheppard Homas, who had trained in mathematics at Harvard, compiled a new mortality table based upon the experience of his company and one other, Mutual Benefit. His *American Experience Table of Mortality* became the standard for actuarial calculations throughout the United States. It indicated that all individuals alive at age 95 would die before turning 96. Actuaries, therefore, treated age 95 as the end of life. Insurers incorporated this presumption into their plans by treating all individuals who lived to age 95 as if they would die that year and paying them their death benefit in full. They had beaten the odds.

Insurers and their clients quickly realized that many people wanted access to the wealth they accumulated at a younger age, like 65, when their earning ability waned or when they desired to retire. By allowing individuals to choose the date when their policy matured, insurers created policies that insured individuals not against the certainties of life or death but against the uncertainty of when one would make the transition from one state to another. A policy with a later maturity date primarily protected one's dependents since it yielded a higher return if one died earlier and accumulated savings slowly yielding fewer funds for retirement. A policy with an earlier maturity date emphasized saving for retirement since it accumulated value faster and was more likely to mature and pay out its face value while the insured remained alive.

The fourth key feature of an ordinary life contract was the reserve. The reserve represented the equity the insured accumulated in their policy. It was their property. It was not forfeited if they missed a payment or if their policy lapsed. The reserve was the sum of past premia payments compounded annually at an interest rate specified in the contract minus expenses. The standard interest rate in the era that we analyze was 3.5 percent per annum. The value of the reserve over the life of the contract was indicated in tables attached to the policy application. Equity accumulated according to a schedule was based in part on actuarial assumptions (e.g., mortality rates and returns on investments), in part on legal requirements (e.g., state laws concerning minimum payouts and maximum fees), and in part on corporate policies (e.g., promising higher payouts to attract more customers). The formula for calculating equity presumed that a policy's initial premia payments covered the costs of issuing the insurance, while subsequent premia payments accumulated value at a constant nominal rate. While parameters varied across corporations, time, and states, in the most common case the premia paid in the initial year went to

cover costs. Before an individual purchased a policy, they could examine the tables and determine the equity that they would have in the policy at any point in the future. They would retain copies of the tables so that they could know the value of their contract and the options open to them at any time.

Insured individuals could access equity in their policies at any time. They did this by exercising options. Four options existed in all ordinary life contracts:

1. A cash payout equal to the equity value of the contract. Individuals who requested this cash would surrender their policies to the company which ended the insurance agreement.
2. Conversion of the current contract to a paid-up contract with a lower death benefit and lower equity value but requiring no additional payments.
3. Converting the current contract to a term life policy that paid a death benefit to beneficiaries if the insured died within a defined interval and which required no additional payments.
4. Borrowing funds from the insurance company at a set interest rate (typically 5 or 6 percent) up to the cash value of the contract. The cash value of the contract served as security for the loan. All other features of the contract remained in place.

These options were standard in the industry and required by law in most states after the 1870s (Owen 1942 pp. 310–5). Their incorporation into law and contract owed a great debt to the most famous man in insurance, Elizur Wright.

A fifth feature of ordinary life contracts was assignability. The insured or their beneficiary could assign their claims to payments under the contract to third parties. Assignments were often used to collateralize or guarantee repayment of loans. An insured father might, for example, assign benefits from a policy to a mortgage company guaranteeing repayment of the home loan in event of his death. The lender would lower the interest rate on the loan in return for this guarantee. In this way, a father could accumulate equity in an insurance policy if he survived and guarantee that his wife and children could remain in their home if he died.

A final feature was underwriting standards. Applicants underwent medical exams and answered screening questionnaires. Key questions included age, occupation, medical history, family history, hobbies, personal habits, and alcohol consumption. Agents who solicited applications were asked to ascertain the accuracy of this information and to add their own insights. Agents forwarded the information to underwriters at the corporate headquarters who scrutinized

the records to determine if the company should insure the applicant and if so under what policy. The process was designed to weed out bad risks, limit adverse selection, and if possible, induce favorable selection. Adverse selection occurred when applicants with higher mortality elected to purchase insurance policies that they thought were good deals while applicants with lower mortality declined to purchase those policies since they thought they were not a good value. Favorable selection was the opposite; applications accepting insurance disproportionately living longer than average. After considering the available information, underwriters might accept an application, allowing the applicant to purchase the insurance plan that they proposed, or decline the application, in which case they might offer alternatives or might decline to offer insurance at all. Underwriters denied applications by individuals with riskier occupations, poorer health, and lower life expectancies than typical for the group insured under a particular plan.

The screening process enabled insurance corporations to segregate individuals with different characteristics, particularly different mortality rates and anticipated longevity, into different groups and price insurance for each group appropriately. All individuals with the same policy taken out at the same age had to pay the same premium. Different policies, however, could (and typically did) have different premiums and different rates of return, because the loading (i.e., fixed charge for expenses) and surrender charges (i.e., charge to offset adverse selection induced by policy options) could (and usually did) differ across policies.

Methodology and Findings: An Ordinary Example

Ordinary life insurance contracts were complex. A standard policy ran about 16 pages with 7200 words and eight tables detailing values at different ages resulting from different payment plans and policy options (e.g., Flitcraft 1915 pp. 517–32). Typical individuals learned about ordinary life policies when they visited an agent's office or when an agent visited their home. Training materials for the Metropolitan Life Insurance Corporation taught agents to spread discussions of policies over multiple meetings during which agents introduced the basic concepts, discussed policy options, explained the benefits of insurance, and finally worked through the details of the policy that an applicant planned to purchase. This section describes Metropolitan Life's most

popular ordinary insurance policy. We take the details from Flitcraft's Insurance Agent's Manual (Flitcraft 1915 pp. 517–32) and discuss issues as in Metropolitan Life's guidelines for its agents.

Metropolitan Life was the most popular insurer in the first half of the twentieth century. Met Life was founded in 1868 and mutualized in 1915 (Owen 1942 p. 759). On December 31, 1937, it had \$4.7 billion in assets, which was 18 percent of the assets of all insurance companies in the United States (Temporary National Economic Committee 1939). It had \$22.6 billion of life insurance in force, which was over 20 percent of the \$110.1 billion of life insurance in force in the United States on that date (Owen 1942 pp. 760–68). Our example is, therefore, the most popular policy issued by the most popular insurer from the era of insurance's peak popularity.

Like all ordinary life policies, Met Life's contract came into force on the date the insured signed the contract and submitted their initial payment. The cost of the contract depended upon the payout and the age at which it was purchased. In our example, the death benefit is \$5,000. The insured was an employed White man who passed the medical screening, worked in a white-collar profession without unusual risks, and entered the contract at age 35. The cost of the policy was \$107 per year. The contract remained in force until the insured chose to end the agreement or until the company completed the payments that it was obliged to make to the insured or their beneficiary. These payments depended on contingencies that arose and choices made by the insured (and possibly their beneficiary) along the way.

