

Long-Term Care Insurance and the Family

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November 11, 2015

JOB MARKET PAPER

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Abstract

This paper demonstrates that informal care by family members significantly weakens the demand for long-term care insurance. This result is largely driven by the fact that insurance does not cover informal care costs. To quantify the effect of informal care on insurance demand and evaluate potential welfare-improving policies, I develop and estimate a dynamic model of long-term care decisions between an elderly parent and her adult child. The model matches the low demand for insurance across the wealth distribution in addition to asset accumulation paths, Medicaid enrollment, and informal care usage. I find that the availability of informal care lowers the demand for insurance by less than 5 percentage points overall, but by 29 percentage points for wealthier individuals. Nevertheless the cost of providing informal care leaves families exposed to significant risk. As a result, introducing an insurance policy that compensates the family for providing long-term care can generate substantial increases in the demand for insurance and result in large welfare gains to families.

1 Introduction

The elderly in the United States face significant risk of incurring large and persistent long-term care expenses. Formal long-term care expenditures totaled over \$200 billion in 2009, a number that is expected to rise dramatically with the aging of the population. These costs are not evenly distributed: while 60% of 65-year-olds will never enter a nursing home, 10% will spend over three years in institutional care at an average annual cost of

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\$75,000.¹ Despite this risk, very few individuals own long-term care insurance. While several studies have proposed reasons for the puzzling low demand for insurance, none have quantitatively addressed the fact that the majority of long-term care is provided informally by family members. This paper fills this gap by examining the effect of informal care – and family interactions more broadly – on the demand for long-term care insurance.

There are two main objectives. The first is to assess whether the availability of informal care can explain the low demand for long-term care insurance. The primary mechanism by which informal care may reduce the demand for insurance relies on the fact that insurance policies do not cover informal care. If the family can replace formal services as a preferable or less costly substitute source of care, then elderly individuals and their families face a trade-off between (a) insurance that provides financial protection against (undesirable) formal care and (b) preferable family care² whose indirect costs are uninsured. The second objective of the paper is to quantify the welfare costs of current insurance policies relative to alternative policies that include coverage of family care.

I first present two empirical facts that suggest that the family, and particularly family care, may be an important determinant of long-term care insurance demand. I show that, controlling for a range of demographic and health characteristics, individuals who have more potential sources of informal care (e.g. individuals with children, siblings, friends, etc.) are significantly less likely to own long-term care insurance policies than individuals who do not have these potential sources of informal care. Second, I show that family care is a substitute for formal care, which provides a plausible mechanism for the difference in insurance demand between individuals with and without children. To do this, I exploit differences in state Medicaid eligibility over time to show that in states with more generous Medicaid eligibility thresholds, the elderly are more likely to reside in a nursing home than with their child.

I use these facts to motivate a dynamic model of decision-making between an elderly

¹Source for nursing home and total long-term care costs: [Kaiser \(2012\)](#). Source for nursing home utilization rates: [Brown and Finkelstein \(2008\)](#).

²I use the terms *informal care* and *family care* interchangeably and to mean family care. Moreover, most informal care is provided by family members.

parent and her adult child. The model provides a framework to study demand for long-term care insurance, family care, savings behavior, and the labor supply of adult children in an environment that offers Medicaid benefits and private insurance of (formal) long-term care services. The family faces three sources of risk: long-term care shocks that require either formal care or informal care by the child, uncertainty over the longevity of the parent, and shocks to the adult child's permanent wage that influence the opportunity cost of informal care. The parent and child interact with strategic and altruistic concerns, but cannot commit to future allocations of resources, and hence cannot fully cooperate (Kocherlakota, 1996). I obtain estimates of the parameters of the model using data from the Health and Retirement Study and the Panel Study of Income Dynamics. The model replicates important features of long-term care behavior, particularly insurance demand across the wealth distribution, savings rates, Medicaid enrollment, and informal care usage.

Using the estimates of the parameters, I find that removing the availability of family care increases overall demand for insurance by less than 5 percentage points. The magnitude of this effect, estimated from a sample of parents with children, coincides with the reduced form difference in insurance demand between parents with and without children. In addition, this impact varies by wealth because removing family care has two opposing effects. On the one hand, it *increases* demand for insurance because without family care, the (only) source of care is covered by insurance. This is the dominant effect for wealthy individuals, whose demand rises by 29 percentage points. On the other hand, long-term care becomes more expensive for some parents whose children had low opportunity costs of time. Because the expected cost of long-term care is higher for these individuals in the absence of family care, this wealth effect induces these parents to spend down to Medicaid in lieu of purchasing insurance (i.e. Medicaid 'crowd-out' (Brown and Finkelstein, 2008)). This is the dominant effect for poor and moderately wealthy individuals, whose insurance demand slightly decreases.

Next, I evaluate a set of alternative policy tools that introduce financial compensation for family care by replacing formal care benefits with cash benefits. This idea is not without basis: many other countries have long-term care policies with cash options,

such as Germany, France, and Austria.³ I find that modifying Medicaid to provide cash benefits has little effect on private insurance demand, implying that wealthy individuals place a high value on protecting their assets over spending down to Medicaid. On the other hand, modifying an insurance policy to provide cash benefits leads to a 66 percentage point increase in insurance demand and a \$20,000 welfare gain to families across the wealth distribution. In addition, it lowers Medicaid spending on long-term care by 60%. I find that these results are muted but still substantial if premiums must rise to pay for moral hazard.

This paper makes several contributions. First, I expand upon models of elderly savings and health risk by incorporating a new channel of care: the family. Work by [Hubbard, Skinner, and Zeldes \(1995\)](#), and in the specific case of long-term care insurance [Pauly \(1990\)](#) and [Brown and Finkelstein \(2008\)](#), show that means-tested social insurance such as Medicaid can reduce the propensity to save or privately insure. [De Nardi, French, and Jones \(2010\)](#) show that large out-of-pocket medical expense risk and life expectancy risk can reduce the propensity to *dis*-save among higher income retirees.⁴ This paper expands on these analyses by introducing family interactions and private insurance as an important channel for understanding elderly savings patterns.

Second, this paper develops a new model of intergenerational family interactions. Most recent studies of intergenerational dynamics assume non-cooperation as the decision process between parents and children ([Kaplan, 2012](#); [Fahle, 2014](#); [Barczyk and Kredler, 2014b](#)) and often impose stringent assumptions on behavior, such as an inability of both individuals to save ([Barczyk and Kredler \(2014b\)](#) is an exception). In contrast, this paper adopts a limited commitment framework, which allows for higher levels of cooperation that may be particularly relevant for long-term care decisions in which many aspects of the lives of parents and adult children are intertwined. Limited commitment

³In the United States, Medicaid is also piloting the use of cash benefits in ‘Cash and Counseling’ experiments in Arkansas, Florida, and New Jersey. In addition, the 2010 Affordable Care Act proposed a public long-term care insurance option that compensated family care called the Community Living Assistance Services and Supports (CLASS) Act. This provision was repealed in 2013.

⁴Many others have also contributed to this literature: [Kotlikoff \(1989\)](#), [Gruber and Yelowitz \(1999\)](#), [Palumbo \(1999\)](#), [Scholz, Seshadri, and Khitatrakun \(2006\)](#), [Kopecky and Koreshkova \(2014\)](#) on medical versus nursing home risk, [Lockwood \(2014\)](#) on bequest motives, and [Low and Pistaferri \(2010\)](#) on disability.

models are increasingly being applied to models of marital interactions (Mazzocco, 2007; Yamaguchi, Ruiz, and Mazzocco, 2014; Voena, 2015; Bronson, 2014) but this paper is the first to show that this type of model is suitable to capture intergenerational interactions.

Third, the results of this paper shed light on issues related to long-term care in the United States and potential policy solutions. As the baby boomers age into retirement, policymakers will need to address the growing demand for long-term care services. Demographic implications for caretakers, such as decreased fertility and rising female labor force participation, may shift long-term care towards increased formal services and put further strain on social programs. A better understanding of why individuals forego private long-term care insurance may help target policies to combat potentially inefficient growth in these programs. Other explanations for the lack of demand, such as Medicaid (Brown and Finkelstein, 2008), bequest motives (Lockwood, 2014), home equity (Davidoff, 2010), beliefs about needs (Brown, Goda, and McGarry, 2012), and market imperfections (Finkelstein and McGarry, 2006), still leave a large portion of the lack of demand unexplained. Furthermore, while Medicaid may account for much of this, interactions with the family may be important to determining optimal Medicaid policies.⁵ This study quantifies these interactions and shows that the extended family on its own does not account for a large portion of the lack of demand for insurance in its current form, but that the welfare consequences of ignoring family care in the design of long-term care policy may be large.

In the next section, I describe key features of long-term care in the United States. Section 3 provides reduced form evidence on the impact of the family on long-term care insurance and evaluates the substitutability between formal and informal care. In Section 4 I describe the model. Data and estimation results are in Section 5, and Section 6 reports results from counterfactuals. Section 7 concludes.

⁵For instance, theoretical work by Bernheim, Shleifer, and Summers (1985) and Pauly (1990) suggests that intra-family moral hazard may cause parents to forego insurance.

2 Long-Term Care in the United States

Long-term care in the United States, defined as assistance performing Activities of Daily Living (ADLs) or Instrumental Activities of Daily Living (IADLs),⁶ is expensive. In 2009, formal long-term care costs in the United States added up to \$240 billion, or 9 percent of *all* health expenditures for *all* ages.⁷ Although over 75% of elderly individuals will depend on long-term care at some point, utilization is not distributed evenly across the population: 40% of 65-year-olds will enter a nursing home at some point, but 10% of them will remain in a nursing home for over 3 years (Brown and Finkelstein, 2008). Formal long-term care costs are financed through three main sources: out-of-pocket spending, private insurance, and public insurance, of which the largest payer is Medicaid. Additionally, over half of long-term care is provided informally by family members. As detailed below, each of these actors play important and inter-related roles in individual long-term care decisions.

2.1 Private long-term care insurance

The long right tail of nursing home utilization suggests that insurance against costly long-term care expenses could produce large gains to individual welfare. Nevertheless, the private long-term care insurance market is small: only 7 percent of formal long-term care expenditures are paid by private insurance policies, and less than 10 percent of elderly individuals own a private insurance policy. Individuals purchase policies at an average age of 67, at which point they lock in an annual nominal premium. A typical policy includes maximum payouts (e.g. \$100 per day in 2000) and pays out 18% less in expected benefits than expected contributions. These price mark-ups and the lack of comprehensiveness in policies suggest that this market suffers from supply-side inefficiencies such as imperfect competition (indeed, five companies provide the majority of policies), transaction costs, and an inability to diversify aggregate risk (see Brown and Finkelstein (2007)

⁶The set of ADLs in the data I use include walking across a room, dressing, bathing, eating, getting in and out of bed, and using the toilet. The set of IADLs include: using a map, using a telephone, managing money, taking medications, shopping for groceries, and preparing hot meals.

⁷In 2012, the average price of a private (semi-private) room at a nursing home was \$74,800 and the average hourly price of a home care aide was \$21 per hour (Kaiser, 2012).

for more details). Private long-term care insurance may also suffer from asymmetric information that leads to an adversely selected market. [Finkelstein and McGarry \(2006\)](#) find that subjective expectations over health can predict both nursing home entry and insurance coverage, suggesting that the market is adversely selected. However, they conclude that the long-term care insurance market is not overall adversely selected because it is also advantageously selected: individuals who have lower-than-average risk but are more risk-averse are also more likely to purchase insurance. In addition, [Hendren \(2013\)](#) demonstrates that most high-risk individuals would not be able to purchase insurance anyway due to stringent rejection practices of insurers.

Despite the existence of supply side market failures, [Brown and Finkelstein \(2007\)](#) argue that they alone cannot explain the small size of the private long-term care insurance market. Several studies have found that demand side forces may also significantly limit the market: bequest motives reduce the opportunity cost of precautionary savings ([Lockwood, 2014](#)), wealth stored in housing can be used to pay for a nursing home ([Davidoff, 2010](#)), individuals have limited information about risks or insurance coverage, and Medicaid can act as a substitute source of coverage ([Brown and Finkelstein, 2008](#)). Aside from [Mellor \(2001\)](#), who shows empirically that demand for long-term care insurance is negatively associated with the number of children, this study is the first to carefully model and estimate the effect of available family care on insurance demand.

2.2 Medicaid

Public expenditures for long-term care are shouldered almost entirely by Medicaid. While Medicare is the primary source of *medical* insurance for individuals 65 and over, it notably does not cover most long-term care costs.⁸ Medicaid, on the other hand, is a means-tested program and thus only available to impoverished elderly. To become eligible, an individual must spend-down their income and assets to sufficiently low levels (monthly income of around \$681 and financial assets of around \$2,650 ([Brown and Finkelstein, 2008](#)),

⁸Medicare will only cover 'post-acute' long-term care expenses. For example, Medicare covers up to 100 days of nursing home care but only following at least a 3-day hospital stay. Because these post-acute long-term care needs are relatively well-insured by Medicare, they are not the focus of this paper.

though this varies by state). At that point, Medicaid will pay for long-term care services and provide a consumption floor. Like private insurance, Medicaid currently only reimburses formal services.⁹

In addition, Medicaid is a secondary payer for individuals who hold private insurance policies. This means that Medicaid will only pay for services above the private insurance payout. [Brown and Finkelstein \(2008\)](#) show that this feature induces a significant ‘implicit tax’ on private insurance. Indeed, given the high costs of formal long-term care and the fact that very few individuals are covered by private insurance, Medicaid ends up paying 60 percent of long-term care services, or \$143 billion per year.

2.3 Informal care

Because most individuals do not purchase private insurance and Medicaid is a payer of last resort, around one-third of formal long-term care expenditures are paid out of pocket. Absent from this institutional framework and the discussion of its costs, however, is the role of informal care and its indirect costs.

Over half of the elderly in need of long-term care rely solely on family members for help with everyday activities. [Table 1](#) shows that among retirees 65 and over who report receiving long-term care help, over 60% of main caregivers are family members. For married individuals, most informal care is provided by spouses, and for single individuals with children, almost all informal care is provided by their adult children. When care is not provided by family members, over 90% of caretakers are paid. The fact that some individuals elect to purchase formal care in lieu of family care suggests that there are important implicit costs of informal care. These indirect costs, such as lost wages, are not included in the annual \$240 billion price tag of long-term care. Using time-use and wage data, [Chari, Engberg, Ray et al. \(2015\)](#) place the annual implicit cost of informal caregiving at an additional \$520 billion.

⁹Historically, Medicaid also excluded most home-based services in favor of nursing home services (its so-called “institutional bias”). However, in the 1980s Medicaid began offering more home and community-based services (HCBS). This was both an effort to lower Medicaid’s long-term care costs by shifting to potentially cheaper home care, and an acknowledgement that most individuals would prefer to remain in the community than receive long-term care in a nursing home (see the Supreme Court’s 1999 *Olmstead* decision, *Olmstead v. L.C.*, 527 U.S. 581, 1999).

Table 1: Relationship of Respondent to Caregivers

	Everyone	Married	Single with children
Spouse	.272	.506	–
Child	.296	.203	.470
Other family	.060	.032	.056
Non-family	.372	.258	.473
Total	1.00	1.00	1.00
<i>% non-family paid</i>	.942	.950	.943
Observations	9573	5135	3750

Note: The sample includes retirees aged 65 and over who report receiving help with (I)ADLs in the Health and Retirement Study, 1998-2010. Rows denote the type of caregiver, and columns denote any restriction to the sample of respondents. The *% non-family paid* row reports the percent of caregivers who are paid among all non-family caregivers (row 4).

Despite the extensive use and potential costs of family care, as mentioned above, neither private insurance nor Medicaid currently offer policies that reimburse informal care costs. As I will show in the rest of the paper, offering policies that compensate families for the cost of informal care could greatly improve welfare and alter the spending structure of the long-term care market.

3 Empirical evidence on insurance and family care

In this section I present two other pieces of evidence that the family, and particularly family care, is an important consideration in long-term care decisions. I first establish that single retirees with children are significantly less likely to own a long-term care insurance policy than single retirees without children. I then exploit variation in state Medicaid eligibility rules over time to show that informal care by children can substitute for formal care. Together, these findings suggest that an important determinant of insurance purchase is the future availability of substitute caretakers. I use this evidence as motivation for the model in Section 4.

