

# To love or to pay: On consumption, health and health care

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People face heterogeneous health shocks and medical spending risks. Using a rich dynamic structural life-cycle model, this paper investigates how these shocks affect the savings behavior of retired single households. Consumers are allowed to respond to health shocks in two different ways: they can directly pay for their health care expenses (self-insure) or they can rely on health insurance contracts. There are two possible insurance options, one through formal contracts and another through informal health care provided by family. Formal insurance contracts may be affected by asymmetric information problems, while informal insurance depends on social ties (cohesion) and on the wealth available for bequeathing. I estimate the model on SHARE data, using the simulated method of moments for four levels of wealth and three European country groups: Mediterranean, Central European and Scandinavian. I find that the risks of living long and facing high medical expenses can provide an explanation for increasing precautionary savings (and consequently bequests) after retirement. Most important and novel, the estimates on family cohesion, by country and wealth level, confirm two relevant social literature findings on the strength of family ties: it generally rises with age and declines with wealth and it is higher in Mediterranean countries as opposed to Central European or Scandinavian countries. Finally, I find that high family cohesion is usually accompanied by a high life expectancy.

Key Words: health, bequest, health insurance, family cohesion, life expectancy.

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