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Wealth and the demand for life insurance: evidence from Ontario, 1892

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Abstract

Our analysis of the life insurance holdings of male probated decedents in Ontario in 1892 demonstrates a negative correlation between the level of personal wealth and the demand for life insurance. Consistent with the theoretical literature on the demand for life insurance, and counter to the findings in much of the empirical literature, self-insurance was a substitute for market purchases of life insurance where self-insurance capabilities are a by-product of wealth accumulation. Our evidence suggests that households primarily demanded life insurance when they lacked accumulated reserves, or wealth, for self-insurance, often early in the life cycle. The growth of the life insurance industry reflected the growth of urban population relative to farming and an increased dependence on the head of household's earnings.

1. Introduction

Over the course of economic development in Canada and the US, rising levels of investment in human capital through work experience and

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education have driven much of the rise of real incomes.[1] While the reliance on human capital investment resulted in higher long-term levels of consumption for North American households, it was also a riskier consumption stream as households became more reliant on a smaller number of more educated workers.[2] Unlike bonds or other financial savings instruments, human capital is an asset that pays returns only when the individual in whom it is vested is alive. For households that relied on a tangible asset like land to generate income, the death of the household head, while tragic, was not as important an event for the surviving dependents' consumption as it was for surviving dependents in households that relied on the household head's human capital to generate household income. As Horrell and Oxley (2000) argue, despite what we know about the range of risk mitigation strategies available to households, we do not know very much about how households chose to address the increase in risk that accompanied the increase in reliance on a household head's human capital.

For the purpose of insuring a household's investment in human capital, was the purchase of market insurance coverage the preferred (or primary) strategy or was self-insurance through precautionary savings or accumulated wealth? The answer to this question is of considerable importance if we are to understand the development of insurance markets. For example, a common theme in historical studies of life insurance is that life insurance was an unsought asset due to the ignorance or improvidence of consumers, or due to consumers perceiving the insuring of a life as a suspect or immoral contract. As such, the rise of the life insurance industry and extent of insurance coverage was largely

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[1] The increasing importance of human capital for household consumption accompanied the rise in wage work arrangements in 19th century industrial market economies and was evidenced by families with fewer children, increasing educational attainment (Goldin, 1998), and an increasing reliance on fewer earners (Gratton, 1996). Falling birth rates coincided with rising savings rates (see Henripen, 1968; Lewis, 1983; Ransom and Sutch, 1986a,b; Sutch, 1991; Urquhart, 1993).

[2] Horrell and Oxley (2000) argue that the rise of the male-breadwinner family form reduced the employment opportunities for women and children and increased opportunity costs for families by more years of compulsory schooling for children and left the family largely dependent on the earnings of the male head of household. Horrell and Oxley highlight the view that with the rise of male breadwinner family forms, households increasingly relied on formal institutions (like insurance contracts) to mitigate earnings risk as an alternative to the labor of women and children. At the same time, the increased use of insurance contracts does not necessarily inform us about the importance of market insurance purchases relative to other risk mitigation strategies for households to cope with crisis.