Annuitized Wealth and Post-Retirement Saving

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Relevance

- Large literature on the theoretical implications of uncertain uninsured health expenses on saving behavior.
- These models are very difficult to solve.
- Simplified representation of 'the real world'—explain the essence of what is happening.
- Highly stylized model which is able to explain rising average wealth holdings with age (among other things).
- Written elegantly in proposition and proof format.
- Intuition is very clear!
- Very useful reference point to compare more realistic models.

The model in a few words

"Simplifying" assumptions

- Limiting health condition occurs only once and is permanent.
- Marginal utility of (medical) consumption rise with low health.
- Self insurance: no private LTC insurance nor safety net by the government.
- Annuitizing becomes VERY RISKY!
- Over-annuitized household increases saving behavior.
- Simulation results predict rising wealth trajectories within a cohort
- Unintended bequests are important.
- Room for risk sharing within the family, which reduce unintended bequests.

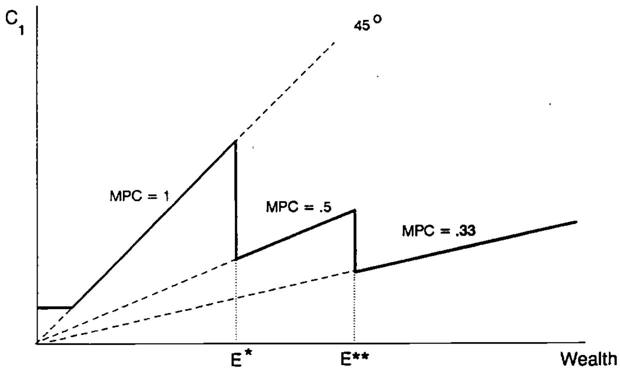
Health expenditure risk

- Results are highly sensitive to (1) assumed riskiness of health expenditures and (2) availability of government insurance.
- Estimate λ, Λ, ω parameters on the data.
- What if people run out of resources to pay for LTC $\cdots$ Just accept it?

Consumption floor

Hubbard, Skinner and Zeldes (1994) formulate a three period problem.

Figure A2(b): Consumption - Wealth Profile: Three-period model



Differential mortality

- Low permanent income groups are over-annuitized (Dushi and Webb, 2004).
- Correlated with morbidity risk λ and mortality risk Λ.
- This would impact the wealth profiles. This probably reduces bequeatable wealth.
- More realistic to incorporate this interaction between permanent income, morbidity risk and health risk in your model.
- No existence of private annuity market: Integrating annuities with long-term care insurance reduce the problem of adverse selection in the market for annuities (Murtaugh, 2001).
- Exponential mortality with age: does this hold when there is a mixture by SES?

Transfers and bequests

- Instead of transfer payments, bequests can be also used as compensation for in-kind services by the children.
- You mention that the period of poor health is relatively short. Hoverer, there might be a significant risk that a person will survive for an extended period of time. How can this 'incomplete contract' be solved?
- There is no bequest motive in the model; $\cdots$ the relevance is probably limited in case of substantial LTC uncertainty (Dynan et al. 2002).
- Extent the model with a bequest motive in which the marginal utility of leaving a bequest is constant (Hurd, 1989).
- Drop in wealth after the death of the spouse. Evidence of the importance of in kind-services?