The Rise and Fall of Fraternal Methods of Social Insurance: A Case Study of the Independent Order of Oddfellows of British Columbia Sickness Insurance, 1874-1951

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Since the depression of the 1930s, Canadian and American workers have relied upon employers and governments for solutions to problems of economic insecurity brought on by illness, accident, unemployment, and old age. In the case of sickness insurance, 86% of Canadian paid workers who were sick for two or more weeks over the period 1978 to 1981 received compensation for lost wages through either employer provided insurance or compensation, unemployment insurance, or Workmen's compensation [12]. This is in stark contrast to the pre-Depression (pre-1930) period when millions of Canadian and American men received sickness and health insurance through membership in voluntary organizations such as fraternal orders, trade unions, and work-place based mutual benefit societies. Members of these institutions typically received cash benefits when they were sick and unable to work and had access to the services of a physician.

While the evolution of contemporary social insurance arrangements coincides with the decline of fraternal insurance arrangements, we know very little about the causal relationship between the two. Why did workers stop providing their own insurance and turn to employers and governments after the Depression but not before? Why were paternalistic social welfare arrangements that had been proposed since the late nineteenth century only embraced after the Great Depression? Were these arrangements supply side developments imposed by social engineers? Did previously indifferent employers and governments become benevolent and paternalistic following the experience of the 1930s [8]? Was the rise of the welfare state a response to growing demand of workers who abandoned the existing arrangements which were inherently non-viable [1]; or as Buffum and Whaples speculate, had fraternal insurance become less viable boosting the growth of market insurance, and ultimately state provision of insurance [2]?

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This is a troubling gap in our knowledge of social insurance history, given that as much as 30% of Canadian and American working class white males participated in fraternal institutions, and given the impact that the emergence of employer and government based arrangements have had upon wages and labor costs, employment, productivity, and government deficits. Only by understanding why contemporary social insurance arrangements emerged can we hope to assess their impact on the economy. To see this one must only notice that alternative explanations of the decline of fraternal insurance are employed by both critics and supporters of current social insurance arrangements. Proponents of the welfare state describe fraternal insurers as part of an obsolete system incapable of adequately meeting the needs of workers [8]. Critics of the welfare state describe the resulting inefficiencies caused by paternalistic governments crowding out a viable and more efficient system of social insurance [5]. Still other authors emphasize the monitoring capabilities and operations of fraternal lodges which reduced the consequences of problems of moral hazard and adverse selection associated with contemporary paternalistic arrangements in looking for lessons about how to provide, and potentially reform, social insurance coverage [9; 11].

To provide some insight into these issues and to test these hypothesized explanations of the decline of fraternal insurance, this work examines the provision of sickness insurance by the Independent Order of Oddfellows of British Columbia (IOOFBC) over the period 1891 to 1950. The analysis reveals that the fraternal insurance system was financially viable. It also reveals that supply side intervention by governments and employers crowding out the fraternal system is an unlikely explanation for the decline of fraternal insurance. Instead, consistent with Buffum's and Whaple's speculation, the Depression created conditions that rendered fraternal insurance less viable, which boosted the development of commercial and government insurance. The severe economic conditions of the Depression devastated fraternal memberships, resulting in more workers than ever before being without insurance coverage. Also, after 10 years of few new joiners, the increased expected liabilities per member left fraternal organizations unable to compete with the emergent sources of insurance after the Depression. To revamp the IOOFBC beneficial system after 1940 was deemed "prohibitively costly" by IOOFBC leaders. It also appears that the IOOFBC members after the Depression had little interest in continuing to provide sickness insurance. Thus, fraternal insurers withdrew voluntarily from the field of sickness insurance, leaving the market to commercial and government insurers.

An examination of fraternal sickness insurance has lessons that extend beyond this specific risk to income. Johnson [6] argues that before 1939 in Britain, "the most common response to social risks in Britain ... was private rather than public, collective rather than individualistic, and local rather than national." Thus, fraternal sickness insurance is representative of a broad class of pre-Depression solutions to working class economic insecurity. For this reason, an examination of fraternal sickness insurance can provide us with a better understanding of developments in other fields of social insurance such as unemployment insurance.

To illustrate the lessons to be learned from this analysis of fraternal sickness insurance, consider the following parable of the development of the

welfare state that was included in the 1985 Royal Commission on the Union and Development Prospects for Canada (Macdonald Commission):

> The new economic and industrial order left people particularly vulnerable to the loss of earnings of the primary breadwinner during periods of unemployment, illness, disability and old age. At the same time, traditional social institutions, such as the family, the church, and the local community, were less and less able to cope with Canadians' social needs. The traditions of private charity, which were an important part of the small, stable and closely knit communities in rural areas and small towns, eroded steadily in the face of a mobile and increasingly urban population. The intense economic and social dislocation of the 1930s graphically demonstrated the inadequacies of the traditional welfare mechanisms and the need for a more comprehensive system of social security... The pressures for social reform thus flowed, in the first instance, from economic development... The twentieth century witnessed a growing acceptance of the legitimacy of social security and, more generally, a deepening belief in the importance of a wider set of social rights which would complement the legal and political rights already established. In the period that followed the Second World War, these ideas were reinforced by the spread of economic theories that were much more compatible with significant income redistribution than earlier orthodoxies had been... During the first half of the twentieth century, support for the welfare state grew steadily. Intellectuals, social reformers, and the developing profession of social work often led the way in documenting the severity of social problems and outlining blueprints for their solution... Organized labor, which grew rapidly after the mid-1930s, also became a consistent champion of expansion of the welfare state. In addition to these external pressures, reformist elements developed within the major political parties and in part of the senior civil service. Moreover, established political leaders were clearly sensitive to the broad current of public support for social spending [3, p. 545].