3.1 Insurance coverage by family characteristics

I start by providing empirical evidence on the relationship between long-term care insurance demand and the presence of future potential informal caregivers. Using a pooled sample of single individuals aged 60-69 in the 1998-2010 Health and Retirement Study (see Section 5.1 for a full description of the data), I examine whether individuals who have more potential future sources of informal care - e.g. individuals with children, siblings, friends, etc. - are significantly less likely to hold long-term care insurance policies than individuals who do not have these potential future sources of care.

Figure 1 shows long-term care insurance coverage across the wealth distribution, broken down by whether the individual has children or not. Overall, 9 percent of these individuals have long-term care insurance policies. However, there is large variation by wealth: less than 5 percent of individuals in the poorest wealth quintile have insurance, while over 20 percent of individuals in the wealthiest quintile own a policy.¹⁰

Importantly, there are large differences in policy holdings by family type. Across the distribution, individuals with children are much less likely to own a long-term care insurance policy. Table 2 reports the relationship between long-term care insurance coverage and children in a linear regression framework using the same sample as the figure above, controlling for a large host of demographic characteristics. Column (1) shows that individuals with children are 5 percentage points less likely overall to own an insurance policy, which is a very large effect on a base of 9 percent ownership. Column (2) distinguishes this effect by wealth quintile and shows that this effect is larger and more significant for wealthier parents. The last three columns explore whether certain characteristics of children affect insurance demand. Columns (3) and (4) show that individuals who live with their children or who have a child within 10 miles are even less likely to have long-term care insurance. Column (5) suggests that people have foresight: individuals who believe that their children will be helpful to them in the future are less likely to have insurance.

Table 3 reports the effects of children on other outcomes that could be related to long-

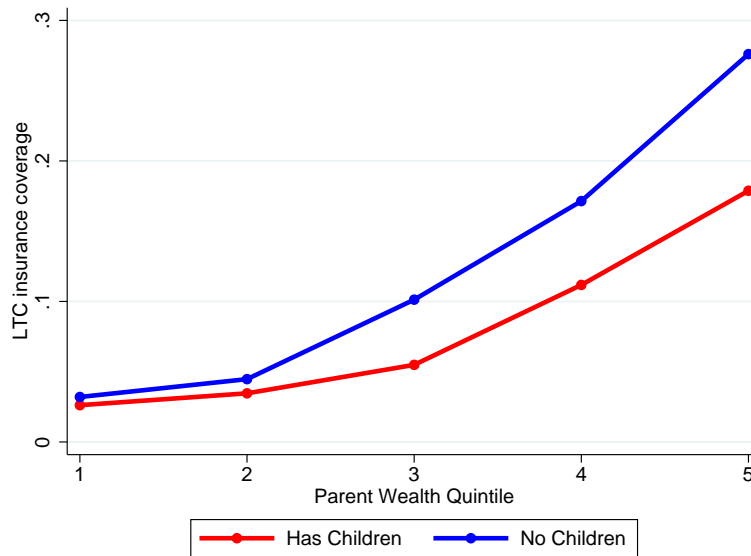
¹⁰Appendix Figure 1 includes additional breakdowns such as having no siblings and having no future helpers. A similar pattern emerges: individuals who have neither children *nor* siblings *nor* future helpers are even less more likely to hold an insurance policy than individuals with children.

Table 2: Relationship between LTC Insurance Coverage and Children Characteristics

Dependent variable:	Long-Term Care Insurance Coverage				
	(1)	(2)	(3)	(4)	(5)
Has child	-0.0492*** (0.014)				
Has child, wealth Q1 (poorest)		-0.00997 (0.012)	-0.00913 (0.016)	-0.00960 (0.016)	-0.00473 (0.016)
Has child, wealth Q2		-0.0184 (0.015)	-0.0326* (0.020)	-0.0367* (0.020)	-0.0256 (0.020)
Has child, wealth Q3		-0.0436* (0.024)	-0.0475* (0.026)	-0.0477* (0.027)	-0.0386 (0.026)
Has child, wealth Q4		-0.0580** (0.029)	-0.0716** (0.032)	-0.0726** (0.032)	-0.0643** (0.032)
Has child, wealth Q5 (wealthiest)		-0.0885*** (0.034)	-0.100*** (0.037)	-0.100*** (0.038)	-0.0904** (0.038)
Has daughter			0.00901 (0.012)	0.0133 (0.013)	0.00875 (0.012)
Has resident child			0.00323 (0.011)		
Has resident daughter			-0.0136 (0.012)		
Has child w/in 10 miles				0.00182 (0.009)	
Has child w/in 10 miles				-0.0164* (0.009)	
Child helpful in future					-0.0164** (0.007)
Means					
LTC insurance coverage	0.0878	0.0878	0.0853	0.0869	0.0862
Has child	0.874	0.874	0.875	0.867	0.870
Has daughter			0.764	0.764	0.761
Has resident child			0.253		
Has resident daughter			0.134		
Has child w/in 10 miles				0.535	
Has daughter w/in 10 miles				0.295	
Child helpful in future					0.425
Observations	11407	11407	10176	9568	9821

Note: The sample includes single individuals aged 60-69 in the pooled 1998-2010 Health and Retirement Study. Estimates are from a linear probability model of whether the individual owns a long-term care insurance policy on child characteristics and controls. Controls include wealth, income, age, marital status, gender, race, gender, education, region, health status, religion, and year fixed effects. Standard errors, clustered by individual, are in parentheses. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

Figure 1: Long-term care insurance coverage by wealth quintile



Note: The sample includes single individuals aged 60-69 in the pooled 1998-2010 Health and Retirement Study. The red line graphs the percent of individuals *with children* who own a long-term care insurance policy, by wealth quintile (from the poorest quintile on the left to the wealthiest quintile on the right). The blue line graphs the percent of individuals *without children* who own a long-term care insurance policy.

term care insurance demand. Column (1) examines the relationship between children and life insurance, which protects an individual’s benefactors in the event of the individual’s death. The results show that individuals with children are 6 percentage points more likely to have a life insurance policy than individuals without children.¹¹ Column (2) shows that having children greatly reduces the probability of being in a nursing home for individuals over age 80. To check that this is not a result of individuals with children simply being healthier (and therefore buying less insurance), column (4) verifies that having children is not related to the probability of having difficulty with an Activity of Daily Living.

On the whole, the results in this section suggest that elderly individuals make insurance decisions with their children in mind. Additionally, the life insurance findings imply that it is not the case that individuals with children are less likely to buy insurance in general; instead, buying insurance may be economically motivated by the presence of children.

¹¹Additionally, Appendix Figure 2 replicates Figure 1 for life insurance. The expected effect of children on life insurance demand is actually ambiguous: insurance protects the children against losing the parent’s eventual retirement income, but it spares the children from either having to care for the parent or from having a lower bequest due to costly later long-term care expenses.

Table 3: Relationship between Other Outcomes and Children

Dependent variable:	Life Insurance (1)	Nursing Home (80+) (2)	Sick (80+) (3)
Has child	0.0670*** (0.021)	-0.0436*** (0.013)	-0.00827 (0.013)
Dependent variable mean	0.607	0.133	0.433
Observations	11484	12783	11255

Note: The sample includes single individuals in the pooled 1998-2010 Health and Retirement Study. Estimates are from a linear probability model of the dependent variable on whether the individuals has a child and controls. In column (1) the sample is restricted to individuals aged 60-69 and the dependent variable is whether the individual owns a life insurance policy. In columns (2) and (3), the samples are restricted to ages 80 and above. The dependent variable in column (2) is whether the individual resides in a nursing home, and the dependent variable in column (3) is whether the individual reports difficulty with an ADL. Controls include wealth, income, age, marital status, gender, race, gender, education, region, self-reported health status, religion, and wave fixed effects. Standard errors, clustered by individual, are in parentheses. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

3.2 Substitutability of informal and formal care

As shown in Table 1, long-term care is provided both formally and informally. What is less clear is whether formal and informal care are substitutes or whether, instead, they provide different services for different types (or severity) of needs. Intuitively, the activities that individuals need help with that define long-term care are basic activities that any able-bodied adult should be able to assist with.

Several studies have tried to causally determine the substitutability of informal and formal care using a variety of methods, margins, and data sources. Using variation in childrens' characteristics as instruments, [Charles and Sevak \(2005\)](#) find strong evidence of substitution between informal care and nursing home care.

Another set of studies exploit variation in the price of formal care. In other work ([Mommaerts, 2015](#)), I use differences over time in state Medicaid eligibility generosity - specifically, Medically Needy policies - as exogenous variation in the price of nursing homes for individuals. While traditional Medicaid eligibility is defined by strict asset and income tests, income in Medically Needy states is defined as income *net of health expenses*. Effectively, this allows individuals with higher income to qualify for Medicaid when they incur large health expenses. Table 4 shows the effects of these policies using the Health and Retirement Study supplemented with restricted-access geocodes. Column (1) reports

that individuals who live in Medically Needy states are more likely to report being on Medicaid. Columns (2) and (3) show that when in need of long-term care, individuals who live in Medically Needy states are 4 percentage points more likely to use nursing homes and 4 percentage points less likely to live with their children (a proxy for informal care). These results are consistent with a story of substitution between formal and family care.

Table 4: Effect of Medically Needy policies

Dependent variable:	Medicaid (1)	Nursing Home (2)	Co-residence (3)	Child help (4)
Medically Needy	0.0224*** (0.005)	-0.00335 (0.005)	-0.00486 (0.006)	-0.0172 (0.015)
MN x LTC need	0.0110 (0.019)	0.0488* (0.029)	-0.0400*** (0.014)	0.00559 (0.019)
Mean dept var	0.172	0.0843	0.256	0.198
N	20158	20434	17809	15966

Note: The sample includes single individuals aged 65 and over in the pooled 1994-2008 Health and Retirement Study supplemented with restricted-access geocodes. Estimates are from a linear probability model of the dependent variable on whether the state of residence has a Medically Needy provision and the interaction of the provision on whether the individual has long-term care needs (any ADLs). Controls include year fixed effects, state fixed effects, lagged dependent variable, income and asset quintile, number of ADLs, self-reported health, long-term care insurance coverage, gender, race and hispanicity, and a quadratic in age. Standard errors, clustered by state, are in parentheses. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

Other studies find similar results. The Channeling Demonstration, an experiment that expanded the generosity of publicly-funded home care for low-income elderly in the 1980's, led to small reductions in informal care (Pezzin, Kemper, and Reschovsky, 1996), and a recent study using a 1998 reform to home care subsidies in Sweden found evidence of substitution between informal care and formal home care (Løken, Lundberg, and Rise, 2015). Finally, but perhaps most relevant to this paper, Coe, Goda, and Van Houtven (2015) use state variation in subsidies to long-term care insurance policies as an instrument for insurance coverage. They find that an increase in long-term care insurance coverage, which significantly lowers the marginal cost of formal care, induces significantly less informal caregiving.

Overall, the evidence in this section has three main implications. First, it suggests that the type of long-term care that individuals receive is to some extent a choice. Second,

this choice is influenced by economic motives, such as the relative price of formal and informal care. Third, because individuals have the option to use informal care as a substitute for formal services, the presence of the family may affect decisions earlier in life of whether to purchase long-term care insurance, and indeed how much to precautionary save. I now turn to a model of long-term care and the family that incorporates these insights.

4 Model

To understand the mechanisms by which the presence of adult children affects long-term care insurance purchase decisions and to evaluate potential welfare-improving policies, I develop a model with four main features that capture the key trade-offs that elderly individuals and their families face when choosing whether to purchase insurance and which type of care to receive. First, the model is dynamic because savings is an important factor in long-term care decisions: it acts as a self-insurance device, a barrier to Medicaid, and a means of transferring wealth across generations. Second, the model includes the behavior of an elderly individual as well as her adult child to account for both formal and informal costs of long-term care.¹² Third, the parent and adult child face risk: long-term care shocks to the parent that require formal care or informal care by the child, uncertainty over the longevity of the parent, and permanent shocks to the adult child's wage that influence the opportunity cost of informal care. Fourth, long-term care insurance and Medicaid provide alternative means for paying for long-term care expenses.

Within this environment, the parent and child decide how much to individually save and consume, how the child allocates her time between market work, family care, and leisure, and whether the parent buys long-term care insurance at retirement. I model the decision-making process between the parent and child as cooperative, but with limited commitment, for two main reasons. First, prior studies have shown that parents and chil-

¹²As shown in Table 1, married retirees receive a significant amount of care from spouses *and* children, while single retirees receive the vast majority of informal care from their children. I model only single retirees in order to focus on a simpler set of set of informal caregivers. I restrict the model to one child for the same reason. See Section 5.1 and Appendix A for further discussions of this choice.

dren do not fully insure each other (Attanasio, Meghir, and Mommaerts, 2015; Hayashi, Altonji, and Kotlikoff, 1996), suggesting that a fully cooperative model is unrealistic. The fact that full commitment results in an indeterminate asset distribution between family members is also unappealing in this setting, particularly from a legal standpoint since Medicaid depends on the resources of the parent but not the child. Second, the level of interaction observed in the data, such as the fact that one-quarter of parents and adult children co-reside and one-quarter of adult children help parents with their finances, suggests a level of coordination beyond a non-cooperative game. For these reasons, I characterize the decision-making process using a model of *limited* commitment in which the parent and child make joint decisions but cannot commit to future allocations of resources that would provide lower value than their ‘outside option’ of non-cooperation.

I begin by describing the parent and child’s preferences, sources of risk, insurance environment, and budget constraint. I then define the family limited commitment problem and close with a discussion of the model’s implications. A notation table for the model can be found in Appendix Table 1.

4.1 Preferences

The model analyzes the relationship between a single elderly parent and her adult child in every period from $t = 1, \dots, T$ in which period $t = 1$ corresponds to retirement (age 65) of the parent. The parent and child have time-separable, expected utility preferences over consumption, leisure, and care arrangements. The parent’s per-period utility is:

$$U_t^P(c_t^P, F_t, U_t^K) = u(c_t^P, \ell_t^P) + z * \mathbb{1}_{F_t} + \eta U_t^K \quad (1)$$

where c_t^P is parent consumption and ℓ_t^P is parent leisure, which is set to the total amount of allocatable hours.¹³ z is disutility for formal care, which is denoted by an indicator F_t

¹³Note that this specification does not allow for health-state dependent utility (except through a separable disutility for formal care). While a relaxation of this would be interesting, the direction of dependence is unclear: estimates from other studies vary in sign on whether poor health increases or decreases the marginal utility of consumption. Moreover, the dependence is likely to be specific to the type of health shock. For long-term care specifically, Brown, Goda, and McGarry (2012) directly ask individuals about preferences and find very weak and heterogeneous evidence of state-dependent utility.

and reflects the notion that parents, all else equal, may prefer care from their child over a hired caregiver. The parent may also care about the child’s well-being, which enters the parent’s utility function as permanent altruism η over the child’s utility U_t^K .¹⁴

The adult child’s per-period utility is:

$$U_t^K(c_t^K, \ell_t^K, NC_t) = u(c_t^K, \ell_t^K) - g * \mathbb{1}_{NC_t} \quad (2)$$

where c_t^K is child consumption and ℓ_t^K is child leisure. Instead of pure altruism towards their parents, adult children experience ‘guilt’ g if they do not cooperate with their parents ($NC_t = 1$). This is in the spirit of [Becker \(1992\)](#), who argues that children are more likely to provide support in old age if they otherwise would feel guilty.¹⁵ I use this specification instead of pure altruism for two main reasons. First, the empirical literature on child altruism toward parents at this stage of life finds small effects.¹⁶ Second, [Li, Rosenzweig, and Zhang \(2010\)](#) find that guilt is an empirically important motive for family interactions. Finally, there are many issues in dynamic non-cooperative¹⁷ games involving altruism that pose problems for tractability and make stark predictions on transfers, as detailed in [Altonji, Hayashi, and Kotlikoff \(1997\)](#) and [Barczyk and Kredler \(2014a\)](#). See [Appendix C](#) for a further discussion of these issues.

