Long-Term Care Insurance and the Family

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Long-term care poses one of the largest financial risks to elderly individuals in the United States. Forty percent of 65 year olds will enter a nursing home at some point, at an average of $75,000 per year. Despite this, few individuals purchase long-term care insurance. In this paper, I offer a potential reason: the extended family. Specifically, I investigate the extent to which care provided by adult children suppresses the demand for the long-term care insurance by elderly individuals.

Importantly, long-term care risk is distinct from other health care risk: while medical care requires attention from trained medical professionals, long-term care - defined as assistance with daily activities such as eating and bathing - can be provided by any able adult. Indeed, the majority of long-term care is provided informally by family members. Given that public insurance provides very incomplete insurance against this risk, I aim to quantify how much family care provided by family members acts as “informal long-term care insurance” and lowers demand for private insurance, which does not generally cover family care.

I first present two stylized facts that suggest that the family may be an important determinant of long-term care insurance demand. First, I show that insurance rates among elderly individuals with children are significantly lower than those without children, across the wealth distribution. This pattern does not hold for life insurance or other types of health insurance, suggesting that the role of the extended family in long-term care insurance decisions is distinct from other types of insurance decisions. Second, I present evidence of substitution between family-provided and market-based long-term care. Using variation in Medicaid eligibility generosity, I estimate that individuals who live in states with higher Medicaid eligibility are more likely to use nursing homes and less likely to live with their children (a proxy for long-term care).

I use these facts to motivate a dynamic model of long-term care that captures key aspects of long-term care risk, care preferences and decisions, and the policy environment. Because the extended family plays an important role in long-term care decisions, the model allows for rich interactions, both strategic and altruistic, between an elderly parent and her adult child. The model indicates that the decision to purchase long-term care insurance is heavily dependent on the relative costs and benefits of family-provided care to each family member. To uncover the structural parameters of the model, I calibrate the model to replicate important patterns in the data. In particular, I use data on family-care rates and savings patterns from the Health and Retirement Study. I then use the structural parameters to perform counterfactual experiments of policies that may improve the welfare of families exposed to long-term care risk, such as designing insurance policies that reimburse family care.