The contract paid different amounts in different contingencies based upon choices of insured. The company calculated these payouts using the standard assumption of 3.5 percent annual return on policy reserves, which were the accumulated value of the funds the insured paid for the policy minus loading (i.e., the cost of issuing and managing the policy, usually set as a fraction of the first year's premium) and the surrender charge (i.e., the cost of finding someone to replay an individual who departed an insurance pool or, in other words, a charge to offset adverse selection due to policy choices). The company described payouts based upon choices and contingencies in a series of tables spanning multiple pages. We condense these tables into Figures 11(a) to (e).

Figure 11 (a) illustrates the potential payout from the basic policy. The horizontal axis indicates the years that the policy has been in force. Adding 35 to the x-axis value yields the age of the insured. The blue line at \$5,000 indicates the amount paid to the beneficiary if the insured

died in that year. The death benefit vested at the inception of the policy. So, the blue line begins at the y-axis and continues until the death benefit and cash value of the policy converge 60 years later. At that point, the insurance company paid the policy's full value to the insured, and the policy terminates.

The orange line indicates the policy's cash value. The line begins in the policy's third year. Before then, the loading and surrender charges exceed the accumulated value of the payments made by the insured. So, the policy could not be converted to cash. After then, the policy's cash value grew every year. The growth in this figure looks nearly linear, but the line has a faint s-shape with annual increases in value accelerating in early years and slowing in later years. Cash value's growth is non-linear for three reasons. One is the compounding of interest, which steepens the slope of the cash-value curve over time. Two is the loading which is a fixed cost subtracted from the compounded value. Three is the surrender charge, which declines during initial years of the policy but rises in later years. Initially, the declining surrender charge increases the slope of the cash-value curve. Eventually, the rising surrender charge more than offsets the compounding of interest.⁸

The cash value is the key to understanding the savings aspects of Met Life's policy and the options that policy holders had during the life of the contract. Policy holders could, at any time, surrender their policy and redeem its cash value. Figure 11 (e) depicts the impact of this option when taken in the twentieth year of our example. The insured received a cash value payout of \$1,553. They surrendered their policy, and their life insurance was no longer in force.

Figure 11 (d) depicts a more popular option, the policy loan. The insured received the policy's cash value of \$1,553, but the funds came as a loan at 6 percent annual interest and the policy continued in force. If the insured died, their beneficiaries now received \$3,447 (thick blue line), which was the policy's full value minus the outstanding indebtedness. The policy's cash value continued to accumulate (solid red line) until it equaled the value of the death benefit at age 96. Interest payments of \$93.18 increased the annual cost of the policy to \$200.18 (from \$107).

⁸ Met Life's manual for insurance agents reveals reasons for the near linearity of the cash value curve for this policy. Ordinary life policies with face value \$5,000 generated favorable selection since their purchasers were often high-income highly educated professional men whose longevity exceeded the average and who were likely to continue paying the policy throughout their lives. Given the favorable selection and low cost of servicing these policies, Met Life assigned them extremely low loadings and moderate surrender charges.

Annual payments remained at the new rate until the loan was paid back and the policy reverted to its original schedule of costs and benefits.

Figure 11 (c) depicts a third option, switching from an ordinary life policy to a paid-up term-life contract. The new term policy would have the same death benefit as the original ordinary life contract. If the insured died within the term (which would be 15.5 years in our example of a man switching from ordinary life to term life at age 55 after paying 20 annual premia), their beneficiary would receive the full benefit (\$5,000 in our example). If the insured survived the term, however, their beneficiary received nothing. The length of the term depended upon the age of the insured, which determined the annual cost of a term contract, and the cash value of the old policy, which determined how much was spent on the term policy. The term policy was paid up. So, the insured need not make any additional payments, and it retained a cash value, which diminished linearly through the term, falling to zero at the end of the term. This option is one reason that most ordinary policies lapsed. Insured individuals who learned about their likely longevity or whose health declined would maximize their return from the policy by switching to term life and ceasing to pay premia.

Figure 11 (b) plots the last option, a paid-up ordinary-life policy with a lower death benefit and cash value. The new death benefit was an actuarial fair value based upon a policy that could be purchased with a lump sum payment equal to the original policy's current cash value. The new policy's cash value was a percentage of its old cash value. The percentage was calculated by dividing the new death benefit by the old death benefit. In our example, the new death benefit was \$2,774. The percentage equaled 54.88 percent ($=2744/5000$). The new cash value for each year was the cash value in the corresponding year of the original policy multiplied by the percentage. The new cash value could also be determined by another calculation, where the cash value of the new policy rose 3.5 percent per year minus the surrender charge proportionate to the new death benefit.

The paid-up policy was an important option in our example because it was the default option if the policy lapsed. The policy lapsed if the insured failed to pay a premium by the due date. After a lapse, the insured had three months from the due date to choose whether the policy converted to a paid-up lower-value ordinary policy [i.e., Figure 11 (b)], a paid-up term life policy

[i.e., Figure 11 (c)], or cash [i.e., Figure 11 (e)]. If the individual failed to contact the company or did not state a decision, the policy would automatically convert to the paid-up ordinary policy.

After a lapse, the insured could reinstate the original policy by paying all overdue premia with interest at 6 percent per annum and any overdue interest on policy loans outstanding. The balance of the loan need not be repaid, although the insured had to acknowledge that the loan remained outstanding. The insured also had to provide “evidence of insurability satisfactory to the Company (Flitcraft p. 520),” which meant that the company or its agent could require the insured to undergo another physical examination.

The premia for all ordinary life policies were based upon the same assumptions and actuarial tables. Met Life stated that they had “no set limit” on the amount of insurance that they would write on a single life, although extremely large requests would be considered on a case-by-case basis. Policies were written in increments of \$1,000. To help individuals choose policies and to help agents explain them to customers, Met Life distributed tables detailing the costs, cash values, loan values, and surrender options for policies with face values of \$1,000 and explained that the figures for policies of larger amounts were multiples of the published tables. An individual purchasing \$2,000 of insurance, in other words, could calculate the values that would apply to them by multiplying all numbers in the table by two. Met Life also had pre-printed blank contracts for common amounts of insurance. These common contracts contained tables with the values of policy options printed on them. The tables contained values for contract years one to 20, 25, and 30; a description of the method of calculating values for these and all other years; and a provision that tables indicating the values for all years (from one to 95) could be viewed at offices of the company and its agents and would be provided to individuals upon request.

The policy remained in force until the company completed payments obligated by the agreement. The payments could be made in different forms depending upon the mode of settlement chosen by the insured. The choices were to receive the payment as a lump sum, as installment payments for a specified number of years, as an annuity for life, as a life annuity with a guaranteed minimum number of payments, or as a series of interest only payments for a specified interval or for life with the balance paid as a lump sum at the end. The company set the present value of all these streams of payment equal assuming an interest rate of 3.5 percent per annum, although the realized interest rate could be higher on participating policies which also received dividends. The

insured could select annual, semi-annual payments, quarterly, or monthly payments. The insured indicated the payment option that they desired. They could change their selection at any time by submitting the appropriate form. After their death, their choice would be locked in unless they assigned the right to change the choice to their beneficiary. Literature recommended reserving this right only for beneficiaries with financial experience. Minor children and adults lacking investment experience might mismanage or squander large sums. They were better off receiving regular payments of moderate amounts.

