OPINION

Insurance as Savings

Property and Casualty Insurance Premiums Compensate, in Part, for the United States' Low Savings Rate

by Joseph S. Harrington, CPCU, ARP

Year after year observers are astounded and dismayed by the persistently low personal savings rate in the United States. The figure for the year 2000 was actually a **negative** $8.5 billion, as reported in the U.S. Commerce Department's *Survey of Current Business*.[1]

Our alleged national profligacy was greeted with a chorus of moralistic hand wringing in the late 1980s and early 1990s, especially as personal bankruptcies reached record levels and continued to climb. Commentators at the time argued that the United States' competitive position and standard of living would surely erode unless Americans spent less and saved more.

The persistently strong performance of the U.S. economy in the 1990s forced analysts to concede, however, that official measures of saving did not necessarily tell the whole story of how Americans conserve wealth.

In the first place, "U.S. savings in the business sector are not dramatically low relative to Germany or Japan," wrote McKinsey & Co. analyst Bill Lewis in a 1996 column in *The Wall Street Journal*.[2] "Commonly published net domestic savings rates . . . paint a misleading picture," he added.

According to Lewis, the intensely competitive U.S. capital markets simply use investment capital more efficiently than their German and Japanese counterparts. "Higher capital productivity translates into higher financial returns," he wrote. "This more than compensates for the lower U.S. savings rate."

As for individuals, tax incentives encourage Americans to preserve much of their wealth in the form of housing; we are almost alone in the world in granting tax deductions for both mortgage interest and real estate property taxes. Thus, an American who uses a home equity loan to build an addition onto his house rightly believes that he is enhancing the value of a long-term asset, but the cost of construction will be counted as consumption.

"Japan has one of the highest savings rates, but Americans enjoy higher home ownership," editorialized *Investor's Business Daily* in 1998.[3] "We pump a lot of income into our homes, yet that equity isn't counted as savings."

Also, official savings figures do not capture all the growth in wealth created by capital gains, since capital gains are not recorded until the assets are sold and the gains realized.

Author's note:

This article was written and submitted before the September 11 terrorist attacks resulted in the largest insured loss in history. While some points in the article may need to be re-evaluated as the actual amount of claims is slowly clarified, the author believes the outcome of the event supports his central thesis.

The fact that private insurance was in place to pay such a wide range of claims suggests that insurance is a significant form of savings for the U.S. economy. At many other times and in many other places, the losses would have been covered from personal savings and public funding. While the insurance industry is currently seeking a short-term backstop against a similar disaster, there is no question that insurers will pay for property, business income, workers compensation, and life insurance claims arising from September 11 losses.

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A Place for Property and Casualty Premium

Premiums for property and casualty insurance have not figured prominently in the debate over personal savings in the United States, but it may be time to bring them into the discussion.

In the first place, property and casualty insurance serves one of the functions of savings, in that money is put aside "for a rainy day," be it an auto accident, damage to a home, or a liability judgment against a policyholder.

This was amply demonstrated following the Northridge and Kobe earthquakes. The former drove the California homeowners market to the brink of collapse, but the money was there and nearly $14 billion was ultimately paid from reserves and reinsurance. In contrast, the damage in the Kobe quake was mostly uninsured. It follows that the Japanese had to draw on their enormous pool of national savings to recover from the losses.[4]

These two disasters demonstrated two forms of preparing for an emergency. One can argue the practical merits of one approach over the other, but moralizing about national character would miss the point.

Americans are well-insured compared to their counterparts overseas. While the United States accounted for 30 percent of the world's gross domestic product in 1999, it accounted for 44 percent of its non-life insurance premium, according to data in Swiss Re's sigma publication.[5]

Indeed, as the U.S. personal savings rate fell in the 1990s, the premium volume for personal lines property and casualty insurance soared 54 percent, from $97 billion of written premium in 1990 to $149 billion in 1999, according to the A.M. Best Company. Written premium for personal and commercial lines coverage rose 32 percent, from $218 billion to $287 billion, and came to consistently exceed the dollar volume of U.S. personal savings.[6]

Along the same line, the French bank BNP Paribas has determined that U.S. property and casualty loss reserves rose from less than 2 percent of U.S. gross domestic product in 1970 to more than 5 percent in 1992, and have fallen to around 4 percent since.[7] This increase roughly corresponds with the period when the U.S. savings rate fell dramatically, begging the question whether there is a connection.

Health Insurance

The global disparity suggested by Swiss Re figures reflects premiums paid for health insurance, which is privately funded for most Americans while many Europeans receive health care funded wholly or in large part through government programs. Does that account for the high level of U.S. non-life premium reported by Swiss Re?

It is an extremely complicated task to determine what percentage of medical care is funded through public programs, workers compensation, liability insurance, and other means from country to country. But even if we exclude U.S. health insurance premium entirely by using A.M. Best's 1999 figure for U.S. property and casualty insurance—$287 billion in written premium—we still see that Americans are very well insured compared to their counterparts abroad.

To illustrate, Table 1 compares 1999 per capita premium in the United States with that in other major industrialized countries.

Even if U.S. property and casualty premium reflects funding for health care that is provided at public expense in some European countries, there is a countervailing factor at work in determining the true picture of national savings.