The preferences over consumption and leisure for both the parent and child take the following form:

$$u(c, \ell) = \frac{[c^\alpha \ell^{1-\alpha}]^{1-\gamma}}{1-\gamma}. \quad (3)$$

¹⁴Several papers argue against a model of altruism by showing that monetary transfers are not very responsive to monetary shocks ([Altonji, Hayashi, and Kotlikoff, 1997](#); [Attanasio, Meghir, and Mommaerts, 2015](#)). However, these studies do not allow for exchange motives to additionally influence transfer behavior (see [Cox \(1987\)](#) for an early model of both altruistic- and exchange-motivated transfers). In addition, the structure of family interactions matter for transfer behavior; for example [Foster and Rosenzweig \(2001\)](#) show that limited commitment models with altruism can generate both increases and decreases in the responsiveness to shocks.

¹⁵This is also similar in spirit to the punishment of leaving a risk-sharing arrangement proposed in [Thomas and Worrall \(1988\)](#), or to the match-specific effect, though non-stochastic, of being in a relationship in the marriage literature ([Voena, 2015](#); [Yamaguchi, Ruiz, and Mazzocco, 2014](#); [Bronson, 2014](#)). Analogies can also be drawn to guilt in ‘pro-social’ ([Bénabou and Tirole, 2006](#)) or ‘free-rider’ ([Gächter and Fehr, 2000](#)) problems.

¹⁶[Barczyk and Kredler \(2014b\)](#) finds that child altruism parameters are less than half the size of parent altruism parameters, and [Fahle \(2014\)](#) finds almost zero child altruism compared to relatively large parent altruism.

¹⁷In a fully cooperative model, altruism would be absorbed into the Pareto weights.

Preferences are not separable over consumption and leisure, as past studies have shown that nonseparability is empirically important (Blundell, Browning, and Meghir, 1994; Atanasio and Weber, 1995). I consider the case where individuals are relatively risk averse ($\gamma > 1$) and consumption and leisure are Frisch substitutes ($\alpha \in \{0, 1\}$).

At the time of the parent's death t_d , any remaining assets of the parent $a_{t_d}^P$ are bequeathed to the child. Consistent with the parent's flow utility, the parent realizes a value $V_{t_d}^P$ of:

$$V_{t_d}^P = \eta V_{t_d}^K \quad (4)$$

where V^K is the value to the child, which will be defined in more detail in Section 4.5. The value to the parent is a form of bequest function that is consistent with the parent's lifetime preferences.¹⁸

The child's behavior after the parent's death is a simple consumption-labor-supply-savings problem through time T , which roughly corresponds to the retirement age of the child (see Appendix B for the precise definition of the problem). The model closes at the end of time T with a terminal condition in order to match the fact that in the data, the adult child values savings for their retirement:

$$V_{T+1}^K(a_{T+1}^K) = \phi \frac{(a_{T+1}^K)^{1-\gamma}}{1-\gamma} \quad (5)$$

In this parameterization, ϕ governs the tradeoff between consumption in time T and assets for the terminal function.¹⁹

¹⁸This 'pure altruism' setup, in which parents care about their child's utility, is in contrast with bequest functions that exhibit 'impure altruism', such as a 'warm glow' in which the parent cares about the amount of bequest rather than the well-being of the child. 'Warm glow' bequest functions are used in De Nardi (2004), De Nardi, French, and Jones (2010), and Lockwood (2014).

¹⁹An alternative to this terminal value approach would be an overlapping generations approach in which the child transitions to a parent at time T . I chose the terminal value approach for several reasons. First, the level of assets is the main ingredient necessary to characterize an individual at retirement. Second, I do not want to make claims about the effects of policies on the well-being of elderly in far future generations, which an overlapping generations approach implies. Finally, there are tractability concerns with an overlapping generations approach.

4.2 Sources of risk

The parent and child face three key sources of risk when making long-term care decisions. The parent faces uncertainty over future long-term care needs and the timing of death, both of which will influence insurance and precautionary savings choices. The child faces a stochastic wage process, which will directly impact the opportunity cost of family care.

Long-term care needs and death

I discretize the parent's long-term needs into three categories $h_t \in \{0; 1000; 2000\}$ corresponding to: (1) they do not need care ($h = 0$), (2) they need 1,000 hours of care each year ($h = 1000$, corresponding to 20 hours per week), or (3) they need 2,000 hours of care each year ($h = 2000$, corresponding to 40 hours per week).²⁰ The transition probabilities for long-term care status depend on prior status, income, and age:

$$h_{t+1} = h_{t+1}(h_t, y^P, t)$$

Parents who need care either receive it formally from a paid source ($F_t = 1$) or informally from their child ($F_t = 0$). The probability of parent death is modeled analogously, so that the probability of survival to time $t + 1$ is $s_{t+1}(h_t, y^P, t)$.

It is important to note that the type of care, F_t , affects the *utility* function but does not enter as inputs into long-term care transition function $h_t(\cdot)$ or the survival function $s_t(\cdot)$. I do this for two main reasons. First, long-term care concerns the ability to perform basic personal tasks, in contrast to other types of health care whose quality may more acutely affect subsequent life-or-death outcomes. Second, a small literature has found no effects of the type of long-term care on mortality ([Applebaum, Christianson, Harrigan et al., 1988](#)), and a larger literature on elderly health more generally has found negligible effects, positing that health stock is largely determined by health investments made at much earlier ages ([Finkelstein and McKnight, 2008](#); [Card, Dobkin, and Maestas, 2008](#)).

²⁰It is conceptually straightforward to discretize long-term care needs into additional, finer categorizations; I select three for computational tractability in estimation.

Income processes

The child's wage is subject to a permanent shock each period that follows a random walk process:

$$\log w_t^K = \log w_{t-1}^K + \xi_t$$

where $\xi_t \sim N(0, \sigma_\xi^2)$. This assumption follows from several previous studies that show empirically that income shocks are well-characterized as a random walk (MaCurdy, 1982; Abowd and Card, 1989; Meghir and Pistaferri, 2004).²¹ The child's income follows as $y_t^K = w_t^K L_t$, in which labor supply is a discrete choice between not working, working part-time (20 hours per week), or working full-time (40 hours per week):

$$L_t = \begin{cases} 0 & \text{if not working} \\ 1000 & \text{if part time (20 hrs/wk)} \\ 2000 & \text{if full time (40 hrs/wk)} \end{cases} \quad (6)$$

The parent's income process is a constant (real) stream of non-asset income y^P (De Nardi, French, and Jones, 2010; Lockwood, 2014). This is a reasonable approximation since most income for retirees comes from annuitized Social Security and pension wealth.

4.3 Long-term care costs and insurance

I define the cost of long-term care as the pre-insurance, 'direct' cost of care. This cost, ltc_t , depends on health status (h_t) and whether the care is provided formally or by the child (F_t): $ltc_t(h_t, F_t)$. When care is hired formally ltc_t is equal to \$20,000 for $h_t = 1,000$ (light care) and \$61,700 for $h_t = 2,000$ (intensive care). This roughly corresponds to hiring a home care aide at \$20 per hour for light care and the non-consumption cost of a mid-range nursing home for intensive care.

When care is provided informally by the child, the direct cost of care is zero for both

²¹I do not model an additional transitory shock, as Blundell, Pistaferri, and Preston (2008) showed that transitory shocks are well smoothed by savings.

care needs states.²² The implicit cost to the child of family care is the hours of care needed: $fam_t = h_t$. For light care, this corresponds to 20 hours per week, and for intensive care this corresponds to 40 hours per week.

The model includes the two main sources of insurance against long-term care risk. The first is private insurance. I model this as a product that covers formal long-term care costs in the event of illness, at the cost of annual premiums during good health. Importantly, this product does *not* reimburse any (implicit) costs associated with family-provided care. The benefit is denoted by $\lambda_t(h_t, F_t, ltc_i)$ and depends on direct long term care needs state h_t , whether care is provided formally F_t , and whether the individual has insurance ltc_i . The contract is a typical contract as described by [Brown and Finkelstein \(2007\)](#) which has a maximum benefit of \$44,350 (corresponding to \$100 per day in 2000 dollars) and an 18% load.²³ Note that because the maximum benefit is less than the cost of long-term care when $h_t = 2,000$, the net formal long-term care cost to the individuals will remain positive, $ltc_t - \lambda_t \geq 0$. The decision to purchase this insurance product is modeled as a once-and-for all decision at age 65, or $t = 1$.²⁴ I do not allow people who are initially in poor health to purchase insurance, a restriction used to match the fact that around a third of individuals are ineligible to purchase long-term care insurance due to health conditions ([Hendren, 2013](#)).²⁵

The second source of long-term care insurance is Medicaid, a means-tested public insurance program (see more details in Section 2). The Medicaid benefit, m_t , is modeled as a consumption floor similarly to [De Nardi, French, and Jones \(2010\)](#). Specifically,

$$m_t = \max\{0, \underline{c} + ltc_t - \lambda_t - [a_t^P + y^P]\}. \quad (7)$$

The Medicaid benefit is positive if the parent's 'net' resources are less than the consump-

²²In practice, family care may entail direct expenses, such as specialized equipment.

²³The load on an insurance product is defined as 1-(EPDV benefits/EPDV premiums), so an 18% load means that the policy pays \$0.82 in expected benefits for every \$1.00 in expected premiums.

²⁴This roughly corresponds to the average age of insurance purchase, which is 67 ([Brown and Finkelstein, 2007](#)).

²⁵As [Hendren \(2013\)](#) notes, "if an insurer were to offer contracts to these individuals, they would be so heavily adversely selected that it would not deliver positive profits, at any price." This is empirically supported in my sample: only 2.6% of individuals who are initially in bad health own a long-term care insurance policy, while 11.5% of individuals who are initially in good health own one.

tion floor \underline{c} . For parents with no long-term care expenditures, ‘net’ resources are simply the sum of income y^P and assets a_t^P , and the consumption floor can be thought of as the benefits received by the Supplemental Security Income (SSI) program.²⁶ For parents with positive long-term care expenditures ($ltc_t > 0$), ‘net’ resources are the sum of income and assets minus *out-of-pocket* formal long-term care expenditures ($ltc_t - \lambda_t$). The distinction between total long-term care expenditures (ltc_t) and out-of-pocket long-term care expenditures ($ltc_t - \lambda_t$) is important: by law, Medicaid is a secondary payer, meaning that private insurance must pay benefits for an individual with an insurance policy before Medicaid will pay.²⁷

4.4 Family budget constraint

The family can transfer resources across time through savings according to the following budget constraint:

$$a_{t+1}^P + a_{t+1}^K = (1 + r)[a_t^P + a_t^K + y^P + L_t w_t^K - c_t^P - c_t^K - ltc_t + \lambda_t + m_t + SSI_t^K]. \quad (8)$$

Because the parent and child make joint decisions, resources are constrained by a single budget constraint defined over the sum of their resources as opposed to individual budget constraints. This family budget constraint is more flexible than two individual budget constraints because it allows for insurance between family members. In other words, cooperation allows transfers between the parent and child such that individual budget constraints need not hold.

However, although resources can be transferred freely between the parent and child, they still own separate assets a_t^P and a_t^K . In a model of full commitment, the distribution of resources would be determined purely by Medicaid eligibility, resulting in the unrealistic outcome that the child would own all of the resources. With limited commitment, individual assets affect the threat points to cooperation, so in each period the family decides

²⁶In this sense, the child also has a consumption floor denoted $SSI_t^K = \max\{0, \underline{c} - [a_t^K + y_t^K]\}$.

²⁷[Brown and Finkelstein \(2008\)](#) argue that Medicaid’s secondary payer status is an important reason that Medicaid crowds out demand for private insurance because part of insurance premiums pay for benefits that would otherwise be paid by Medicaid (an ‘implicit tax’).

the optimal distribution of assets with the parent and child's outside options in mind.

4.5 Family problem

I now describe the decisions that the parent and child make until time T .²⁸ In each period t , the parent and child solve a Pareto problem with participation constraints in which the weight on the parent's utility is θ_t^P and the weight on the child's utility is θ_t^K . These weights capture any current or prior renegotiation necessary to support cooperation, and can be interpreted as the relative decision power of each individual. The family solves:

$$V_t(\omega_t) = \max_{q_t} \theta_t^P U_t^P(c_t^P, F_t, U_t^K) + \theta_t^K U_t^K(c_t^K, \ell_t^K, NC_t = 0) + \beta E_t V_{t+1}(\omega_{t+1} | \omega_t) \quad (9)$$

where the decision variables are $q_t = \{c_t^P, c_t^K, a_{t+1}^P, a_{t+1}^K, F_t, L_t\}$ and the state variables are $\omega_t = \{a_t^P, a_t^K, y^P, w_t^K, h_t, ltci, \theta_{t-1}^P, \theta_{t-1}^K\}$,²⁹ subject to the following sets of constraints. The first are monetary constraints consisting of the family budget constraint (equation 8), the Medicaid benefit (equation 7), and no-borrowing constraints: $a_{t+1}^P \geq 0$ and $a_{t+1}^K \geq 0$. The second is the child's time constraint:

$$\mathcal{T} = L_t + \ell_t^K + fam_t. \quad (10)$$

Finally, the evolution of the Pareto weights θ_t^P and θ_t^K follow:

$$\theta_t^P = \theta_{t-1}^P + \mu_t^P$$

$$\theta_t^K = \theta_{t-1}^K + \mu_t^K$$

in which $\mu_t^P \geq 0$ and $\mu_t^K \geq 0$ are chosen to satisfy the following participation constraints:

$$V_t^P(\omega_t) \geq Z_t^P(\omega_t) \quad (11)$$

$$V_t^K(\omega_t) \geq Z_t^K(\omega_t) \quad (12)$$

²⁸If the parent dies before time T , the problem reverts to the child's problem in Appendix B.

²⁹In the first period, $ltci$ is a decision variable and not a state variable.

which state that the value of cooperation, $V_t^P(\omega_t)$ and $V_t^K(\omega_t)$, must be larger than the value of non-cooperation, $Z_t^P(\omega_t)$ and $Z_t^K(\omega_t)$, respectively. [Marcet and Marimon \(2011\)](#) show that if person i 's participation constraint is not satisfied, μ_t^i is set so as to shift just enough resources to them to satisfy them in cooperation under a new weight θ_t^i .³⁰ The left-hand side of these constraints, for choices $\{q_t^*(\omega_t)\}_{t=1}^T$, are equal to:

$$\begin{aligned} V_t^P(\omega_t) &= U_t^P(c_t^{*P}(\omega_t), F_t^*(\omega_t), U_t^{*K}(\omega_t)) + \beta E_t V_{t+1}^P(\omega_{t+1}|\omega_t) \\ V_t^K(\omega_t) &= U_t^K(c_t^{*K}(\omega_t), \ell_t^{*K}(\omega_t), NC_t^*(\omega_t) = 0) + \beta E_t V_{t+1}^K(\omega_{t+1}|\omega_t) \end{aligned}$$

and are defined recursively using the terminal condition in equation (5):

$$\begin{aligned} V_T^P(\omega_T) &= U_T^P(c_T^{*P}(\omega_T), F_T^*(\omega_T), U_T^{*K}(\omega_T)) + \eta \beta V_{T+1}^K(a_{T+1}^{*K}(\omega_T)) \\ V_T^K(\omega_T) &= U_T^K(c_T^{*K}(\omega_T), \ell_T^{*K}(\omega_T), NC_T^*(\omega_T) = 0) + \beta V_{T+1}^K(a_{T+1}^{*K}(\omega_T)) \end{aligned}$$

in which $V_T(\omega_T) = \theta_T^P V_T^P(\omega_T) + \theta_T^K V_T^K(\omega_T)$. If the parent dies before time T , the parent's terminal value is simply $V_T^P(\omega_T) = \eta \beta V_T^K(\omega_T)$.

The right-hand sides of equations (11) and (12), Z_t^P and Z_t^K , are the values of non-cooperation to the parent and child. I define non-cooperation as a breakdown in family ties in which the parent and child make separate decisions in all future periods, and all opportunities for family care cease. The only monetary transaction between the parent and child is a potential bequest at the death of the parent, which arises through the parent's altruism, η , towards the child.³¹ The model incorporates these restrictions on behavior to capture the notion that family care is a complex decision that requires a level of coordination that is infeasible when families cannot make joint decisions.