The policy also contained disability benefits. The company waived premium payments for individuals younger than age 60 with “total and permanent disabilities” who through “bodily injury or disease” had “become wholly and permanently disabled . . . so that he is and will be permanently, continuously, and wholly prevented thereby from performing any work for compensation or profit (Flitcraft p. 522).” Applicants who applied for disability benefits had to submit proof of their claims and be examined by doctors employed by Metropolitan Life. Conditions warranting compensation included but were not limited to “irrecoverable loss of the sight of both eyes, or the severance of both hands above the wrists, or of both feet, or of one entire hand and one entire foot (Flitcraft p. 522).”

Several pages of the policy reviewed standard provisions in ordinary life contracts. The company could not contest the contract after two years from its date of issue. Benefits from the contract were assignable; all assignments had to be “executed upon blanks furnished by the Company and filed with the Company at its Home Office in New York City (Flitcraft p. 518).” The policy did not cover deaths in military or naval service during times of hostility. The policy could be reinstated after lapse for non-payment of premiums by paying the past due premiums plus interest at six percent per annum and presenting “evidence of insurability satisfactory to the Company (Flitcraft p. 520).” This evidence usually included passing a medical exam. The policy participated in the profits of the company. Each year, the company would ascertain and apportion the divisible surplus (i.e., retained earnings not reserved for taxes or contingencies). Policyholders could take their dividend in cash, apply it to payments of premiums, use the dividend to purchase paid-up additions to the sum insured, or leave it on deposit at the company where it would earn an interest rate of 3.5 percent per year (or higher should the company raise the rate, but never lower)

with principal and interest withdrawable on any anniversary date of the policy and payable when the insured perished or the policy matured.

Attractions of Ordinary Life Policies

Ordinary life policies had many features that made them attractive to men planning their financial futures. The policies reduced risks, eliminated uncertainties, raised returns, reduced taxes, circumvented probate, and enabled men to direct funds towards anticipated expenses even if they should die too young to make the payments themselves. Two obvious attractions, emphasized in previous sections, were protecting one's dependents and saving for retirement. Ordinary life contracts were good at both.

Investments in ordinary insurance had respectable returns. Returns varied, of course, depending upon the specifics of one's policy, choices that one made while the policy remained in force, and one's lifespan. Table 2 illustrates the latter point by examining returns on the Met Life policy described in the previous section. The table indicates returns earned on the insurance policy when it paid out due to death or maturity after various years in force. The investment return after one year was 4572.9 percent, since one paid \$107 and 365 days later received \$5,000 in return. The total return was slightly higher. In the first year, the policy did not pay dividends, but the insured benefited from life insurance over the year to the amount of \$11.70, which was the cost of a term life policy over that interval. They benefitted because if they had died earlier, their investment of \$107 would have paid out immediately and they would have reaped a higher rate of return. The investment return remained above 10 percent for more than 20 years, declined to 3.4 percent after 30 years, and fell below 0 percent by 50 years when individuals had paid more for their policy than they would receive in return.

Over years, however, the declining pure investment return on insurance was more than offset by the value that individuals received from the insurance itself and the dividends paid on their policies. The insurance value equaled the cost of term insurance over that span, since term insurance was the market price for a policy that paid money to beneficiaries if the insured died over a span of time but lacked a savings component or investment return. Dividends depended upon a policy's reserves and the insurers' profits. Policies paid no dividends in their initial years.

Dividends rose the longer policies remained in force and could be substantial. In the 1920s, Metropolitan Life paid dividends averaging about 1.5 percent of policies' net reserves (Best 1924 pp. 446–9). The policy in our example would have received dividends of roughly \$20 per year after 20 years in force and \$75 per year as the policy approached maturity.

The policy's returns need not end when the policy matured. The insured could leave their funds invested in the company. Their investment would have received an annual return of about 5 percent (3.5 percent stipulated annual return plus dividends averaging over 1.5 percent per year). The return might also depend upon their longevity if they decided to have the funds paid out as a life annuity which paid a fixed amount per month for the rest of their lives.

Returns for ordinary insurance were not just good but also safe. After the early 1870s, no legal reserve life insurer failed with loss to policyholders. Only a few minor firms failed with losses to policyholders before that and those losses were typically small. Legal reserve insurers were safe because state regulations required them to hold reserves sufficient to pay policies. Most states calculated these reserves based on the American Experience Mortality Tables, which were the most scientific and up-to-date tables available when most states initially regulated insurance in the 1860s through the 1880s. Rising incomes and improved health care reduced mortality rates in the late nineteenth and early twentieth centuries. These reductions were not reflected in insurance regulations for many decades. This delay meant that insurers accumulated more reserves than they needed to service their outstanding policies. Insurance companies that approached insolvency according to regulatory standards typically had sufficient reserves to service their outstanding policies. These reserves enabled them to reinsure or sell their outstanding policies to solvent insurers so that their policies remained in force and so that they could liquidate without imposing losses on their policy holders.

Legal reserve life insurance companies proved to be much safer than their competitors. Almost all life insurers organized as fraternal or assessment associations defaulted on obligations at some point between 1890 and 1940. Thousands of banks failed with losses to depositors in that span of time. Banking panics occurred about once every twenty years (Jalil 2015). Stocks and bonds experienced huge swings in value. Distress among banks, bonds, and stocks were correlated. The risk of these investments rose and returns on these investments fell during recessions like those beginning in 1907 and 1921 and depressions like those beginning in 1873, 1893, and 1929.

Nominal returns on life insurance savings were uncorrelated with these downturns. Life insurance reserves accumulated at a steady rate, typically 3.5 percent, compounding annually. Life insurers paid steady dividends since their portfolios were safe and diversified, which meant their earnings declined little during downturns, and income from premiums fell little when the economy contracted, since the downturn highlighted a benefit of savings via insurance rather than alternatives.

Deflation during depressions meant that real returns on life insurance savings were inversely correlated with returns on most types of investments. When stock prices declined and bond defaults widened, the real return on life insurance savings—the nominal return plus the rate of deflation—rose (Ezekiel 1937 p. 189). During the contraction of the early 1930s, for example, when deflation exceeded 10 percent per year, the real return on life insurance rose near or above 15 percent.

Life insurance had additional value during difficult times. Life insurers served as a reservoir of funds. Policy loans served as a lifeline for policyholders (Jacqua 1951). Training materials for life insurance agents at the time told them to tell prospective clients about life insurance's use as a hedge against financial downturns (Owen 1942, ALC 1953).

Another advantage of life insurance was the safety and convenience of entrusting one's funds to a national conglomerate rather than a local bank. Large financial institutions, including both insurance corporations and commercial banks, headquartered in New York and other eastern states with strict regulations offered payment services that spanned the nation and failed infrequently, almost never. Most banks, however, were small, local, and risky. Regulations limited branching. Most banks operated out of a single building in a single town. Few operated across towns. None operated locations across state lines. Local banks had difficulty diversifying lending, failed at high rates, and had difficulty helping clients at a distance. While it was possible for individuals from anywhere in the nation to deposit funds in a Wall Street bank with a broader reach, it was difficult and costly to do so, and therefore, seldom done. The large East coast insurance conglomerates operated differently. They had subsidiaries operating in every state and agents operating throughout the nation. The largest insurance conglomerates had agents in almost every county in the nation, and in many states, almost every town. Their agents canvassed most

neighborhoods and knocked on most doors in the nation. Life insurers, in other words, had the advantages of local presence and national scale.