Table 1

Country (Type of Premium)	1999 Per Capita Premium (U.S.$)
United States (all non-life)	$1,474
United States (P/C only)	**$1,054**
Germany (all non-life)	$913
Japan (all non-life)	$806
Great Britain (all non-life)	$741
Canada (all non-life)	$700
France (all non-life)	$688
United States (personal lines)	$548
United States (commercial lines)	$506
Italy (all non-life)	$495

To the extent that a country funds health care through tax payments, it will show a higher personal savings rate because tax payments are generally deducted from disposable personal income. One-hundred dollars spent on health insurance in the United States is counted as consumption; the same $100 taxed for a public health program would be deducted from disposable household income, making savings a higher percentage of a smaller amount.

Narrowing the Gap

To illustrate how insurance can narrow the savings gap, consider what happens when you compare per capita savings with per capita savings plus non-life premium for the major industrialized countries. (See Table 2.)

Table 2 uses 1995 because data from that year were available online from the Organization of Economic Cooperation and Development (OECD). Significantly, the table multiplies OECD figures for per capita GDP by the net national savings rate for each country. That rate encompasses business, personal, and public saving, and would therefore reflect health expenditures however they are made.

Table 2 shows that, while official U.S. per capita savings lagged behind most of the major industrialized countries in 1995, its per capita savings plus non-life insurance expenditures were essentially equivalent or superior to all the listed countries except Germany and Japan. Skilled statisticians and economists can point out limitations to these rough calculations, but there is little doubt that Americans put a lot of money into property and casualty insurance relative to citizens of other countries.

As evidence, consider that the U.S. property and casualty industry has been wrestling with excess capital capacity for more than a decade. “The industry’s surplus grew at an average annual rate of 9.6 percent during the 1990s,” writes Robert Hartwig, chief economist of the Insurance Information Institute.

Given historically low premium to surplus ratios, he adds, “analysts have estimated the industry’s ‘excess’ capital at $100-$125 billion” (out of a total surplus of $317 billion at the end of 2000).[8]

Table 2

Country	1995 Per Capita GDP*	1995 Net National Saving*	1995 Savings Per Capita	1995 Non-Life Premium Per Capita**	1995 Savings Plus Non-Life Premium
Japan	$21,795	15.0%	$3,269	$1,012	$4,281
Germany	$20,497	8.2%	$1,681	$1,136	$2,817
Italy	$19,464	8.2%	$1,596	$425	$2,021
France	$19,939	6.9%	$1,376	$834	$2,210
United States	**$26,438**	**3.8%**	**$1,005**	**$1,366**	**$2,371**
Canada	$19,354	4.6%	$890	$703	$1,593
Great Britain	$18,777	3.4%	$638	$616	$1,254

Sources: *Organization of Economic Cooperation and Development
**Swiss Re

Insurance as Consumption

One can dispute whether the U.S. property and casualty industry is really "overcapitalized" when you consider the exposure to an insured loss from a "mega-catastrophe," as would happen if a hurricane struck the heart of Miami.

Along the same line, one can dispute the value of having so much money invested in an industry that earns less of return than others, and that finances litigation, settlements, and recoveries whose costs are extravagant by world standards.

What we cannot dispute, however, is that property and casualty insurance is a method for putting money away to meet contingencies. Unfortunately for the public image of Americans, their efforts to be prudent compounds their image as spendthrifts.

That's because premiums paid for auto, home, and health insurance, including privately administered workers compensation coverage, are all counted as consumption by the Commerce Department in its *Survey of Current Business*.[9]

It's easy to see why. For all practical purposes, once you pay a health or property and casualty insurance bill, those dollars are gone. There is no "cash value" for you to draw on (unless you cancel a policy and get a refund of the unearned premium). As far as the Commerce Department is concerned, insurance is merely an extension of the property you consume.

But even if the premium dollars are gone, the insurance buyer has purchased a valuable asset of sorts—the right to be compensated for a fortuitous loss. This is an asset that does not appear on balance sheets, and does not figure into national accounts of saving. It's time that it did.

No attempt to understand and modify the savings habits of Americans will be complete or effective without considering the role of property and casualty insurance as a form of savings. Apart from tax incentives and accounting peculiarities, it may simply be that Americans find insurance to be an effective way to put money away for the "rainy day."

Endnotes

1. U.S. Department of Commerce, *Survey of Current Business*, June 2001, p D-14.
2. Lewis, Bill, “The Wealth of a Nation,” T*he Wall Street Journal*, June 7, 1996; p. A14.
3. “Taxing Savings,” *Investor’s Business Daily*, Aug. 5, 1998, p. A6.
4. See EQE International, “Economic Impact,” in The January 17, 1995 Kobe Earthquake: An EQE Summary Report, April 1995, www.eqe.com/publications/kobe/economic.htm.
5. Swiss Re, sigma, No. 9/2000, pp. 29, 34.
6. A.M. Best Co., *Annual Aggregates & Averages*, 2000 edition, p. 270.
7. Howard, Lisa S., “Higher Risks, Softer Rates Form Dangerous Re Mix,” *National Underwriter*, August 30, 1999, p. S-4.
8. Hartwig, Robert P., “Commentary on Year-End 1999 Results,” March 30, 2000, and “Commentary on Year 2000 Results,” April 10, 2001, both by Insurance Information Institute, New York City.
9. U.S. Commerce Dept., op.cit., p. D-31.