³⁰Indeed, μ_t^P and μ_t^K correspond to the Lagrange multiplier of the sequential participation constraints. This shift in the Pareto weight is the constrained efficient solution to limited commitment problems. Under full commitment, the efficient solution fixes the Pareto weight at the original level μ_0 . As [Kocherlakota \(1996\)](#) shows, the allocation under limited commitment that delivers a solution nearest the efficient solution while satisfying participation constraints is the minimal adjustment in Pareto weights.

³¹The parent may want to make inter-vivos transfers to the child as well. However, because of strategic incentives, I restrict transfers to only occur as bequests (see Appendix C for a more complete discussion about this issue).

The value of non-cooperation to the parent is thus the solution to:

$$Z_t^P(\omega_t) = \max_{c_t^P} U_t^P(c_t^P, F_t, U_t^K) + \beta E_t[Z_{t+1}^P(\omega_{t+1}|\omega_t)]. \quad (13)$$

The expectation is over future long-term care needs, survival, and the child's income,³² subject to her own budget constraint:

$$a_{t+1}^P = (1+r)[a_t^P + y^P - c_t^P - ltc_t + \lambda_t + m_t] \quad (14)$$

and a no-borrowing constraint $a_{t+1}^P \geq 0$. In the first period, the parent also chooses whether to buy long-term care insurance ltc_i .

The value of non-cooperation to the child is the solution to:

$$Z_t^K(\omega_t) = \max_{c_t^K, L_t^K} U_t^K(c_t^K, \ell_t^K, NC_t = 1) + \beta E_t[Z_{t+1}^K(\omega_{t+1}|\omega_t)] \quad (15)$$

subject to her time constraint: $\mathcal{T} = L_t + \ell_t^K$ and her own budget constraint:

$$a_{t+1}^K = (1+r)[a_t^K + L_t^K w_t^K - c_t^K + SSI_t^K] \quad (16)$$

as well as a no-borrowing constraint $a_{t+1}^K \geq 0$ and consumption floor \underline{c} . Equation (16) is slightly modified at the parent's death at time t_d : at that point, the child also receives the remaining assets of the parent $a_{t_d}^P$.

The values of the parent and child's non-cooperative problems are dependent on each others' decisions because of the parent's altruism, which may result in a bequest. In each period, I assume the following timing: First, the parent chooses her own consumption (and, in the first period, whether to buy insurance), all the while anticipating the child's response functions. Second, the child chooses her consumption and labor supply. Because this problem can be defined recursively and all decisions are based on payoff-relevant state variables, the equilibrium concept to this game is a Markov perfect equilibrium.

³²Since bequests depend on the well-being of the child, the circumstances of the child factor into the parent's consumption and savings decisions, even in this non-cooperative state. A similar argument applies to the parent's circumstances in the child's decisions.

While non-cooperation is a credible threat for both the parent and child, it will never materialize in equilibrium. This is because, as other models of risk-sharing with limited commitment have shown (see for example [Ligon, Thomas, and Worrall \(2002\)](#)), both the parent and child will always be at least as well off cooperating as non-cooperating due to a positive surplus of cooperation. In the model above, this surplus consists of risk-sharing opportunities, as well as monetary savings by the ability to substitute family care for formal long-term care, preferences over family care, and child guilt.³³ Indeed, the surplus in this problem allows for a greater degree of cooperation than risk-sharing alone would.³⁴ This is in contrast to recent marriage models with limited commitment (e.g. [Voena \(2015\)](#), [Bronson \(2014\)](#), [Yamaguchi, Ruiz, and Mazzocco \(2014\)](#)), in which non-cooperation (divorce) is feasible because negative preference shocks can eliminate any marital surplus that previously made marriage desirable.

4.6 Model discussion

I numerically solve the model using backward induction from the final period T (see Appendix [D](#) for details). However, there are several features of the model that can be discussed informally. I focus the discussion on the implications for the two main mechanisms through which families choose to insure long-term care risk: private insurance and savings.

In a model of long-term care insurance demand without family care (e.g. a single agent life-cycle model), demand for insurance is largely dictated by Medicaid and savings. First, Medicaid crowds out the demand for private insurance: since Medicaid pays formal care expenses for individuals with no resources, private insurance is redundant for Medicaid enrollees. This is particularly salient for low-wealth individuals with few assets to protect, but may also be relevant further up the wealth distribution. Second, the ability to save, or ‘self-insure’, may act as a substitute for private insurance (particularly if insurance does not offer actuarially fair policies): individuals can transfer their own

³³As pointed out by [Kandel and Lazear \(1992\)](#), feeling guilty, or ‘guilt aversion’, will minimize limited commitment problems.

³⁴The parent’s altruism toward the child may also alleviate risk-sharing constraints (see [Foster and Rosenzweig \(2001\)](#) for a discussion on this issue).

resources across time to smooth consumption. This feature may also reduce the demand for insurance, and is particularly salient for high-wealth individuals. Nonetheless, [Brown and Finkelstein \(2008\)](#) find that a single agent model with Medicaid and self-insurance can generate the positive correlation between insurance demand and wealth found in the data, but it cannot explain the relatively muted demand for insurance by wealthy individuals.

Adding the family to this model introduces new implications for insurance demand through family care, altruism, and risk-sharing channels. Family care may reduce the demand for insurance through the budget constraint and preferences. First, wage rates and the value of leisure determine the opportunity cost of family care to the child. A relatively low opportunity cost of time makes family care cheaper than formal care. Cheaper care effectively lowers the riskiness of becoming sick, and therefore may lower the demand for insurance. Second, the parent's preference for family care may lower the demand for insurance because insurance does not cover family care.

Parent altruism, such as bequest motives or pure altruism, has an ambiguous effect on insurance demand. On the one hand, the desire to leave a bequest (or transfer assets to a child) increases the value of long-term care insurance because insurance protects assets ([Pauly, 1990](#)). On the other hand, bequests lower the value of insurance by reducing the opportunity cost of precautionary savings ([Lockwood, 2014](#)).

The ability of the parent to share the financial risk of long-term care with the child will also lower the demand for insurance: the ability of the parent to spread long-term care cost shocks between both members of the family is a form of insurance in and of itself, thereby displacing the role of a formal insurance product.³⁵ Limited commitment decreases the overall ability to share risk, which will mute the effect of risk-sharing on insurance demand.³⁶

The model also has implications for savings, a form of 'self-insurance' against long-term care risk. First, the means-tested nature of Medicaid and SSI decreases the value of

³⁵See [Mobarak and Rosenzweig \(2012\)](#) for an interesting application of the interaction of informal risk-sharing and formal insurance to agricultural risk.

³⁶Technically, the more the participation constraints bind due to the limited commitment nature of the problem, the less effective is the risk-sharing component of the relationship.

saving in the model, as shown in [Hubbard, Skinner, and Zeldes \(1995\)](#). Second, uncertainty over future long-term care needs and mortality increases the value of savings, as do bequest motives, as shown in [De Nardi, French, and Jones \(2010\)](#). Third, analogously to the insurance argument, the value of savings is lower when cheap family care is available and when the family is able to share risk.

Finally, limited commitment will affect savings behavior. This paper is one of the first to incorporate individual saving in an empirical model of limited commitment.³⁷ Theoretically, [Ligon, Thomas, and Worrall \(2000\)](#) show that larger asset holdings makes non-cooperation more attractive through an enhanced ability to self-insure, but that a risk-sharing network can use savings as a partial substitute for commitment by strategically transferring savings between members. The member that receives most of the surplus of the risk-sharing relationship optimally stores most of the assets, creating a “liquidity constraint” on the member that may otherwise find non-cooperation more attractive. Thus, in my model the fraction of the surplus captured by each member will have implications for the distribution of assets between the parent and the child.

5 Estimation

To quantify the effect of the family on long-term care insurance demand and evaluate counterfactual policies, I structurally estimate the model using data from the Health and Retirement Study and the Panel Study of Income Dynamics. I use a two-step procedure following [Gourinchas and Parker \(2002\)](#) and [De Nardi, French, and Jones \(2010\)](#). In the first step, I estimate certain parameters of the model directly from the data. In the second step, I numerically solve the model and structurally estimate the remaining parameters conditional on the first stage parameters as well as some calibrated parameters. I estimate the model using simulated method of moments ([McFadden, 1989](#); [Pakes and Pollard, 1989](#)).

³⁷Savings is joint in almost all empirical marriage models with limited commitment. An exception to this is [Bayot and Voena \(2014\)](#), who study prenuptial agreements.

5.1 Data

To estimate the model, I mainly use data from the Health and Retirement Study, a nationally representative longitudinal survey of individuals aged 50 that began in 1992. The survey contains detailed questions about health, wealth, income, and demographic and family information, including some key characteristics of their children.

My sample consists of single (divorced, widowed, or never married) individuals aged 65 and above who are retired and have at least one child.³⁸ Following Lockwood (2014), I restrict the sample to individuals who do not miss an interview between 1998 and their death and to individuals with annual labor earnings of less than \$3,000 to better ensure they are retired.³⁹ All dollar amounts are converted to 2010 dollars using the CPI.

Table 5 reports summary statistics for this sample of parents. 92% of the parents are widowed and 83% are female. This reflects the fact that women often outlive their spouses. On average, the parent has over 3 children, 20% of them are on Medicaid, and only 8% own a long-term care insurance policy.

I measure long-term care needs by the amount of help the parent reports receiving for activities of daily living or instrumental activities of daily living.⁴⁰ I categorize their needs as $h_t = 0$ if they do not need any care, $h_t = 1000$ if they need 1-100 hours per month of help (light care), and $h_t = 2000$ if they need over 100 hours per month (intensive care). In addition, I categorize their needs as $h_t = 1000$ and $h_t = 2000$ if the parent reports living in an assisted living facility or a nursing home, respectively. Table 5 shows that 17% of the sample needs light care and 20% needs intensive care at a given point in time.

³⁸While the model includes only one child, I do not restrict my sample to parents with one child because this would significantly reduce my sample. For parents with multiple children, I use selection criteria to choose which child's characteristics to use in estimation, as described below.

³⁹From the sample of 9,141 individuals age 65 and over in 1998 who do not miss a future interview, the restriction to single individuals reduces the sample size to 3,480. The restriction to annual labor earnings less than \$3,000 reduces the sample size to 3,186. Finally, the restriction to individuals with at least one child reduces the sample size to 2,630.

⁴⁰The set of ADLs asked about are: walking across a room, dressing, bathing, eating, getting in and out of bed, and using the toilet. The set of IADLs asked about are: using a map, using a telephone, managing money, taking medications, shopping for groceries, and preparing hot meals. The exact wording of the question is: "Because of a health or memory problem do you have any difficulty with...?" and the respondent is specifically asked to "exclude any difficulties you expect to last less than three months". If the respondent reports any difficulty, s/he is asked "Does anyone every help you...". The look-back period for the hours of care is only the previous month. Because the length of a period in the model is two years, the implicit assumption in the model is that this monthly amount is consistent over the course of two years.

Table 5: Parent Characteristics

	Mean	Median
Female	.83	
Widowed	.92	
Children	3.4	3
Medicaid	.20	
Own LTC insurance	.08	
Need light care	.17	
% Family care	.61	(7.5 hrs/wk)
Need intensive care	.20	
% Family care	.42	(52.5 hrs/wk)
Permanent income	\$18,308	\$14,157
Wealth	\$225,253	\$78,427
# Individuals	2,630	

Note: The sample includes single retired individuals aged 65 and over in the pooled 1998-2010 Health and Retirement Study. Light care is defined as 1-100 hours per month; intensive care is defined as over 100 hours per month. The first column of the 'family care' rows denote the percent of care that is provided by family members, and the second column denotes the median hours per week of family care received for those who receive family care. Income is defined as the average over all periods of total income less asset income and government transfers. Wealth is defined as the sum of all assets less debts.

I assign the type of care (formal or family care) based on the relationship of the helper to the parent as well as the residential status of the parent. If the parent receives any help from the child, the help is categorized as family care. Otherwise, it is categorized as formal care. The only exception to this is if the parent resides in an assisted living facility or a nursing home, in which case the help is categorized as formal care.⁴¹ In my sample, 61% of light care is provided informally for 8 hours per week at the median, and 42% of intensive care is provided informally for 53 hours per week at the median.

Permanent income of the parent is the average over all periods observed of total income less asset income and government transfers such as Supplemental Security Income (SSI) that I explicitly account for in the model. On average 80% of this income comes from Social Security, and most of the remainder from pension income. Median income is around \$14,000 a year in my sample.

⁴¹Only 10% of parents categorized as formal care recipients also receive some amount of family care (a median of 15 hours per month conditional on any family care). Only 25% of parents categorized as receiving family care also receive some amount of formal care (a median of 60 hours per month conditional on any formal care).

I measure parent assets as the sum of all assets less debts. The HRS has a rich set of asset questions that includes the value of housing and real estate, vehicles, the value of a business or farm, savings accounts and other liquid assets, individual retirement accounts, Keoghs, stocks, mutual funds, bonds, and other assets. Because of inaccuracies in the wealth variables in early survey years, I only use data from 1998 onward (see [Lockwood \(2014\)](#) and the references cited therein for more details). Because I model a parent from age 65 through death but only have data from 1998-2010, I rely on multiple cohorts to trace out life-cycle savings paths. To isolate life-cycle effects from potential cohort effects,⁴² I regress assets on age and cohort dummies. From these regression coefficients, I predict median assets by age for the cohort that is 65-69 in 1998. These values, which are purged of cohort effects, will be used as moments for estimation.⁴³ Across all ages, median wealth is \$78,000.

For child characteristics, I use a combination of the Health and Retirement Study and the Panel Study of Income Dynamics. The first step is to determine which child to use in the sample when a parent has multiple children (82% of the sample has multiple children). To do this, I first choose the child who provides the highest number of hours of family care over the sample period. This determines 52% of the sample with multiple children. For the remaining sample, I sequentially apply the following rules until a tie is broken: (1) the child who lives closest to the parent, as determined by whether the child lives within 10 miles of the parent (this determines an additional 29%), (2) whether the child is a daughter (9%), (3) the oldest child (10%), and (4) for the remaining few ties, I randomly select a child. A comparison of sample children and all children of the parents is shown in [Table 6](#). Selected children are more likely to be female and more likely to be educated but less likely to be working full time. They are much more likely to live within 10 miles or even live with their parent. These effects are all magnified for selected children who eventually provide long-term care for their parent.

In the HRS, demographic information about the child is limited and stems from ques-

⁴²Different cohorts may have very different rates of return on their wealth. The model, on the other hand, captures only life-cycle effects, so for this reason I take out cohort effects.

⁴³The left panel of [Appendix Figure 3](#) shows median raw assets and median assets purged of cohort effects.

Table 6: Child Characteristics

	Non-Selected	Selected	Selected Caregivers
Age	53	54	55
Age gap with parent	29	28	29
Female	0.45	0.60	0.70
Married	0.66	0.64	0.57
Number of children	2.2	2.2	2.2
Less than high school	0.14	0.08	0.11
High school	0.41	0.38	0.39
Not working	0.29	0.33	0.42
Part-time work	0.08	0.09	0.11
Owns home	0.60	0.59	0.51
Lives w/in 10 miles of parent	0.43	0.88	0.92
Coresides with parent	0.06	0.17	0.35
Receives childcare from parent	0.03	0.05	0.05
Average care when parent sick (hrs/wk)	2.0	17.1	20.8
Child in will	0.81	0.89	0.91
Transfer to child \$500+ past year	0.07	0.14	0.13
Transfer from child \$500+ past year	0.04	0.06	0.08
Observations	6,499	2,630	1,363

Note: The sample includes all children of single retired individuals aged 65 and over in the pooled 1998-2010 Health and Retirement Study. Children who have no siblings are all in the 'Selected' category. When a parent has multiple children, the selected child is determined by a set of 4 criteria: first the child who provides the most care (this determines 52% of the sample of multiple children), then who lives nearby (this determines 29%), then whether the child is a daughter (this determines 9%), and finally the oldest child (this determines 10%). For the few remaining ties, a random child is selected. 'Selected Caregivers' is the subset of 'Selected' children who provide care at any point during the sample period.

tions asked to the parents. In the model, children are differentiated by their potential wage and their savings. To measure the child's potential wage, I use the child's education instead of the child's household income, which is a result of labor supply decisions and only reported in large brackets. I assign children with a high school degree or less as low 'types' and children with more than a high school degree as high 'types' to capture differences in opportunity costs of time.