Ordinary life policies had additional features that made them attractive investments, particularly in the early twentieth century, an era of rising estate taxes and with the introduction of income taxes. Life insurance benefits were neither subject to the federal estate tax nor to estate taxes in most states. Life insurance benefits were also not subject to federal and state income taxes. Investment returns withdrawn from insurance plans—particularly paid-up additions in excess of a plan's initial parameters—were taxed as income, but the income was treated as a capital gain, taxed at a lower rate than ordinary income, and only taxed when withdrawn from the account. These tax advantages were particularly attractive to professionals with high incomes and substantial assets who benefitted from convenient and low-cost methods of minimizing taxes.

Lower-income households were attracted to other advantages. Life insurance plans avoided probate, the legal process that distributed the assets of a deceased individual's estate. Probate was costly. The standard executor's fee was 7 percent of the value of one's estate. Probate could be slow. It took time for executors to catalogue a decedent's assets, offset them against debts, communicate with interested parties, process paperwork, and execute the will. If someone died with numerous creditors, the process could be slow while the executor verified the debts, determined their precedence, and settled disputes related to these claims. If someone died intestate (without a will), distribution of assets would depend upon state law. A probate that finished within a month would be quick. A probate that lasted six months to one year would not be unusual. Disputes about probate could delay distribution of assets for much longer periods. Life insurers processed claims for benefits without charge and as rapidly as proof of death could be verified. Beneficiaries could expect to receive the first payment within weeks if the insured died near their home, authorities recorded the death, and newspapers published an obituary or details of funeral arrangements.

Life insurance benefits were also protected from creditors. The benefits were the property of the beneficiaries, who would receive the benefits of the policies despite the debts of the decedent. The benefits, of course, were assignable, and a creditor could be a beneficiary. Heads of household might direct the proceeds of their policies to creditors so that they could borrow at lower interest rates and ensure that their survivors secured the benefits of borrowing after their demise.

Arrangements like this were often used for mortgages, for example, to ensure that a family could remain in a home if its breadwinner passed. The arrangement, it should be noted, was the choice of the insured. While they were alive, they could decide who would receive their benefits from their life insurance and whether creditors would be guaranteed all, some, or none of their funds.

A last advantage of life insurance policies was the ability to direct funds to particular parties or purposes after one's demise. In this respect, life insurers operated like legal trusts. While the insured party lived, they retained access to the equity in their policies. After they perished, the funds remained with the life insurance company, who paid the funds to the parties and in the manner that the insured directed before their death.

Comparisons to Social Security

The attractions of ordinary life policies illuminate similarities and differences between retirement savings today, using Social Security, and retirement savings in the past, using ordinary life policies issued by legal reserve insurers. The two systems can be compared along many dimensions.

The trajectories of returns for the two systems differed dramatically. Social Security pays the highest returns to those who live the longest. The survivors' portion is small, only received by dependents, and ceases when dependents become adults, remarry, or receive other sources of income. The survivors' portion also depends upon the salary that one received early in one's career, which is usually much lower than that earned as one gains tenure and experience. Disability payments are moderate. Retirement benefits can be generous but are paid as an annuity, so the total return depends upon longevity. Social Security is a much better investment for people who live to age 95 and collect benefits for about 30 years than people who die at age 70 and collect benefits for less than a decade. In contrast, returns on ordinary life policies were highest for those who died soon after acquiring insurance. Returns declined the longer one held the policy, approached those of investing in equity after about 25 years, approached those of investing in housing or bonds after about 30 years, and approached those of savings accounts after 45 years. On maturity, an ordinary-life investor could have their funds paid out as an annuity, and then, their return would rise the longer they lived. This payment plan was optional, however, and the insurer

equated expected returns on all payout options. Annuity payouts, moreover, were not compulsory as in Social Security.

The different trajectories shed light on the ways in which the two systems compensated individuals afflicted by ill fortune as well as the societies which devised these systems. Social Security shifts funds to those who live the longest. Individuals blessed by longevity receive the highest returns. Individuals who die early earn lower returns. If an individual dies before retirement, their dependents receive small payouts whose value falls far below what they themselves would have received had the policyholder lived to a ripe old age. A modern equivalent of an ordinary life payout would be to give designated survivors of Social Security enrollees a payout equal to the present value of the enrollee's future Social Security benefits, assuming the enrollee lived as long as and received annual salary increases as large as the average individual. The ordinary life system provided reasonable returns for retirement savings. Ordinary individuals with moderate savings and little investment expertise probably earned returns as high or higher than they could earn through other intermediaries. Ordinary life, however, emphasized leaving an estate for one's survivors, particularly widows and children. This emphasis made sense in society with little social safety net and limited funding for higher education where married women seldom worked and rarely earned salaries similar to men's. In that world, if a father did not provide for his widow and children, they would struggle and might be destitute.

Another large difference between Social Security and ordinary life policies is their interactions with inflation. Social Security is indexed. Nominal benefits are raised each year by an amount equal to the increase in the Consumer Price Index (CPI). This automatic increase keeps real returns constant (and might increase them over time if CPI inflation overstates the actual rise in prices). Indexing began in the 1970s. Before then, Congress had to approve each increase in benefits, which it did on numerous occasions to compensate Social Security recipients for the loss of purchasing power due to high inflation in the 1960s and 70s. Benefits of ordinary life policies were not indexed. Payouts were never adjusted for inflation. Instead, returns to ordinary life contracts were fixed in nominal terms. While inflation could rapidly erode these returns, ordinary life policies were good protection against deflation. During periods of deflation and recessions, values of competing investments—stocks, bonds, housing, and bank accounts—declined, sometimes substantially, while values of ordinary life policies rose because their nominal payouts

did not change and legal life reserve companies seldom (almost never) failed with losses to policyholders.

Ordinary life was instituted in an era with a stable monetary regime, the gold standard. Prices typically declined. Peacetime deflation averaged about 1 percent and could be much higher during recessions and depressions. Deflation of consumer prices exceeded 10 percent per annum during the contractions in the early 1920s and 1930s. Deflation of wholesale prices was higher. Substantial price increases occurred mainly during wars, particularly World War I. Otherwise, the general price level in the 1900s was similar to prices in the 1870s. Prices at the end of the 1930s were lower than prices at the end of World War I.⁹

It may have been possible, of course, for ordinary life contracts to have been indexed to inflation, but the contracts and the entire industry were established in an era of long-run stable prices. Nobody anticipated the change to an inflationary monetary regime during the New Deal. So, it did not make sense to devise and market long-run savings plan that protected individuals' savings against inflation when most people's principal economic concern was deflation. Ordinary life policies were well insulated against that eventuality.

