Annuitized Wealth and Post-Retirement Saving

John Laitner, Daniel Silverman and Dmitriy Stolyarov

Comments by Raun van Ooijen

University of Groningen and Netspar

Netspar International Pension Workshop
Amsterdam, 29 January 2015
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 $\lambda, \Lambda, \omega$ parameters on the data.
- What if people run out of resources to pay for LTC ··· Just accept it?
Consumption floor


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

- MPC = 1
- MPC = 0.5
- MPC = 0.33
Differential mortality

- Low permanent income groups are over-annuitized (Dushi and Webb, 2004).
- Correlated with morbidity risk $\lambda$ and mortality risk $\Lambda$.
- 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. However, 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; ⋯ the relevance is probably limited in case of substantial LTC uncertainty (Dynan et al. 2002).

▶ Extend 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?