Child assets are not ascertained in the HRS, so I turn to the Panel Study of Income Dynamics (PSID). The PSID is a nationally representative longitudinal study that started in 1968 that includes detailed information about income and assets. Importantly, it follows children as new sample members after they split off from their parent's household. I follow the same sample restrictions and wealth definitions for parents in the PSID as in the HRS, and link this sample to their children. Like parent assets, I use multiple child cohorts and isolate life-cycle effects from cohort effects (see the right panel of Appendix Table 3).

Additionally, I impute child assets onto the HRS sample for initial conditions. Specifically, I use demographic information about the parent and child contained in both datasets, including parent wealth and income percentiles, child income bin corresponding to the child income bins in the HRS,⁴⁴ child home ownership, a fourth order polynomial in child age and a quadratic in parent age, child gender, child marital status, child education, child number of children, and year. I impute assets using predictive mean matching, which involves using a linear prediction of assets as a distance measure to find a set of nearest neighbors from which a randomly drawn value is assigned. This method preserves the distribution of values from the PSID beyond only a linear prediction, which did not replicate the skewed distribution of assets (Little, 1988).

5.2 First stage parameters

Prior to estimating the key parameters inside the model, I estimate certain parameters outside the model that do not require the structure of the model. Parent income and

⁴⁴The bins are: <\$10,000; \$10,000-\$35,000; \$35,000-\$70,000; >\$35,000; and >\$70,000.

long-term care costs can be estimated directly from the data. Because I assume that survival probabilities and transition between long-term care needs states only depend on prior need state, age, and permanent income, these transitions are exogenous to choices made within the model. These values, in addition to values of parameters taken from the literature, are shown in Table 7.

I allow for three values of parent permanent income, which are the medians of each tercile in the sample. I allow the child's wage process to vary by whether the child went to college or not. The mean initial wage for high school graduates is set to $w_0 = \$13$ and the mean initial wage for children with more than a high school degree is $w_0 = \$26$. The annual variance of permanent shocks to log wages is set to $\sigma_\xi^2 = 0.05$.⁴⁵ The consumption floor for Medicaid and SSI is \$8,000 annually. Total hours available is set to 16 hours each day, or 5840 per year. The discount factor is set to 0.93 and the return on assets is 3%. The constant relative risk aversion parameter is 2.0. Each period in the model is 2 years to match the biennial nature of the HRS data.

Long-term care and mortality transitions

I estimate the probability of death and transitions between states of long-term care need as logistic functions of previous long-term care need, permanent income percentile, a cubic in age, and age interacted with permanent income rank and previous long-term care need, similarly to [De Nardi, French, and Jones \(2010\)](#).⁴⁶ In the model, simulated individuals are assigned actual long-term care need and mortality trajectories of individuals from the data to reduce simulation noise. To form their expectations over future long-term care and mortality shocks, however, they use the estimated transition probabilities.

Table 8 uses the estimated long-term care and mortality transitions to simulate individuals with the initial conditions (but not the actual trajectories for this exercise) found in the data. Conditional on reaching age 67, individuals on average live 13.6 more years,

⁴⁵This is on the high end of estimates of this sort, but not far from estimates found in [Meghir and Pistaferri \(2004\)](#). In the future, I plan to estimate the variance of permanent shocks using the PSID sample.

⁴⁶[Brown and Finkelstein \(2008\)](#) and [Lockwood \(2014\)](#) use an actuarial model of formal services ([Robinson, 2002](#)) to calculate health state transitions. Since I assume that formal services are a choice, I cannot use this model.

Table 7: First stage parameters

Parameter	Description/Source	Value
Income parameters		
y^P terciles	Estimated from HRS sample	7,804 / 14,526 / 25,883
w_0^K	Init. mean child wage, set	Low edu: \$13 ($y_0^K \approx 25,000$) High edu: \$26 ($y_0^K \approx 50,000$)
σ_ξ^2	Child perm. inc shock var (set)	0.05
LTC parameters		
λ_t for $h_t = 0$	LTC insurance premium	\$4,107 (18% load)
λ_t for $h_t = 1, h_t = 2$	Cost of formal LTC	\$20,000 / \$61,700
fam_t for $h_t = 1, h_t = 2$	Hours of informal LTC needed	1,000 / 2,000
Transition parameters		
LTC probabilities	Estimated from HRS sample	See Table 8
Survival probabilities	Estimated from HRS sample	See Table 8
Other parameters		
\mathcal{T}	Total hours available	5840
β	Discount factor	0.93
r	Market return on assets	1.03
γ	CRRA parameter	2.0
\underline{c}	Consumption floor	\$8,000
t	Length of a time period	2 years

Note: Parameters values are denominated in yearly amounts. All monetary values are in 2010 dollars.

with 38% dying by age 75 and only 4% living past age 93. 77% of the sample initially receives no long-term care, but by age 85, over half of living individuals need long-term care, and by age 93, 84% will need long-term care. Almost three-quarters of individuals at 67 will need some amount of long-term care within their life.

Table 8: Simulated mortality and long-term care use

	Age 65	Age 75	Age 85	Age 93	Ever
Life expectancy at 65	15.6				
Percent dead	0.0	0.38	0.74	0.96	
<i>Long-term care status</i>					
Percent healthy	0.77	0.70	0.45	0.16	–
Percent need light care	0.18	0.20	0.23	0.36	0.59
Percent need intensive care	0.04	0.10	0.33	0.48	0.44
Percent need any care					0.73

Note: This table reports simulated long-term care and mortality statistics. The simulations use the initial health and income conditions of the sample of parents reported in Table 5; simulated individuals are assigned long-term care needs and mortality status based on the estimated transition probabilities. Transitions are estimated at a biennial rate. Light care is defined as 1-100 hours per month; intensive care is defined as over 100 hours per month.

Long-term care cost and insurance parameters

For light care, I assume that formal care costs \$20,000 per year (equivalent to around \$20 per hour for a home aide for 1,000 hours) and informal care costs 1,000 hours per year to the child. For heavy care, I assume that formal care costs \$61,700 per year, which is the average non-consumption cost of a nursing home in 2010 (Lockwood, 2014).⁴⁷

Following Lockwood (2014), I use a simple long-term care contract in which premiums are paid annually in exchange for benefits in years in which the parent needs and uses formal long-term care services, up to a maximum daily benefit of \$100 in 2000 dollars, which in 2010 amounts \$44,350 per year. Using the average long-term care needs distribution in my estimation sample, I calculate expected benefits and set the premium

⁴⁷This assumes that the average non-health expenditure (e.g. housing, food) is \$7,800. I do not include long-term care costs in total consumption, but include the consumption value of institutional care in consumption. The consumption value of nursing homes can vary in reality: for example, there are private and semi-private rooms, so my specification allows this to enter the consumption decision.

to exceed expected benefits by 18%, which is the average load in the US (Brown and Finkelstein, 2007). This amounts to premiums of \$4,017 per year.

5.3 Internally estimated parameters

In the second stage, I use the method of simulated moments to estimate the remaining parameters inside the model: the parent’s preference for family care z , the parent’s altruism η , the child’s guilt g , the consumption floor \underline{c} , and the terminal value parameter ϕ . These estimates, $\hat{\psi}$, are chosen to match the simulated moments from the model as closely as possible to the moments from the data. I use 41 moments that capture the tradeoffs discussed in Section 4.6: 15 parent median assets and 15 child median assets corresponding to ages 65 to 93 of the parent (taken every other year), the percent of parents on Medicaid, the percent of parents with long-term needs who receive family care for each wealth quintile of the parent’s assets at age 65, and the percent of parents who own private long-term care insurance for each wealth quintile of the parent’s assets at age 65.

The optimal choice of $\hat{\psi}$ is the solution to the criterion function

$$\hat{\psi} = \arg \min_{\psi} (\mathbf{m}_{\text{data}} - \mathbf{m}_{\text{sim}}(\psi)) \mathbf{G} (\mathbf{m}_{\text{data}} - \mathbf{m}_{\text{sim}}(\psi))' \quad (17)$$

where \mathbf{m}_{data} is the vector of empirical moments and $\mathbf{m}_{\text{sim}}(\psi)$ are the corresponding simulated moments calculated at ψ .⁴⁸ The weighting matrix \mathbf{G} is the inverse of the diagonal of the variance-covariance matrix of the data, $[\text{Var}(\mathbf{m})]^{-1}$ (Altonji and Segal (1996) show the potential biases introduced by the optimal weighting matrix). Standard errors are calculated using the standard sandwich formula, taking as given the first stage estimates.⁴⁹

The parameters estimates are shown in Table 9. The first two preference parameters indicate that parents have a distaste for formal care and children feel guilty if they do not cooperate with their parent. The magnitude of both of these values can be interpreted as one-time losses of \$15,000 in consumption. Parent altruism is similar to Kaplan (2012),

⁴⁸I first search for a global minimum using a genetic algorithm, and enhance the precision using a simplex method after the global optimizer converged.

⁴⁹I use numerical methods to calculate gradients. In an effort to deal with the lack of smoothness, I use simulated moments generated by 10,000 simulated individuals.

Table 9: Internally estimated parameters

Parameter	Description	Value	Std. Err.	Cons. value
z	Parent formal care preference	-1.8E-5	7.1E-8	\$15,236
g	Child guilt	8.8E-6	8.3E-8	\$14,360
η	Parent altruism	0.09	0.008	
ϕ	Terminal value weight	0.35	0.009	
α	Consumption-leisure tradeoff	0.40	0.003	
θ_0	Initial weight on parent	0.4		

Note: This table reports estimates of the structurally estimated parameters of the model. The parameters are estimated by method of simulated moments. The weighting matrix is the diagonal of the variance-covariance matrix of the data. Standard errors are calculated using the standard sandwich formula, taking the first stage estimates as given. Computation of the standard error of μ_0 is in progress. The consumption value of z and g are calculated as the equivalent value of a one-time loss in consumption for the parent and full-time child, respectively.

whose estimate is 0.04 for parents at a younger stage in life. The low value of altruism is also consistent with [Cox \(1987\)](#) and [Bernheim, Shleifer, and Summers \(1985\)](#) who find that exchange motives are more important than altruistic motives in long-term care decisions. The weight that the child places on the terminal value is 0.35. My paper is the first that uses a terminal value of this form. The consumption-leisure tradeoff of 0.40 is consistent with that used elsewhere ([Low, 2005](#)), and the initial Pareto weight for the parent of 0.4 signifies that at age 65, they have somewhat lower bargaining power in the relationship than their children.

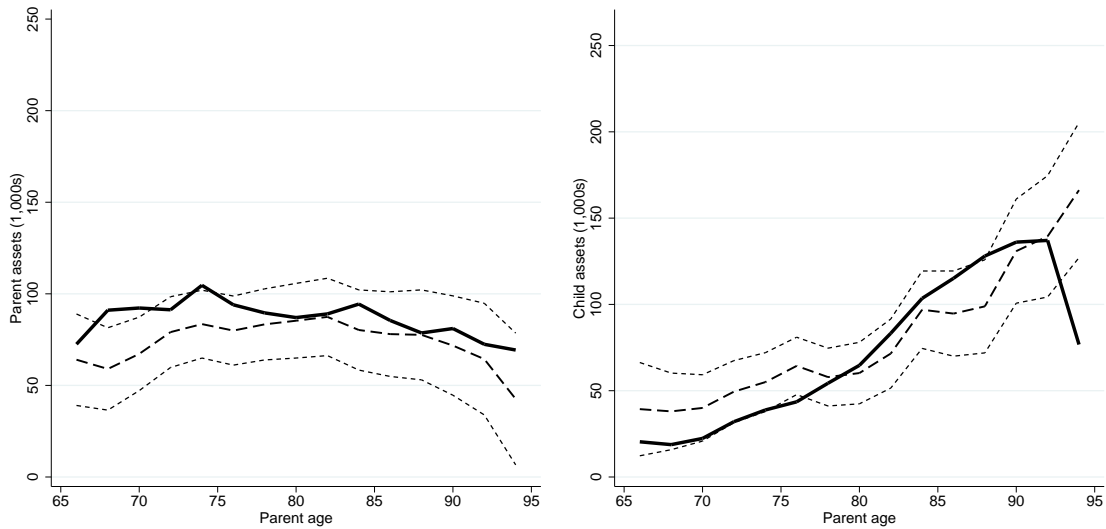
The model fit based on these moments are in [Table 10](#) and [Figure 2](#). The simulated moments match most of the empirical moments pretty well, and the parameter estimates that accompany these moments are also sensible. To my knowledge, this is the first paper to match long-term care insurance coverage rates across the wealth distribution. The model is able to capture both the overall low demand for insurance as well the increase in demand with wealth. It also matches the percent of parents on Medicaid and median wealth over time for parents and children. The model captures the mean rate of informal care use among unhealthy parents (56% in the model and 52% in the data), but it has more difficulty matching the inverse-U shape across the wealth distribution in the data. One reason for this may be that the model does not capture variation in nursing home

Table 10: Moments matched in estimation

Moment	Data [95% CI]	Model
Long-term care insurance coverage rates		
1st asset quintile (poorest)	2.23% [1.06,3.37]	1.29%
2nd asset quintile	4.49% [3.34,5.65]	0.40%
3rd asset quintile	5.92% [4.77,7.08]	2.00%
4th asset quintile	8.40% [7.25,9.55]	6.35%
5th asset quintile (wealthiest)	17.82% [16.67,18.97]	22.52%
Informal care usage (indiv. w/ LTC needs)		
1st asset quintile (poorest)	41.00% [38.45,43.54]	18.90%
2nd asset quintile	52.42% [49.38,55.47]	57.81%
3rd asset quintile	63.14% [59.67,66.62]	56.02%
4th asset quintile	57.68% [53.68,61.68]	71.07%
5th asset quintile (wealthiest)	52.82% [48.76,56.88]	82.67%
Percent of parents on Medicaid	19.76% [18.98,20.53]	21.84%

Note: Table reports data and simulated moments for long-term care insurance coverage by parent wealth quintile, informal care usage among parents with long-term care needs by parent wealth quintile, and overall Medicaid enrollment. Median parent and child assets are also matched and shown in Figure 2.

Figure 2: Median wealth of parents and children



Note: Figure reports median wealth (in \$1,000s) of parents (left graph) and children (right graph) over time. The dashed lines denote the data moments (from the HRS for parents and the PSID for children), with 95% confidence intervals denoted by the short-dashed lines. The model moments are denoted by the solid lines.

quality, particularly the low quality of Medicaid nursing homes.⁵⁰ A second reason may be that the model does not capture other inputs to the opportunity cost of informal care, such as complementarities between leisure and informal care that may arise in coresident households.⁵¹ Finally, the model may be mis-measuring child wages and the correlation between child wages and parent wealth. This could result in higher informal care among wealthy parents because I am underestimating the opportunity cost of time.⁵²

Figure 3 shows graphically the variation in the data that helps identify the formal care preference parameter and the child guilt parameter. For each graph, the solid purple horizontal line denotes the value of the moment in the data, and the solid black line denotes the value of the simulated moment as the value of the parameter on the x-axis

⁵⁰Medicaid nursing homes are of significantly lower quality than nursing homes that do not accept Medicaid residents (Hackmann, 2015). The model does not explicitly capture this difference in care except through consumption choices, which are limited for Medicaid enrollees through \underline{c} . One way to extend the model would be to estimate a specific consumption floor when $h_t = 2,000$ that would capture the consumption value (quality) of Medicaid nursing homes.

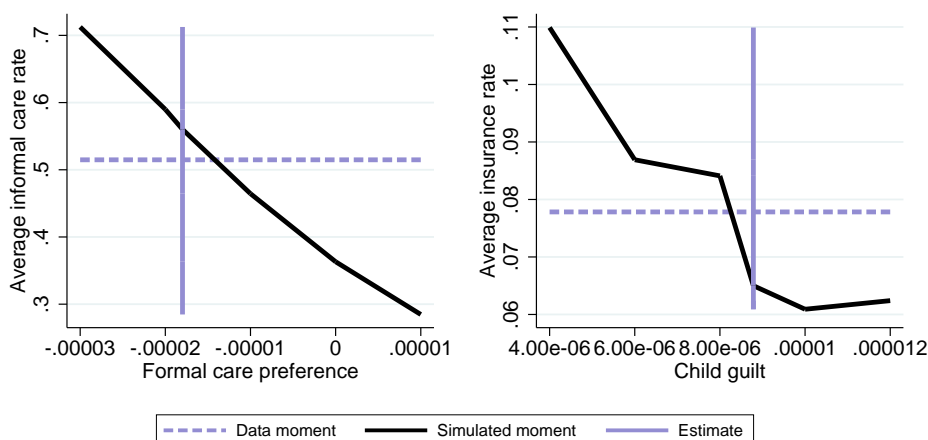
⁵¹Since coresidence is particularly common in lower wealth families and informal care is often provided through coresidence, the model may be overstating the opportunity cost of time for less wealthy families. A useful extension could be to incorporate coresidence as a choice, or alternatively estimate a reduced-form parameter on the time cost of informal care (i.e. ρ in $\mathcal{T} = L_t + \ell_t^K + \rho * fam_t$ where most likely $\rho \in \{0, 1\}$).