Ordinary life insurance as devised during the nineteenth century, in other words, depended upon the maintenance of price stability and a hard-money monetary regime. It may not have been possible to devise a different system at that time. The creation of insurance conglomerates that could operate over generations required developments in actuarial mathematics and the accumulation of accurate life tables. Developing mathematics that could accurately account for inflation would have been time-consuming and expensive; insisting on it could have delayed the development of the insurance industry substantially. Without it, ordinary life insurance was incompatible with inflation. This may be one reason that Democratic political candidates—like William Jennings Bryan and Franklin Roosevelt—who advocated adopting inflationary (of reflationary) monetary regimes also advocated establishing national old-age assistance programs.

⁹ The last two statements are based National Bureau of Economic Research, Index of the General Price Level for United States [M04051USM324NNBR], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/M04051USM324NNBR>, July 25, 2024.

The inflation-deflation contrast raises a related issue. Social Security returns are political calculations as much as economic concerns. Taxes paid to and benefits received from Social Security are agreements between the population and the federal government. Parameters are not set in stone. They can be changed by Congress. Most individuals do not receive the returns promised when they entered the system by paying OASDI taxes or when they began receiving benefits. The age when beneficiaries receive full benefits, for example, has been raised.¹⁰ So have benefits paid to retirees. Ordinary life differed. Costs and benefits were set at the outset of the policy. The insured could exercise options throughout the life of the contract, but the contract contained those options when they entered into the bargain. The parameters of the deal, which would last for years, decades, or in many cases, the rest of one's life, were fixed at the deal's onset.

The political-versus-contractual contrast raises the issue of incentive compatibility. Social Security participation is compulsory. The government compels participation. Individuals must pay Social Security taxes. No one can opt out of the system. The government collects the funds, transfers them to current retirees, and loans any surpluses to the government itself. Ordinary life contracts were never compulsory. Individuals and corporations entered into the agreements voluntarily. The contracts had to be compatible with individual and group incentives. Corporations had to want to issue the contracts and desire to stay in business to service them. Individuals had to want to sign the contracts and continue to participate.

Incentive compatibility underlies different returns offered by the two programs. Social Security paid initial generations of members returns much higher than they would have received based on their contributions (plus interest) alone. High payouts to initial generations were financed by compelling future generations to participate and pay taxes to the program. Fraternal and assessment insurers in the nineteenth and early twentieth centuries tried to create voluntary (non-profit and for-profit) organizations with similar overlapping generations' structures. All failed because they could not induce enough young individuals to join their organization.

Social Security's structure of government control and mandatory participation had broad implications for administration, employment, and education. Operating the legal reserve life

¹⁰ The Social Security Administration describes changes in the law and the evolution of the Social Security system on its website at <https://www.ssa.gov/history/50mm2.html>.

insurance system was costly. Life insurance conglomerates had agents in every county and city in the United States. In 1935, employment in the life insurance industry exceeded 300,000 (Statistical Abstract of United States 1935, p. 348). Annual payments to life insurance employees amounted to 1.8 percent of national income (Kuznets 1937 p. 5). Legal reserve life insurers needed these employees to sell and service financial contracts that spanned individuals' adult lives. Insurers believed that they had to actively sell insurance by educating people about the long-run benefits of savings. Insurers sold an array of introductory savings/insurance vehicles designed to attract new customers, particularly low- and middle-income individuals and even children, to educate them on the benefits of long-term savings. Social security does not require such a large sales force. They have less need to educate the public about their products, since participation is mandatory, and administrative costs per policy are lower, since Social Security has a huge volume of policies over which to spread the costs of its operations.

Discussion & Conclusion

Understanding how the creation of Social Security impacted American society requires an understanding of the institutions that it replaced. A lacuna exists in the literature on this issue. The literature has forgotten how ordinary working Americans saved for retirement in the decades preceding the creation of Social Security. The Social Security Administration's own website, which is the most prominent explanation of the system's origins and impact, is a case in point.¹¹ It does not mention legal reserve insurers or ordinary life insurance. It indicates that immediately before the creation of Social Security "one-third to one-half of the aged" were destitute and dependent on "friends or family for support." It asserts that due to the Great Depression of "the mid-1930s, the lifetime savings of millions of people had been wiped out."

These assertions, this essay argued, were unfounded. Most ordinary Americans held most of their savings in ordinary life insurance issued by legal reserve insurance companies. If they retained their jobs and had made their periodic payments, the value of their savings had risen rapidly during the 1930s relative to wealthier families who invested in stock, bonds, and housing.

¹¹ <https://www.ssa.gov/history/50mm2.html>.

Far from being unprepared for retirement, most heads of household in the United States 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 United States to create Social Security. The inflation which began during World War II and continues to this day did that.

This realization helps to clarify the problem that Social Security initially tried to solve. Some people had not saved enough for retirement, or their retirement plans fell through. Others lost their jobs during the depression and lacked the ability to save even though they desired to do so. The patchwork of programs that existed in 30 states in the mid-1930s did not do enough to assist these individuals. Social Security was initially established to handle this issue, providing moderate pensions in old age to stave off indigency for the many Americans who through bad luck or bad planning did not have sufficient support in retirement. It was not designed to be the main savings vehicle for ordinary Americans. Most of their retirement savings were held by legal reserve life insurance companies during the 1930s. Those funds were safe. Their real value increased substantially during the deflation of Depression.

Looking ahead to the period after the advent of peacetime inflation, then, 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. However, it is important to note that not all Americans were initially eligible to participate in Social Security: Just as political concerns helped shape other aspects of Social Security's design, political considerations also led to many Black Americans being excluded from participation by dint of their employment in farming or service occupations, which were initially carved out in the Social Security Act. Accordingly, it is also easy to see the potential implications of the transition from ordinary life insurance to Social Security for disparities in old-age savings and in wealth more generally. With Black households already heavy participants in life insurance for historical reasons (Arthi et al. 2024), and with many Black households now (at least temporarily) locked out of Social Security, these households would have seen their old-age savings eroded, even as other households shifted from more- to less-impacted retirement savings vehicles. In this way, the transition from private to nationalized retirement savings may have contributed to persistence in racial disparities, at least until occupational

eligibility restrictions with disparate impacts on Black workers were unwound in the decades following the Social Security Act. The downstream impacts of these policies on racial wealth gaps remain a matter for future research.