This story of the welfare state's development contains several key themes. First, traditional social institutions were always inadequate but it took the Depression to demonstrate the need for better, more comprehensive arrangements. Second, the development of welfare state institutions is attributed to the enlightening influence of the Depression. The efforts and influences of politicians, unions, social reformers, intellectuals, and civil servants are credited as the driving forces behind the welfare state.

My study of IOOFBC sickness insurance provides a new context within which to examine these themes and the accuracy of them. Contrary to the Macdonald Commission's parable, there was an extensive and adequate system of social insurance. Up until 1930, fraternal insurance was one of the most

important sources of sickness insurance, health insurance and life insurance throughout the world. Fraternal sickness insurers catered to both the mobile and urban populations and the stable and rural populations. Thirteen percent of the population in British Columbia had health/sickness insurance coverage through fraternal organizations. This extent of coverage did not change until the 1930s.

The primary benefit associated with fraternal membership was the weekly "sick benefit." Members of IOOFBC lodges whose membership dues were not in arrears were eligible for cash sickness benefits for each week that a lodge member was "incapable of earning a livelihood" due to sickness or accident provided that their incapacity was not the result of intemperance or immoral conduct or "bodily infirmity which existed at the time of his admission." From 1874 to 1930, the value of sick benefits in IOOFBC subordinate lodges were typically $5 to $10 per week of sickness which was equivalent to one-third to two-thirds of average weekly wages in 1918.

Membership also provided members with access to the services of a physician who was either a lodge member or a non-member physician with whom the lodge had established a contract for medical services. Thus, membership provided a worker and his family with access to the services of the "lodge doctor" in return for their annual membership dues. Lodge doctors verified sickness claims, performed physical examinations of prospective lodge members, and attended to sick members typically for a pre-paid annual fee that was often based on a capitation rather than on fee-for-service.

Contract practices between physicians and fraternal lodges were commonplace at the turn of the century. Many authors suggest that friendly societies in Britain and Australia operated as Maintenance Organizations, where it is estimated that as many as 60% of wage earners had access to lodge doctors [11]. On the eve of the National Insurance Act of 1911, at least half of Britain's 20,000 physicians were engaged in contract practices [7]. Similarly for the United States, Rosen in his analysis of lodge practices, cites that in 1914, 8,000 persons in North Adams Massachusetts, a town with a population of 22,000, were in the care of lodge physicians to whom lodge members paid an annual stipend [10].

Fraternal insurers were able to provide insurance at a lower cost than commercial insurers through the use of screening and peer monitoring to alleviate problems of adverse selection and moral hazard. Typically men over forty were discouraged or prohibited from joining. Lodge Brothers claiming sickness benefits were visited weekly by the Lodge visiting committee until they were restored to health. Sick Brothers were also not permitted to drink or gamble and often could only be out of doors between dawn and dusk. Smith and Stutzer also document that through their non-profit motives, these organizations also had lower operating costs than commercial insurers.

Critics of fraternal insurance argued that the fraternal cost advantage was the result of hazardous pricing practices. While they may have had low costs, they led a financially precarious existence. The incidence and duration of sickness was known to increase with an individual's age. Despite this actuarial reality, many fraternal organizations, including the IOOFBC, had a system of level dues and benefits. While initiation fees were scaled by a joiner's age, membership dues and sickness benefits were not. Annual dues for all IOOFBC

subordinate lodge members were 12 dollars. Because this "pay-as-you-go" insurance arrangement ignored actuarial realities, critics of fraternal insurance argued it was inherently non-viable for financial reasons. This is in fact not a good explanation of why fraternal insurance declined. An analysis of IOOFBC lodges for the period 1891 to 1950 reveals that even with the most hazardous of pricing practices, IOOFBC lodges had almost no probability of being bankrupted by high claims. Early in lodge operations, revenues not spent on operating costs, or current sick benefit claims, were invested in assets, like the lodge hall, which generated a stream of revenue that subsidized lodge operations and benefit payments. Thus, while dues revenues alone were not adequate to meet expected liabilities, dues plus the additional revenue generated by invested funds were more than adequate.

Given that fraternal insurers were viable the question remained as to why they were not an important source of insurance after the Depression, and why commercial and government arrangements flourished after the Depression. An analysis of the membership histories of 1044 members of four IOOFBC lodges revealed that for the IOOFBC, the 1930s were unlike any period before. The impact of the Depression resulted in more workers than ever before being without coverage as the probability of suspension for non-payment of dues tripled. Another impact of this change in the probability of leaving the membership, is that it meant the expected value of fraternal sickness benefits, expected largely after age 45, was almost zero. Prospective joiners in the 1930s would have had little expectation of ever receiving the benefits. These factors combined created the necessary demand conditions for commercial insurers to gain a valuable foothold in the industry.

Through and after the Depression, the IOOFBC lodges abandoned their insurance functions. The lodge memberships had "aged" so much between 1930 and 1945 that the insurance that lodges could provide was more costly than that provided by commercial and government insurers. In addition, members who had been in favor of abandoning the insurance function gained control of the organization after 1939. It thus appears that the 1930s purged the Order of members primarily interested in insurance, while the more "social" and popular members were retained through the Depression. Thus, only once the 1930s had pared down the membership could these members get the 75% majority support necessary to enact changes to the lodge constitution.

The sum of these findings supports a familiar theme in social insurance history: that the severity of the Depression devastated traditional institutions which encouraged the growth of new alternatives. In the case of fraternal insurance, governments did not crowd out private initiative. The story of the IOOFBC shows that economic Depressions have powerful effects upon the social fabric of society beyond immediate financial impacts. In the case of fraternal insurance, the Depression created the necessary conditions for the fraternal system to give way to the seeds of paternalism which we refer to as the welfare state.

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