⁵²This mechanism may be particularly relevant because I do not directly observe child wages in the HRS.

changes. Ideally, the parameter estimate should be determined by the intersection of the two solid lines. In reality, most parameters are jointly determined by multiple moments.⁵³ Thus, the estimated parameter value, denoted by the dashed purple vertical line, does not always cross through the intersection.

The left panel of Figure 3 shows that the prevalence of informal care in the data provides identification for the parent’s preference over formal care, z . The simulated moment increases as the preference for formal care decreases. The empirically high prevalence of informal care in the data suggests that this preference parameter should be sufficiently high that high earning children choose to provide care informally, even though their opportunity cost of time is higher than the monetary cost of formal care.

Figure 3: Identification of z and g



Note: The figure on the left shows identification of the formal care preference z , and the figure on the right shows identification of the child guilt parameter g . For each, the x-axis is the value of the parameter, and the y-axis is the moment that identifies the parameter. The black line denotes the simulated moment, and the vertical purple line denotes the estimated value. The horizontal dotted line denotes the data moment.

The child guilt parameter g influences the degree to which the parent and child are able to cooperate. As g decreases, the likelihood that the child can effectively threaten non-cooperation increases and the ability to risk-share may break down. The right panel of Figure 3 shows that this ‘instability’ increases the appeal of long-term care insurance, and therefore the average long-term care insurance coverage in the data provides information to estimate g . The long-term care insurance coverage rate also provides informa-

⁵³In addition, the moments shown in Figure 3 are an average of all of the quintiles, while in estimation the moment for each quintile is matched.

tion about z : *ceteris paribus*, a parent with a high disutility of formal care is less likely to buy insurance than a parent with a low disutility of formal care, since long-term care insurance only covers formal care services.

The median asset paths of parents and children and Medicaid reciprocity rates of parents provide information to identify the remaining parameters. The amount of assets the child holds towards the end of the model directly informs the parameter of the terminal value function, ϕ . The asset holdings of the child throughout the model informs the consumption-leisure trade-off parameter, α : the more leisure is valued, the less consumption, and therefore assets, are valued. The parent’s altruism toward the child, η , influences the rate at which the parent decumulates assets: the larger the altruism parameter, the more the parent wishes to bequeath upon death. Since strategic storage of assets can help ensure cooperation (see the model discussion in Section 4.6), altruism and guilt parameters will also affect the distribution of assets between parent and child.

As an out-of-sample test of the fit of the model, Table 11 reports the labor force status of children as a function of the parent’s health in the data and model. Despite not explicitly targeting these moments in estimation, the model fits the overall magnitudes of full-time and part-time work relatively well, in addition to the decreasing trend in full-time work as the parent’s health deteriorates.

Table 11: Child labor force status, by parent health status

	Full-time		Part-time	
	Data	Model	Data	Model
Healthy	61.1%	70.9%	7.8%	3.1%
Needs light care	55.6%	64.6%	8.3%	3.7%
Needs intensive care	45.0%	44.4%	4.0%	11.4%
Deceased		50.3%		21.3%

Note: Table reports data and simulated moments for child labor force status by parent long-term care need. These moments are not used in estimation. Data moments come from the HRS, 1998-2010.

6 Counterfactuals

With these estimates of the structural parameters, I evaluate alternative environments and policies to understand how they may affect long-term care behavior and welfare.

6.1 Family care and the demand for long-term care insurance

First, I calculate the demand for long-term care insurance without the option to use family care. From this, I can quantify how much family care can explain the lack of demand for long-term care insurance. In the model, this is equivalent to setting $F_t = 1$ whenever $h_t \neq 0$ (and hence $fam_t = 0$ for all h_t). This counterfactual is depicted in the left panel of Figure 4. The gray line denotes the percent of parents who are initially healthy, and therefore eligible to purchase insurance. The red line is the benchmark model with family care and the blue line is the counterfactual model without family care (the dotted lines are the overall means for each model). The availability of family care decreases the overall demand for insurance by less than 5 percentage points. The magnitude of this effect, estimated only on a sample of parents with children, is very similar to the reduced form difference in insurance demand between parents with and without children.

The graph shows that virtually none of this change in demand comes from the lower 80% of the parent's initial wealth distribution; in fact, without family care most of the distribution demands *less* insurance. The intuition behind this result is a wealth effect: parents are effectively poorer without family care because some of them face higher long-term care expenses.⁵⁴ This wealth effect induces more people to spend down to Medicaid in lieu of purchasing insurance, or Medicaid 'crowd-out' (Brown and Finkelstein, 2008). This mechanism is corroborated in Appendix Figure 4, which shows that without family care, the lower 80% of the distribution spends down their assets more rapidly than with family care.

For the wealthiest parents, in contrast, insurance demand increases from 23% to 52%. Although they are subject to a wealth effect, they also have a stronger desire to protect

⁵⁴The inability of parents in the model to adjust to the removal of family care prior to age 65 may account for the relatively small difference between the blue lines in Figure 1 and Figure 4.

their assets than less wealthy parents. Insurance increases in the absence of family care because there is no longer a trade-off between the risk-protection value of insurance and the value of using family care. The only source of care available is covered by insurance.

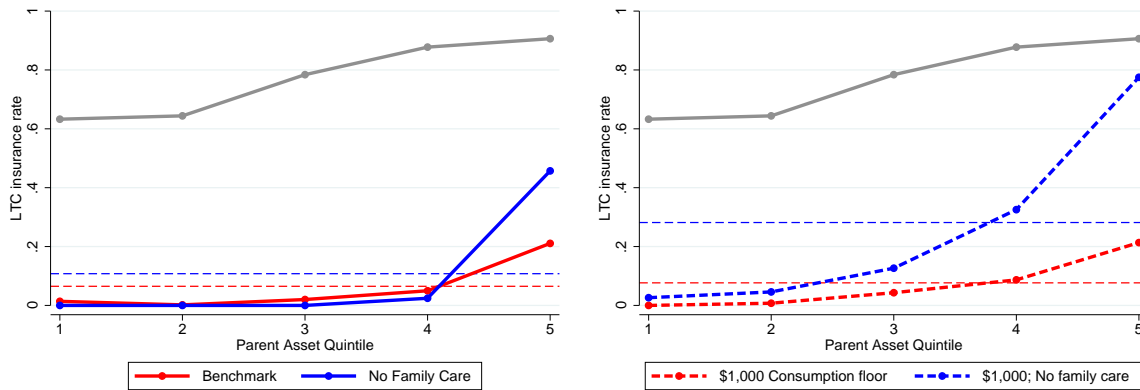
These results suggest that insurance demand generally, and the effect of family care on insurance demand more specifically, may be sensitive to Medicaid policy. In the right panel of Figure 4, I lower the generosity of Medicaid significantly by changing \underline{c} from \$8,000 down to \$1,000. The dotted red line shows that there is almost no change in insurance demand in an environment with family care (compared to the solid red line of the left panel). This implies that families highly value the use of family care *despite* a much worse standard of living if the parent eventually receives Medicaid. Without family care, the demand for insurance increases across the wealth distribution to an average of almost 30% and almost 80% for the wealthiest quintile. The downside to forgoing insurance is much worse when $\underline{c} = \$1,000$ and family care is absent, resulting in less Medicaid crowd-out when family care is absent than when $\underline{c} = \$8,000$. Overall, these results imply that Medicaid alone cannot explain the low demand for private insurance, nor can family care alone explain it. Rather, the interaction between Medicaid and the ability to substitute to family care jointly play a large role in the demand for long-term care insurance.

6.2 Insurance with cash benefits

While family care does not solely account for the low demand for insurance, the neglect of family care in available insurance policies may have large welfare consequences. Specifically, families must trade off (1) a preference and potential cost savings of family care with (2) the insurance value of a product that only covers formal care. Alternatively, an insurance product that covers both formal and family care would allow families to use family care without foregoing risk protection of indirect family care costs.

I next analyze a counterfactual insurance policy that pays cash to the parent whenever the parent is sick. This product has the same premium structure and pays the same dollar benefits in cash to the parent instead of to a formal care provider, or $\lambda^{cash}(h_t, ltc_i) =$

Figure 4: Counterfactual LTC insurance coverage by parent wealth: the impact of family care and Medicaid



Note: Both figures report the percent of parents with long-term care insurance coverage at age 65, by parent wealth quintile. The gray line denotes the percent of parents who do not need long-term care at age 65 (and thus are eligible for long-term care insurance). In the left panel, the red line denotes the matched long-term care insurance coverage reported in Table 10, and the blue line denotes the insurance coverage rate when family care is unavailable ($fam_t = 0$). In the right panel, the red line denotes the insurance coverage rate when the Medicaid floor (\underline{c}) decreases from \$8,000 to \$1,000, and the blue line denotes the insurance coverage rate when $\underline{c} = \$1,000$ and family care is unavailable ($fam_t = 0$). For both figures, the dotted horizontal lines denote the respective average long-term care insurance coverage rates over all parent wealth quintiles.

$\lambda(h_t, F_t = 1, ltc_i)$.⁵⁵ This allows the parent to choose whether to hire a formal service or simply cover all or some of the costs of family care.⁵⁶ The left panel of Figure 5, which replicates the percent of healthy parents for each wealth quintile (gray line) and the benchmark insurance demand (red line), reports the insurance demand for the cash benefit counterfactual. The demand for this insurance policy is almost 100% among healthy parents. This is not surprising for wealthy parents, who no longer must trade off insurance and family care.⁵⁷ The fact that even poorer parents choose to purchase insurance in lieu of spending down to Medicaid (which does not reimburse family care) implies that they highly value family care.

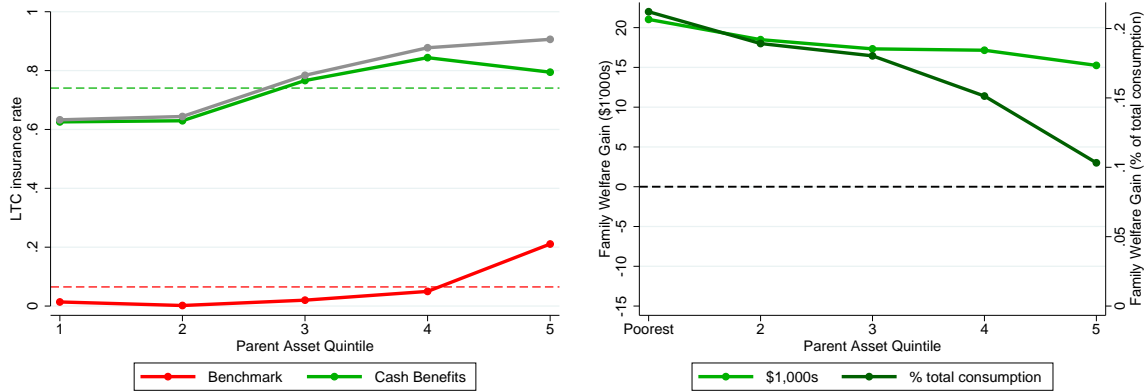
I then calculate the welfare gain of an insurance policy with cash benefits. I define the welfare gain of this policy as the value the family places on cash benefits *above and beyond*

⁵⁵This is, in a sense, analogous to the benefits and drawbacks of ‘cash’ vs. ‘in-kind’ transfers for other goods (e.g. the Food Stamp program (Moffitt, 1989)). With this set-up, this product ignores moral hazard problems. I discuss these issues and attempts to combat moral hazard in Section 6.2.1.

⁵⁶Since child wages vary and are not necessarily equal to the formal cost of long-term care, the cash benefit will be either more or less than the wage-value of the child’s time, depending on the child’s wage.

⁵⁷The 10% of wealthy parents who continue to forego insurance most likely do so because they are more willing to self-insure with their assets than incur the 18% load on the insurance policy.

Figure 5: Counterfactual LTC insurance coverage and welfare gain: cash benefits



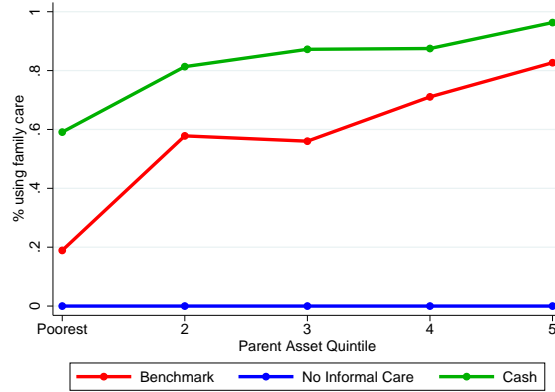
Note: The left panel reports the percent of parents with long-term care insurance coverage at age 65, by parent wealth quintile. The gray line denotes the percent of parents who do not need long-term care at age 65 (and thus are eligible for long-term care insurance). The red line denotes the matched long-term care insurance coverage reported in Table 10, and the green line denotes the insurance coverage rate when the insurance policy provides cash benefits. The dotted horizontal lines denote the respective average long-term care insurance coverage rates over all parent wealth quintiles. The right panel reports the welfare gain to the family of an insurance policy with cash benefits relative to an insurance policy that only covers formal care. The lighter green line denominates the welfare gain as the asset transfer to the parent in the absence of the cash benefit that would make the family indifferent between formal care benefits and cash benefits. The darker green line denominates the welfare gain as the one time percent increase family consumption.

the value of insurance that only covers formal care expenses. I calculate the ‘value’ of each product as the willingness to pay, or in other words, the amount of money the parent would have to be given in the absence of the insurance product to be indifferent between having the insurance product and not. The right panel of Figure 5 shows that the welfare gain is \$21,000 for the poorest parents and slightly decreases to \$15,000 for the wealthiest parents (light green line). This is equivalent to a 10-20% one-time increase in total family consumption (dark green line). One of the main reasons for this welfare gain, as shown in Figure 6, is that cash benefits allow a larger fraction of parents to be cared for by their child compared to the benchmark case, when it was financially less feasible to use family care. In fact, the welfare gain is on the same order of magnitude as the consumption value of family care to the parent, as shown in Table 9.

6.2.1 Combating moral hazard

An important concern with provision of cash benefits vis-a-vis ‘in-kind’ benefits is the potential for moral hazard. In other words, individuals have an incentive to feign sickness

Figure 6: Family care rates among parents with long-term care needs



Note: The figure reports the simulated rate of family care usage among parents with long-term care needs, by parent wealth quintile. The red line denotes the matched family care usage rates reported in Table 10. The blue line denotes family care usage when family care is unavailable ($fam_t = 0$), and the green line denotes family care usage when insurance provides cash benefits.

to obtain cash that they can use for ordinary consumption. In contrast, with in-kind benefits (i.e. only formal care), individuals do not gain any utility from using formal services unless they are sick.