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Appendix

Table 1: Savings During the Roaring Twenties and Great Contraction

| | Individuals via Institutions | | | Corporate | Equity |
|-----------------|------------------------------|---------------------|------------------|-----------|--------|
| | Life Insurance | Building & Loans | Bank Deposits | | |
| 1920-24 | 5,478 | 2,639 | 4,446 | 4,193 | |
| 1925-29 | 9,420 | 3,929 | 3,155 | 10,788 | |
| 1930-35 | 11,616 | -2,250 | -3,547 | -26,573 | |
| Total 1920 – 35 | 25,514 | 4,318 | 4,054 | -11,602 | |

Source: Ezekiel 1937 Table 11 p. 190

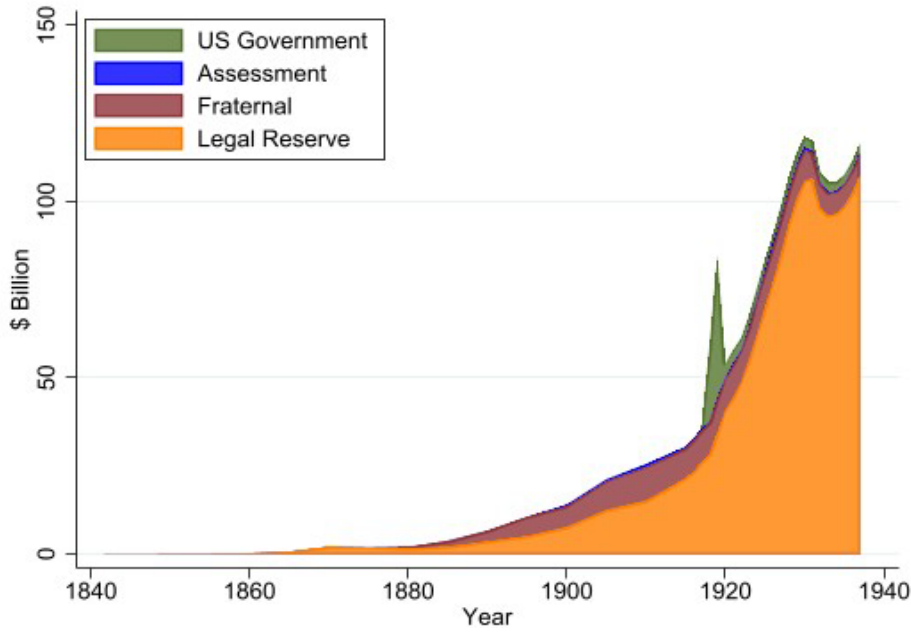
Table 2: Returns on Ordinary Life Insurance Contracts

| Year | Total | Investment | Dividends + Insurance |
|------|---------|------------|--------------------------|
| 1 | 4572.9% | 4572.9% | 0.1% |
| 2 | 535.1% | 535.0% | 0.1% |
| 3 | 221.2% | 221.0% | 0.2% |
| 5 | 87.3% | 87.0% | 0.2% |
| 7 | 49.5% | 49.1% | 0.4% |
| 10 | 39.6% | 39.1% | 0.5% |
| 20 | 15.4% | 14.4% | 1.0% |
| 30 | 4.9% | 3.4% | 1.5% |
| 40 | 2.9% | 0.9% | 2.0% |
| 50 | 2.2% | -0.3% | 2.5% |
| 60 | 2.1% | -0.9% | 3.0% |

Source: Authors' calculations based upon Met Life Policy from Flitcraft (1915 pp. 517–32).

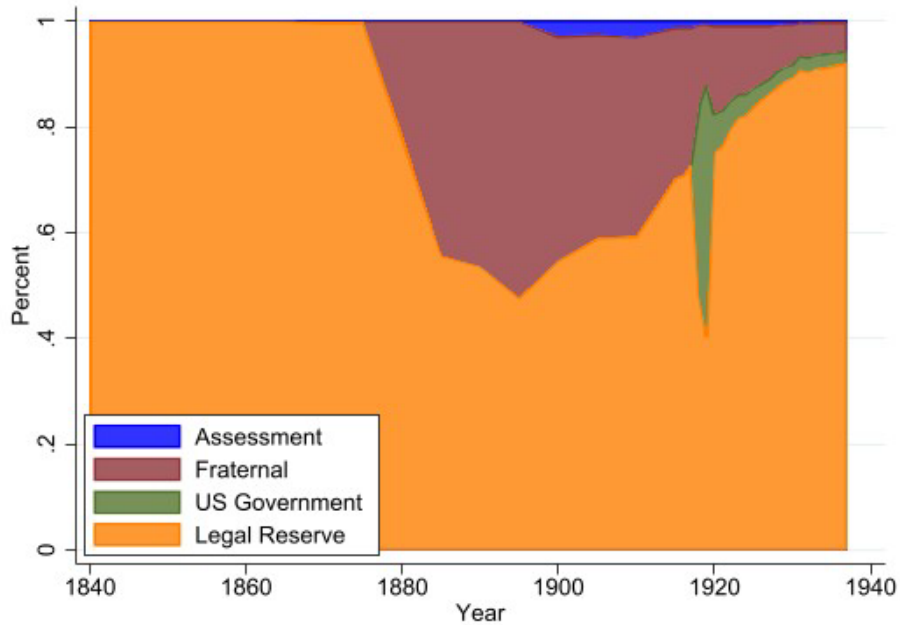
Notes: Returns calculated on the last day of the year. *Year* indicates number of years for which policy was in force. For years below 60, the *investment return* indicates the annually compounded nominal return earned if the insured perished and the beneficiary received payment of the face value. For year 60, the investment return indicates the annually compounded nominal return earned by the insured when they received the payout of the face value when the policy matured. *Total return* indicates the return earned after adding to the face value received upon death or maturity the compounded value of the dividends received on the policy and the term premium that the insured would have paid for life insurance protection from the start of the policy until the date of death. Returns on *dividends plus insurance* is total return minus investment return.

Figure 1: Total Life Insurance in Force by Underwriter



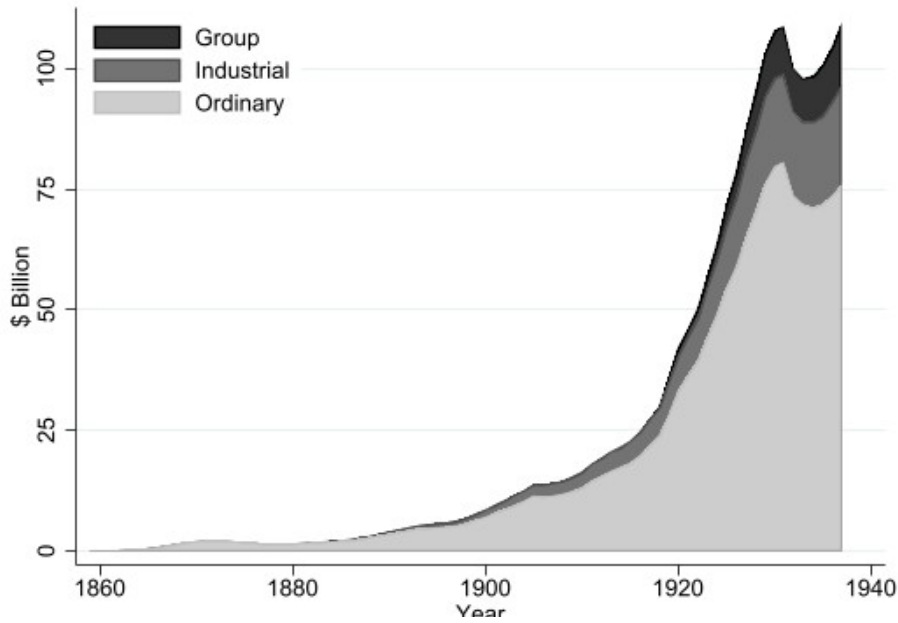
Source: Owen 1942 Appendix 25 pp. 816–8
 Note: Canadian and European underwriters excluded.

Figure 2: Shares of Life Insurance in Force by Underwriter



Source: Owen 1942 Appendix 25 pp. 816–8
 Note: Canadian and European underwriters excluded.

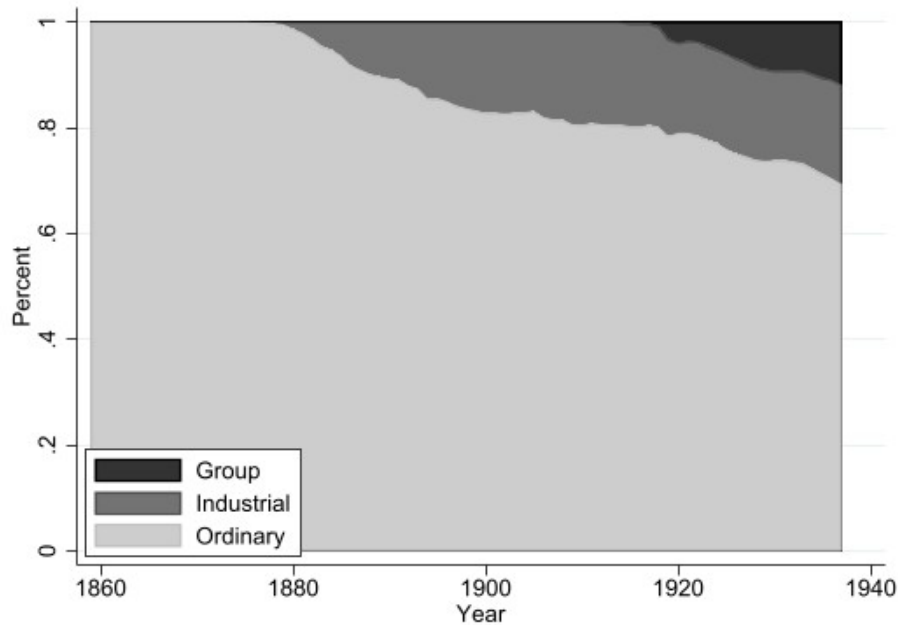
Figure 3: Total Legal Reserve Life Insurance in Force by Type



Source: Owen 1942 Appendix 24 pp. 813–5

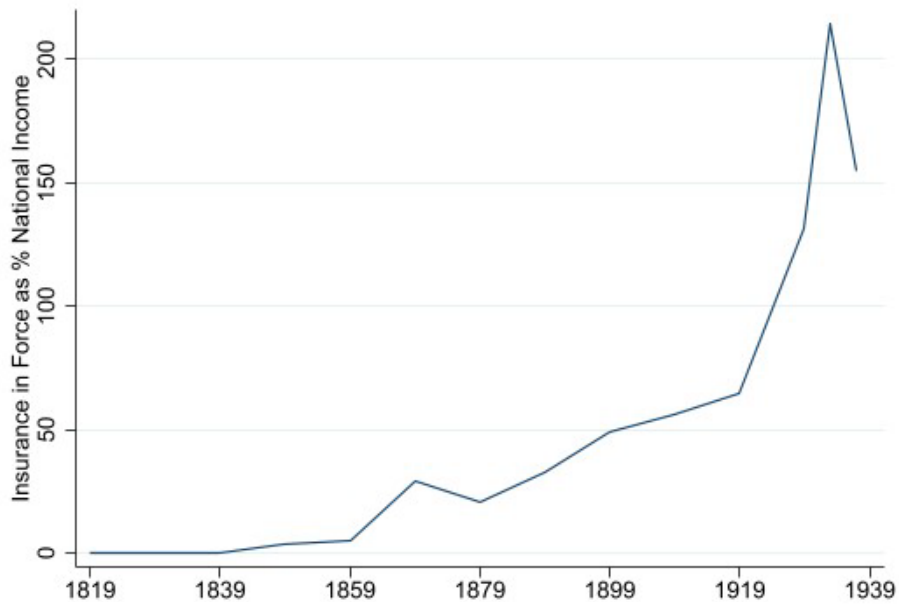
Note: Canadian and European underwriters

Figure 4: Shares of Legal Reserve Life Insurance in Force by Type

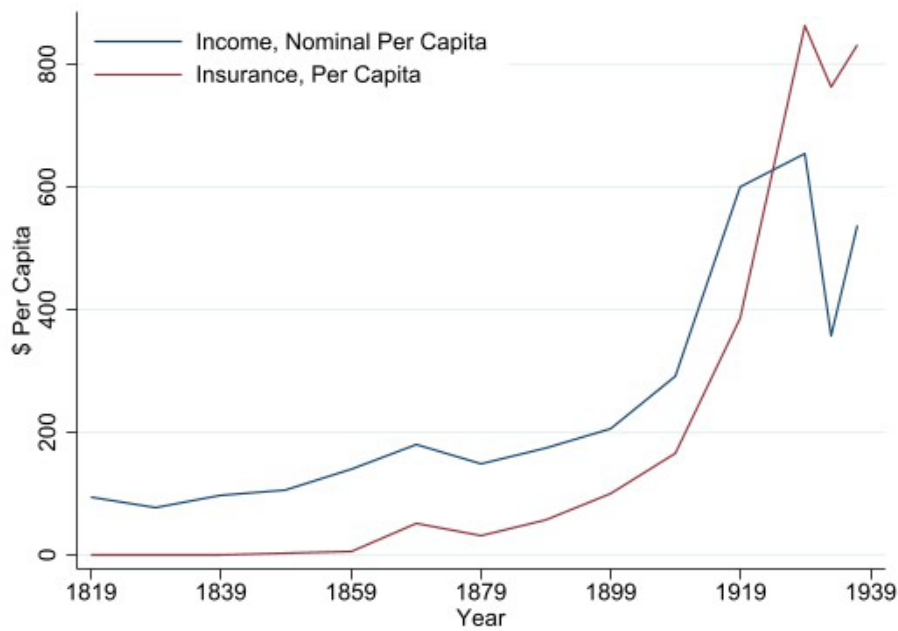


Source: Owen 1942 Appendix 24 pp. 813–5

Note: Canadian and European underwriters excluded.

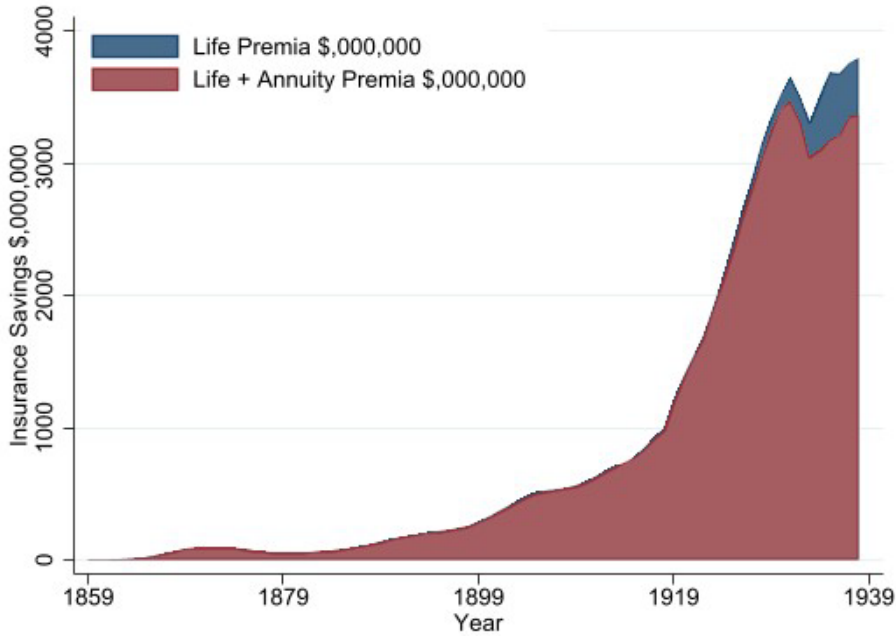
Figure 5: Insurance in Force Relative to National Income