However, programs in several countries have devised systems that manage to control this problem: Germany, France, Austria, and other European countries offer some form of cash benefit for long-term care.⁵⁸

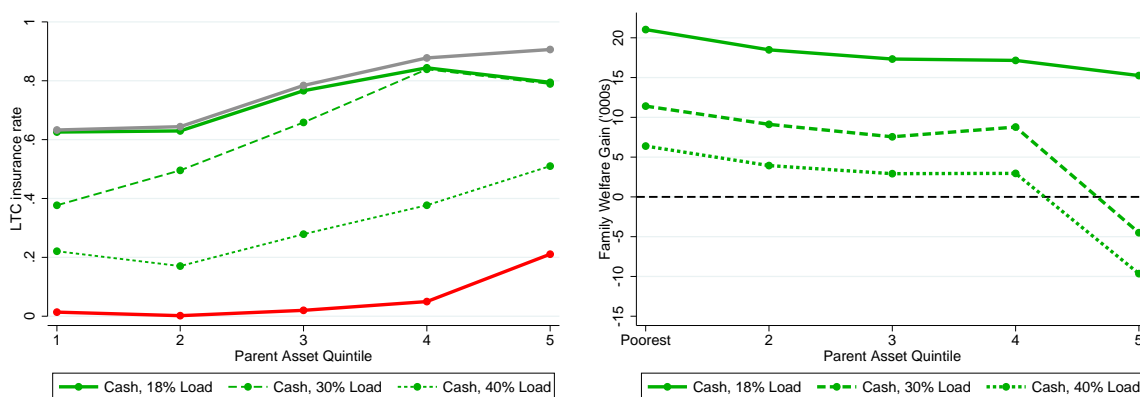
I run a simple counterfactual exercise that evaluates a potential effect of moral hazard on insurance and welfare. To do this, I assume that subjecting individuals to lengthy doctor evaluations and home checks provides perfect verification of long-term care need. Under this assumption, parents cannot feign sickness. However, these evaluations are costly. To accommodate these extra costs, I increase the insurance premiums from \$4,017 to \$4,777 and \$5,574.⁵⁹ The changes in insurance demand and changes in welfare gain of these policies are shown in Figure 7. Insurance demand decreases, but even with a 40% load, the demand for insurance with cash benefits is still 20 percentage points greater than in the benchmark model. However, the welfare effect of this product in lieu of the ‘in-kind’ product is not always positive. For the lower 80% of the wealth distribution,

⁵⁸For a summary of long-term care systems in several European countries, see da Roit and le Bihan (2010).

⁵⁹This corresponds to an increase in load from 18% to 30% or 40%. Of course, this type of policy could exacerbate adverse selection problems by shutting out healthier individuals from the market. This paper assumes away adverse selection, as justified in Section 2.1.

a cash product produces a welfare gain of \$5,000-\$10,000: these families prefer to insure family care, even at higher premiums. However, on average the wealthiest parents would prefer an ‘in-kind’ insurance policy that covers formal care at a reduced cost to a ‘cash’ insurance policy that covers family care.

Figure 7: Insurance demand and welfare gain of cash benefits at different loads



Note: The left panel reports the percent of parents with long-term care insurance coverage at age 65, by parent wealth quintile. The gray line denotes the percent of parents who do not need long-term care at age 65 (and thus are eligible for long-term care insurance). The red line denotes the matched long-term care insurance coverage reported in Table 10, and the solid green line denotes the insurance coverage rate when the insurance policy provides cash benefits at the same loads as an insurance policy that provides formal care benefits (as in the left panel of Figure 5). The dashed green line denotes the insurance coverage rate when the insurance policy provides cash benefits at a 30% load, and the dotted green line denotes the insurance coverage rate when the insurance policy provides cash benefits at a 40% load. The right panel reports the welfare gain to the family of an insurance policy with cash benefits relative to an insurance policy that only covers formal care. The welfare gain is denominated as the asset transfer to the parent in the absence of the cash benefit that would make the family indifferent between formal care benefits and cash benefits. The green lines correspond to the same insurance policy definitions as in the left panel.

6.3 Medicaid cash

As shown above, an insurance policy with cash benefits has the potential to generate large welfare gains to families, but in practice might be difficult to implement. One policy lever that could be implemented within the existing set of social programs is to replace Medicaid’s ‘in-kind’ benefit with a cash benefit. Indeed, several states are currently piloting cash benefits, such as Arkansas, Florida, and New Jersey (see [Lieber and Lockwood \(2013\)](#)). In terms of model parameters, this is equivalent to a Medicaid benefit of

$$m_t = \max\{0, \underline{c} + ltc_t^{cash} - \lambda_t - [a_t^P + y^P]\} \quad (18)$$

where $ltc_t^{cash} = ltc_t(h_t, F_t = 1)$. In other words, Medicaid pays the cost of long-term care services regardless of whether the parent uses formal or family care.

Table 12 reports the impact of this product on private insurance demand and welfare impacts of this policy. There is virtually no change in private insurance demand. This null effect for poor individuals is unsurprising, since they enrolled in Medicaid even without cash benefits. Individuals with more wealth are not induced to spend down to Medicaid eligibility, however. The fact that they still choose to purchase private insurance in spite of Medicaid’s increased attractiveness implies that they place a high value on protecting their assets.

Table 12: Counterfactual insurance demand with Medicaid cash policy

Asset quintile	Insurance demand	
	Benchmark	Medicaid cash
1 (poorest)	0.01	0.00
2	0.00	0.00
3	0.02	0.00
4	0.05	0.03
5 (wealthiest)	0.21	0.22
<i>Average</i>	0.07	0.06

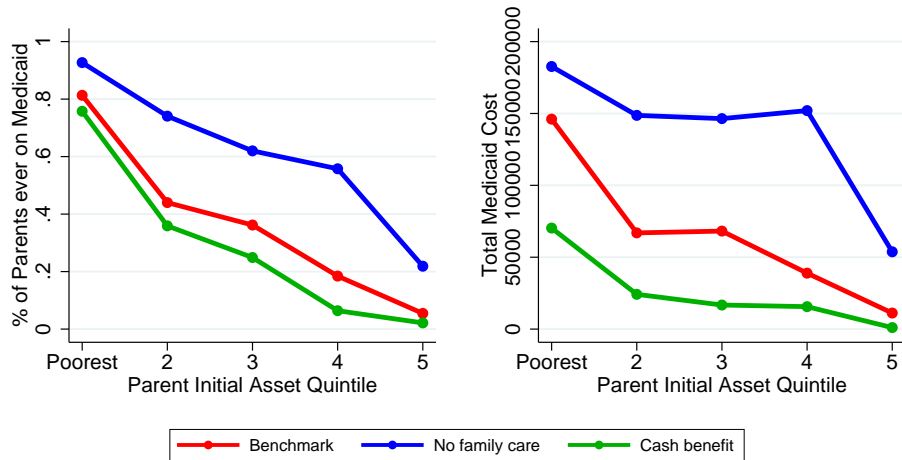
Note: Table reports the long-term care insurance demand by parent wealth quintile. The first column reports the matched insurance coverage rates reported in Table 10. The second column reports the simulated insurance coverage rates when Medicaid provides cash benefits.

6.4 Impacts of counterfactual policies on Medicaid spending

Family care, and its coverage through cash benefits, has potentially large implications for Medicaid enrollment and spending. In the model, parents without available family care spend down to Medicaid for much of the wealth distribution. This suggests that demographic changes in the United States that affect the availability of family care, such as lower fertility rates and higher female labor force participation rates, may place a heavy burden on Medicaid. In contrast, cash benefits - as modeled above as a revenue-neutral stand-alone policy in which total premiums pay total costs - allows individuals to insure

family care and as a result, be less likely to spend down to Medicaid.

Figure 8: Consequences for Medicaid



Note: The left panel reports the percent of parents who ever enroll on Medicaid, by parent wealth quintile. The red line denotes the percent of parents who ever enroll on Medicaid in the estimated scenario, the blue line denotes the percent of parents who ever enroll on Medicaid when family care is unavailable ($fam_t = 0$), and the green line denotes the percent of parents who ever enroll on Medicaid when the insurance policy provides cash benefits. The right panel reports the total cost to Medicaid over the lifetime of the parent for the same scenarios.

The left graph of Figure 8 shows the percent of parents at each wealth quintile who ever qualify for Medicaid in the model. The benchmark scenario, depicted in red, shows that over 80% of the poorest parents eventually end up on Medicaid, and this decreases sharply to less than 10% for the wealthiest parents. Shutting down the ability to use family care when sick increases these numbers significantly (shown in blue), with the largest increases in the middle of the distribution. Intuitively, there are small changes in Medicaid expenditures for poor and wealthy individuals, since poorer parents use Medicaid regardless of the availability of family care, and wealthy parents either have enough savings or purchase insurance. In contrast, parents in the middle of the wealth distribution are the most financially vulnerable to long-term care shocks since they are less able to rely on savings and they do not purchase insurance. Without family care, they choose to spend down to Medicaid eligibility.

Insurance with cash benefits (shown in green) lowers the percent of parents who end up on Medicaid compared to the benchmark scenario slightly, again with most of the difference occurring in the middle of the distribution. The right graph of Figure 8 shows

the average per person total Medicaid cost over the remaining lifetime of the parent. The same general pattern holds between counterfactuals, though the difference in total Medicaid spending between the cash benefits counterfactual and the benchmark model is much larger than the difference in the fraction of parents ever enrolled in Medicaid.

Table 13 quantifies the gaps in the right graph of Figure 8: the final row shows that total Medicaid spending on long-term care would be double its benchmark amount if families did not provide informal care. In contrast, insurance with cash benefits would provide relief to the Medicaid program: Medicaid spending would be 40% of the benchmark amount of spending. The other rows of Table 13 break down long-term care spending by source, first by only direct costs, and then including indirect family care costs priced at the child's hourly wage. In the benchmark scenario, Medicaid pays for 88% of formal long-term care costs, while private insurance and out-of-pocket expenditures split the difference.⁶⁰ Without informal care, the breakdown of formal care costs does not change dramatically, though again the overall dollar amount is much higher since all indirect costs of family care are translated to direct costs of formal services. Finally, an insurance policy with cash benefits shifts the majority (75%) of direct spending to the insurance policy, which pays for itself through premiums as opposed to Medicaid, whose revenue generation process is outside the model. Note that the private insurance costs under the cash benefit counterfactual include payments for family care. For some families this is below the wage-cost of informal care and for others it is above the wage-cost, but it represents the total payout of insurance policies.

When indirect costs of family care are included as the wage value of the child's time, almost two-thirds of long-term care costs are borne by family members in the form of family care. With cash benefits, over half of costs are still borne by family members, even after insurance payments.⁶¹ Overall, Table 13 reveals that family care and its insurance coverage is an important determinant of Medicaid spending.

⁶⁰The fraction paid by Medicaid is higher in the model than the data. This may be due to the fact that the consumption value of nursing homes is not included in long-term care spending in this table. This would skew spending towards non-Medicaid sources since the consumption value of Medicaid nursing homes is low (Hackmann, 2015).

⁶¹A more accurate measure of the cost of family care would be the willingness to pay to get rid of the time cost of family care. Nevertheless, the wage cost is an important benchmark.

Table 13: Long-term care spending, by source

Payer	Benchmark	No Family Care	Cash
<i>Direct costs only</i>			
Medicaid	86.7%	80.1%	22.5%
Out of pocket	7.1%	11.8%	2.1%
Private insurance	6.2%	8.1%	75.4%*
<i>Including family care costs (wages)</i>			
Medicaid	33%	80.1%	11%
Out of pocket	3%	11.8%	1%
Family (wages)	62%	–	52%
Private insurance	2%	8.1%	36%
<i>Medicaid as % of benchmark Medicaid costs</i>	100%	206%	39%

Note: Table reports the percent of long-term care spending paid by source. The first panel, ‘Direct costs only’, does not include un-reimbursed family care (in the final column, reimbursed family care is included). The second panel, ‘Including family care costs (wages)’, includes the costs of family care valued at the child’s wage. The first column corresponds to the estimated (benchmark) scenario. The second column corresponds to the counterfactual scenario in which family care is unavailable ($fam_t = 0$). The final column corresponds to the counterfactual scenario in which the insurance policy provides cash benefits. The final row denotes Medicaid spending in the particular counterfactual as a percentage of the Medicaid spending in the benchmark scenario.

6.5 Consumption insurance

I use the counterfactuals described above to conduct one final exercise about consumption insurance. Risk-sharing models are often useful to examine the response of consumption to shocks as a measure of insurance. I perform this exercise by regressing the change in log consumption on the long-term care need state for the sample of the simulated families whose parents were healthy in the previous period.

$$\Delta \log(c_{it} | h_{i,t-1} = 0) = \alpha + \beta_{light} light + \beta_{intensive} intensive + \gamma' X_{it} + \varepsilon_{it} \quad (19)$$

The coefficients β_{light} and $\beta_{intensive}$ report the degree of transmission of health shocks into consumption: if shocks are fully insured, the coefficients would be zero; otherwise negative. These coefficients are shown in Table 14 for each counterfactual scenario. When the parent has an intensive long-term care shock, her consumption decreases by 17.5% and the child’s consumption decreases by 6%. Without family care, these numbers rise to 27.9% and 19.9%, respectively, implying that the ability to use family care insulates

families - both parents and children - from costly long-term care expenses. With insurance with cash benefits, consumption actually *increases* with an intensive long-term care shock, particularly for the child (a 12.7% increase). Intuitively, since children are spending more time providing care in this counterfactual, and since consumption and leisure are substitutes, the family compensates the child for lost leisure with higher consumption that is more easily afforded due to the cash payouts.

Table 14: Consumption insurance

Counterfactual scenario	Parent	Child
<i>Benchmark</i>		
Light care	-0.129	-0.059
Intensive care	-0.188	-0.065
<i>No family care</i>		
Light care	-0.159	-0.139
Intensive care	-0.281	-0.197
<i>Cash benefits</i>		
Light care	0.007	0.078
Intensive care	0.012	0.128

Note: Table reports the coefficients of a regression of the change in log consumption on whether the parent needs light or intensive long-term care given that the parent did not need care in the previous period, corresponding to equation (19). The first column reports the effect on parent consumption, and the second column reports the effect on child consumption. The first panel, 'Benchmark', corresponds to the estimated (benchmark) scenario. The second panel, 'No family care', corresponds to the counterfactual scenario in which family care is unavailable ($fam_t = 0$). The final panel, 'Cash benefits', corresponds to the counterfactual scenario in which the insurance policy provides cash benefits.

7 Conclusion

This paper argues that informal care by family members plays an important role in long-term care decisions. I build and estimate a dynamic model of long-term care decisions between an elderly parent and her adult child to examine (1) whether the availability of informal care can explain the low demand for long-term care insurance and (2) what the interaction between informal care and insurance reveals about optimal long-term care

policy.

I find that the availability of informal care lowers the demand for long-term care insurance by 29 percentage points for the wealthiest 20% of parents. In contrast, insurance demand for the rest of the wealth distribution is largely crowded out by Medicaid. In counterfactual insurance exercises, I show that introducing a policy that compensates the family for providing long-term care induces almost full take-up. Moreover, this type of policy can generate welfare gains to families of up to \$15,000-\$20,000. These magnitudes are comparable in absolute terms to the value of delaying Medicare eligibility from age 65 to age 67 (Khwaja, 2010). These results suggest that the fact that current insurance policies do not cover informal care is a key reason for the low demand for insurance.

More generally, the prevalence of informal care has important implications for long-term care policy in the United States. The availability of informal care can have substantial effects on the size of the Medicaid program: I find that the removal of informal care would double Medicaid expenditures for long-term care. These results suggest that future demographic changes that impact the availability of informal care (through lower rates of fertility, for example) may impose a heavy burden on Medicaid. Second, insurance that compensates the family not only is welfare-improving to families, but also significantly reduces Medicaid spending. Several countries around the world have implemented such insurance programs; policy discussions in the United States should continue to consider them.

Appendix A Multiple Children

The model in Section 4 is restricted to interactions between a parent and only one child. In my sample of single elderly retirees, however, most parents have multiple children. In what follows, I show that despite the existence of multiple potential caretakers, parents receive the majority of care by one child. I then discuss potential additions to the model to allow for multiple children.

Appendix Table A1 reports statistics for families in the sample that report at least one child caregiver over the sample period, similarly to [Fahle \(2014\)](#). The first row shows that the majority (85.3%) of parents have multiple children. The second row shows the percent of parents who receive care from only one child caregiver over the 1998-2010 sample period, split by the number of children. In the majority of cases, a single caretaker provides all family care hours. For parents with two children, in 76% of cases only one child provides care; for parents with four children this decreases to 61%. However, though there is a significant number of parents with multiple caregivers, the third and fourth rows show that most of the hours of care are provided by one caregiver. Across all families in this sample, 92% of child caregiver hours over the sample period are provided by one child. Conditional on having multiple caregivers, the percent decreases to 73%, but that is applicable to less than one-third of the sample. Overall, these numbers show that despite the presence of several multiple child-caregiver families, the vast majority of hours are provided by a single child caregiver.