Source: Owen 1942 Appendix 44 pp. 876



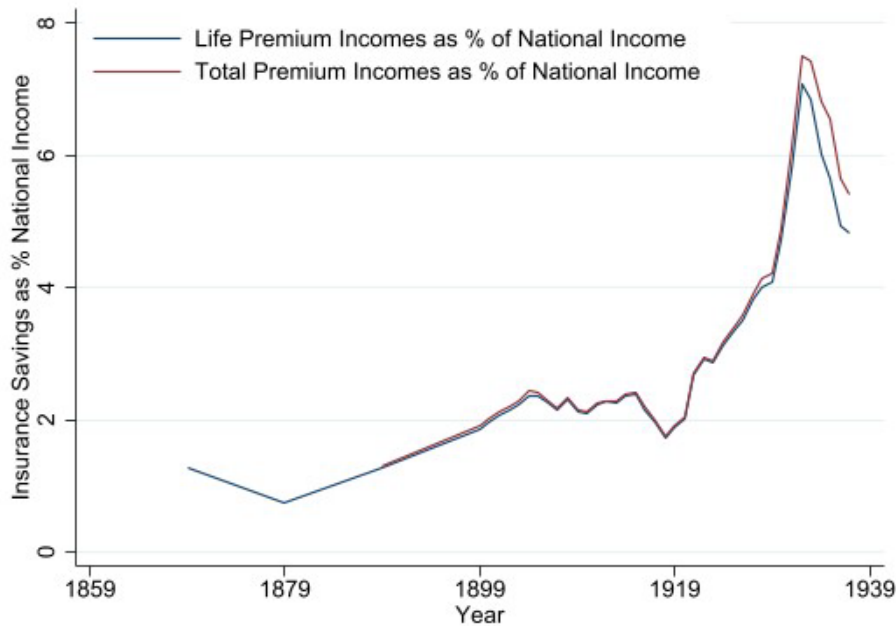
Source: Owen 1942 Appendix 44 pp. 876

Figure 7: Premia Paid to Legal Reserve Life Insurance Companies



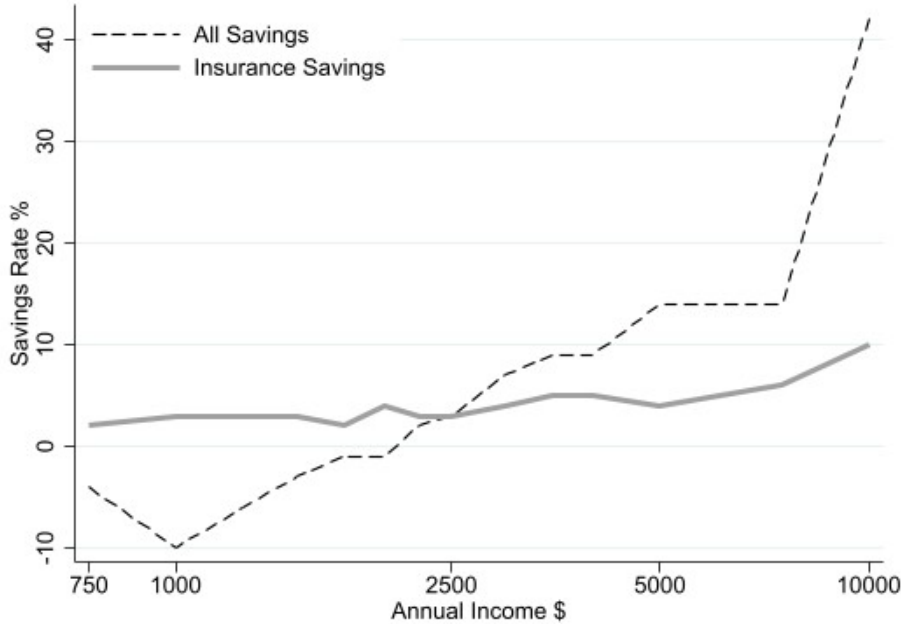
Source: Owen 1942 Appendix 45 pp. 877–9

Figure 8: Legal-Reserve Life Insurance Savings Rate



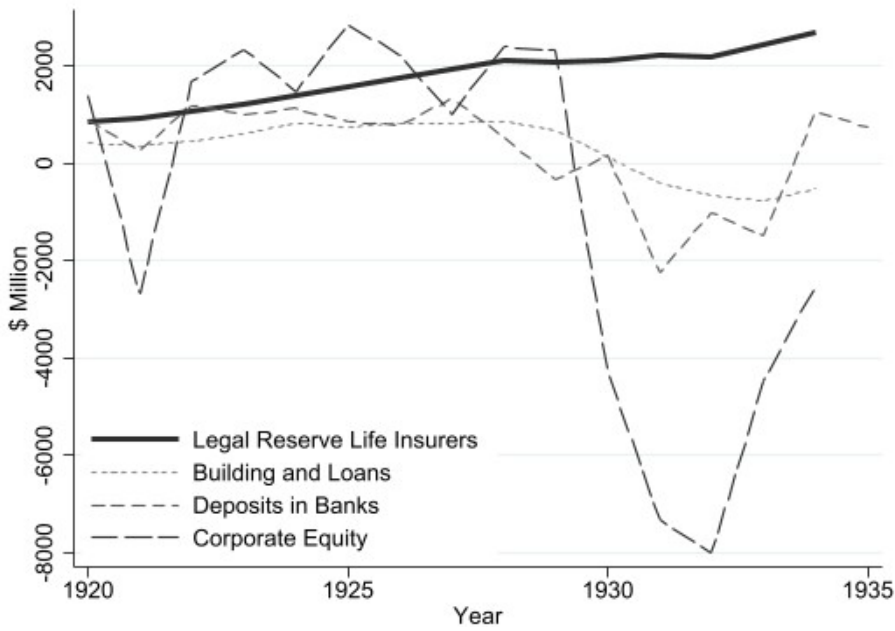
Source: Owen 1942 Appendix 44 p. 876 and Appendix 45 pp. 877–9

Figure 9: Savings Rates Relative to Annual Income, 1935



Source: Geren 1943 p. 37

Figure 10: Savings via Four Main Financial Intermediaries, 1920 to 1936



Source: Ezekiel 1937, Table 11, p. 190

Figure 11: Metropolitan Life's \$5,000 Ordinary Life Policy