Table A1: Caregiving characteristics of families with multiple children

	Number of Children					Total
	1	2	3	4	5+	
% of sample	14.7	25.5	19.7	13.8	26.4	100
% with only one caregiver	100	76.1	66.0	60.6	50.0	68.6
% of hours by main caregiver	100	94.1	92.3	88.3	85.5	91.5
% of hours by main caregiver multiple caregivers	–	75.3	77.3	70.4	70.9	73.0

Note: Table reports the caregiving characteristics of children of single retirees aged 65 and over who receive long-term care from their children at some point in the 1998-2010 HRS. The main caregiver is defined as the child who provides the most hours of care (ties broken randomly).

Several studies have examined long-term care decisions within a multiple caregiver framework. Most of these studies are static (e.g [Brown \(2006\)](#)), with a few exceptions ([Hiedemann, Sovinsky, and Stern, 2013](#)), and none within a structural, life-cycle framework. From the results of Table A1 and the findings from previous studies that key drivers of long-term care decisions are inherently dynamic (i.e. savings and spend-down to Medicaid), this paper abstracts from the modeling complexities of multiple children to concentrate on the life-cycle dimension of long-term care.

My approach minimizes the biases that could arise in a one-child model by selecting the child most likely to care. There are two main outcomes that may cause bias: (1) the model gives the entire bequest to one child, and (2) the model assigns all family care to one child. Most studies have found that the majority of bequests are split equally between children, but of the 20% of cases of unequal bequests, most are a result of altruistic and exchange motives involving elderly care ([Light and McGarry, 2004](#)). In order to match child assets, the model may underestimate the parent altruism parameter (η), which affects bequest size and therefore future assets of the child. By assigning all informal care one child, the model may overestimate guilt (g), underestimate the value of leisure ($1 - \alpha$), and overestimate in absolute terms the disutility of formal care (z). Many of these effects lower the opportunity cost of a child's time, which in turn would lower the demand for insurance. On the other hand, side payments by non-caregiving children to caregiving children (as discussed in [Engers and Stern \(2002\)](#)) would mute these biases.

Appendix B Child problem after parent's death

After the death of the parent at time $t = t_d$, I continue to model the child until time T , which is roughly the retirement age of the child. The child continues to face wage risk, and chooses consumption and labor supply to maximize:

$$V_t^K(a_t, w_t) = \max_{c_t^K, \ell_t^K} u(c_t^K, \ell_t^K) + \beta E_t V_{t+1}(a_{t+1}, w_{t+1}) \quad (20)$$

subject to her time constraint: $\mathcal{T} = L_t + \ell_t$ and her per-period budget constraint:

$$a_{t+1} = (1 + r)[a_t + L_t w_t - c_t^K] \quad (21)$$

in which $a_{t_d} = a_{t_d}^K + a_{t_d}^P$, again with a consumption floor $c_t^K \geq \underline{c}$ and $a_t \geq 0$. The child's per-period utility remains the same over consumption c_t^K and leisure ℓ_t but excludes potential guilt:

$$u(c_t^K, \ell_t^K) = \frac{[(c_t^K)^\alpha (\ell_t^K)^{1-\alpha}]^{1-\gamma}}{1-\gamma} \quad (22)$$

The model ends with the terminal value as shown in equation (5).

Appendix C Dynamic models of altruism

In the model in Section 4, parents exhibit altruism to their children, but children do not exhibit altruism to their parents. This appendix discusses the theoretical challenges in dynamic models with one- and two-sided altruism. I restrict the discussion to a model with non-cooperation (in a model with full commitment, altruism simply adjusts the Pareto weights).

I begin by reviewing the fact that even a very simple dynamic model with one-sided altruism has stark predictions over transfer behavior. Consider a two-period model of one-sided altruism between a parent and child in which both parent and child can save and the child's second period income is uncertain. In this model, [Altonji, Hayashi, and Kotlikoff \(1997\)](#) show that transfers depend critically on the child's second period income and the degree to which the child is liquidity constrained. If the child is not liquidity constrained, the parent will refrain from transfers in the first period. She does this first to avoid regretting a first period transfer if the child receives a high income realization in the second period. She also does this to overcome the 'Samaritan's dilemma' ([Lindbeck and Weibull, 1988](#)) in which the child would over-consume in the first period in order get more transfers. By restricting transfers to the second period, the parent restricts over-consumption in the first period because of the threat of zero transfers in the second period if the child receives a high income realization. On the other hand if the child is liquidity

constrained, she cannot intertemporally smooth her income without transfers. In this case, the parent may provide transfers in the first period by trading of the benefit to the child and the costs mentioned above.

This simple model demonstrates that even with one-sided altruism, dynamic interactions lead to the stark prediction that the parent will withhold most transfers until all uncertainty is revealed. The non-cooperative solution in my model adopts this feature: by assumption, the parent provides a bequest at death, but no inter-vivos transfers. However, in equilibrium the parent and child cooperate and inter-vivos transfers occur.⁶² In this way, my model still rationalizes the fact that transfers occur in the data.

A few studies have examined two-sided altruism in a dynamic model, but few without restrictions to dynamic behavior. [Foster and Rosenzweig \(2001\)](#) use a limited commitment model with two-sided altruism with no savings. [Fahle \(2014\)](#) estimates a life-cycle model between a parent and child with two-sided altruism, but does not allow the child to save. Two main exceptions in which both agents can save are [Barczyk and Kredler \(2014a\)](#) and [Barczyk and Kredler \(2014b\)](#). These models, which are somewhat stylized, show that the mechanisms of the two-period model extend to an infinite-horizon setting. They characterize a ‘dynamic Samaritan’s dilemma’ in which both agents over-consume. In addition, transfers are delayed until an agent is constrained (a ‘race to the bottom’). However, these predictions are not fully borne by the data: if anything, parents continue to accumulate assets well into old-age. To avoid these stark predictions, the model in this paper assumes partial commitment, which is able to match asset accumulation paths of both parents and children.

Appendix D Numerical Solution

There is no analytic solution to this model. Instead, I numerically solve the model using backward induction from the final period T with the terminal value function $V_{T+1}^K(a_{T+1}^K) = \phi \frac{(a_{T+1}^K)^{1-\gamma}}{1-\gamma}$. I first describe the solution to the child’s problem after the parent’s death, then

⁶²In my sample, parents transfer money to their children over a two-year period in fewer than 10% of cases. In those cases, the mean and median amounts are \$6,900 and \$2,700, respectively.

I describe the solution to the non-cooperative problem, and finally the solution to the cooperative problem.

The problem of the child after the parent's death has two state variables in addition to age: assets and wage and two decision variables: consumption and labor supply. I discretize the state space and solve by backward induction. At each point in the state space, I solve conditional value functions for each labor supply option and choose the maximum conditional value function. For each conditional value function, I use a golden search to obtain optimal consumption/savings and use linear interpolation to evaluate continuation values between asset gridpoints.⁶³

The non-cooperative problem has six state variables in addition to age: parent and child assets, parent permanent income, child wage, parent long-term care needs, and whether the parent owns long-term care insurance. The parent chooses consumption/savings (and long-term care insurance in the first period) and the child chooses consumption/savings and labor supply. I again discretize the state space and solve the problem by backward induction with the terminal value function. Within each period, I additionally discretize the consumption/savings decisions of the parent and child and compute conditional value functions for all possible consumption and labor supply choices, still using linear interpolation to evaluate continuation values between asset gridpoints. I first assign the child's choice conditional on each parent choice, and then going backward within the period, assign the parent's choice. This pins down the child's decision.

The cooperative problem has the state variables in the non-cooperative problem as well as the Pareto weight.⁶⁴ The parent and child jointly make choices over individual consumption/savings for the parent and child, whether the parent uses formal or informal care if she needs long-term care, the labor supply of the child, and whether to purchase long-term care insurance in the first period. The state variables are discretized and I solve the problem by backward induction with the terminal value function. At each

⁶³As [Low and Pistaferri \(2010\)](#) discuss, value functions are not necessarily concave in assets – even conditional on labor supply in time t – because of future changes in labor supply. However, enough uncertainty should make the expected future value function concave.

⁶⁴I simplify the state space by normalizing one Pareto weight to θ_t and the other to $1 - \theta_t$, so that I only have to condition on one weight. This does not affect the within-period distribution of resources between the parent and child, though it may slightly affect the cross-period distribution of resources.

point in the state space, I solve conditional value functions for each labor supply and type of care option and choose the maximum conditional value function. For each conditional value function, I discretize the choice over the distribution of future assets and use a golden search to obtain optimal total consumption. I use linear interpolation to evaluate continuation values between asset gridpoints.

The solution method to determine the evolution of the Pareto weights largely follows the solution to limited commitment problems outlined in [Voena \(2015\)](#):

1. Maximize $V_T(\omega_T)$ subject to the family budget constraint and the child's time constraint at weights corresponding to the state variable (i.e. not updated). Call the parent- and child-specific solutions $V_T^{*P}(\omega_T)$ and $V_T^{*K}(\omega_T)$.
2. Check to see if $V_T^{*P}(\omega_T)$ and $V_T^{*K}(\omega_T)$ satisfy their respective participation constraints, equations (11) and (12). In other words, check to see if these values are larger than the respective values of the non-cooperative solution. There are three possibilities.
 - (a) If both participation constraints hold for both the parent and the child, then the solution to the cooperative problem at time T is $V_T^{*P}(\omega_T)$ and $V_T^{*K}(\omega_T)$.
 - (b) If the parent's participation constraint holds and the child's participation constraint does not hold, then the overall weight must shift such that solving:

$$\max_{q_T, M_T^K} (\theta_T - M_T^K) U_T^P(c_T^P, F_T, U_T^K) + (1 - \theta_T + M_T^K) U_T^K(c_T^K, \ell_T^K, NC_T = 0)$$

subject to the family budget constraint and child time constraint leads to the child's value $V_T^{**K}(\omega_T)$ such that $V_T^{**K}(\omega_T) = Z_T^K(\omega_T)$ where $Z_T^K(\omega_T)$ is the child's value of the non-cooperative problem. Then the solution at time T is $V_T^{**P}(\omega_T)$ and $V_T^{**K}(\omega_T)$.⁶⁵

- (c) If the child's participation constraint holds and the parent's participation con-

⁶⁵In practice I discretize the choice of M_T^K (and M_T^P in the next possibility) so that $(\theta_T - M_T^K)$ falls on one of the same discretized values of θ_T .

straint does not hold, then the overall weight must shift such that solving:

$$\max_{q_T, M_T^P} (\theta_T + M_T^P)U_T^P(c_T^P, F_T, U_T^K) + (1 - \theta_T)U_T^K(c_T^K, \ell_T^K, NC_T = 0)$$

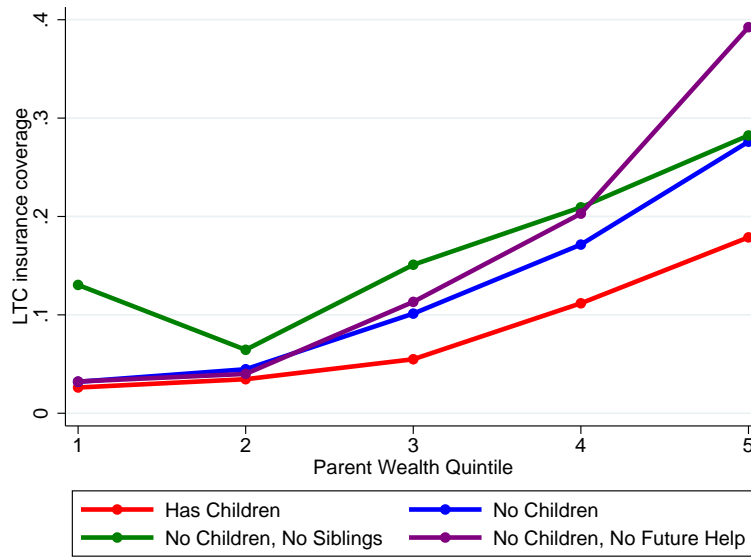
subject to the family budget constraint and child time constraint leads to the parent's value $V_T^{***P}(\omega_T)$ such that $V_T^{***P}(\omega_T) = Z_T^P(\omega_T)$ where $Z_T^P(\omega_T)$ is the parent's value of the non-cooperative problem. Then the solution at time T is $V_T^{***P}(\omega_T)$ and $V_T^{***K}(\omega_T)$.

Because there is always positive surplus to cooperation, a fourth possibility of neither participation constraint satisfied should never occur.

3. With these solutions, the problem continues backwards to time $T - 1$, in which the problem is set up analogously and uses the continuation values computed in Steps (1) and (2).

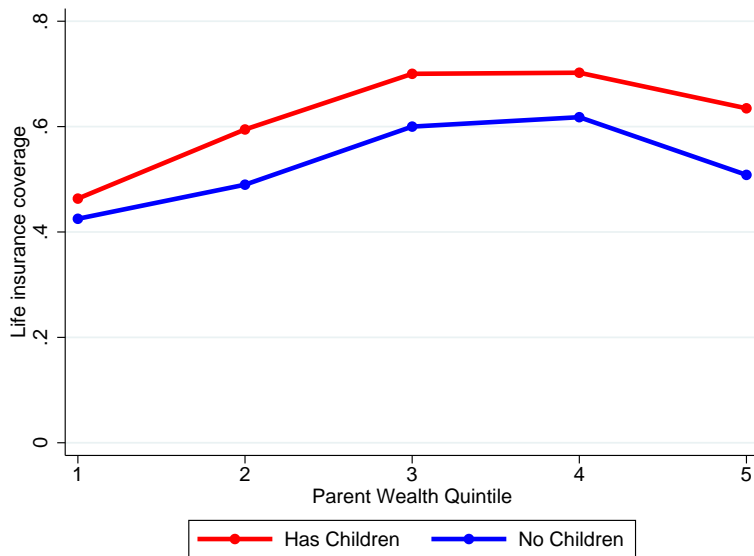
Appendix E Additional tables and figures

Appendix Figure 1: Long-term care insurance coverage by wealth quintile, more categories



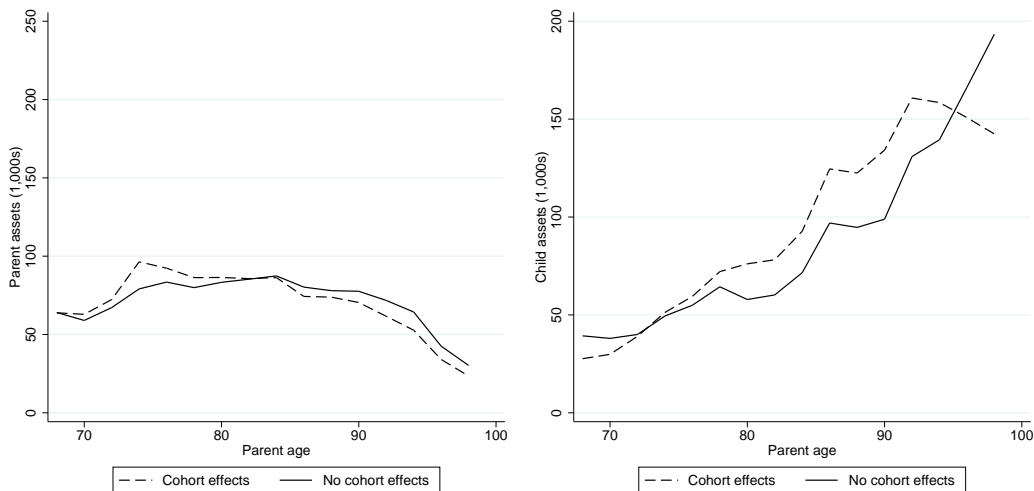
Note: The sample includes single individuals aged 60-69 in the pooled 1998-2010 Health and Retirement Study. The red line graphs the percent of individuals *with children* who own a long-term care insurance policy, by wealth quintile (from the poorest quintile on the left to the wealthiest quintile on the right). The blue line graphs the percent of individuals *without children* who own a long-term care insurance policy. The green line graphs the percent of individuals *without children and without siblings* who own a long-term care insurance policy. The purple line graphs the percent of individuals *without children and without future prospects for informal care* who own a long-term care insurance policy.

Appendix Figure 2: Life insurance coverage by wealth quintile



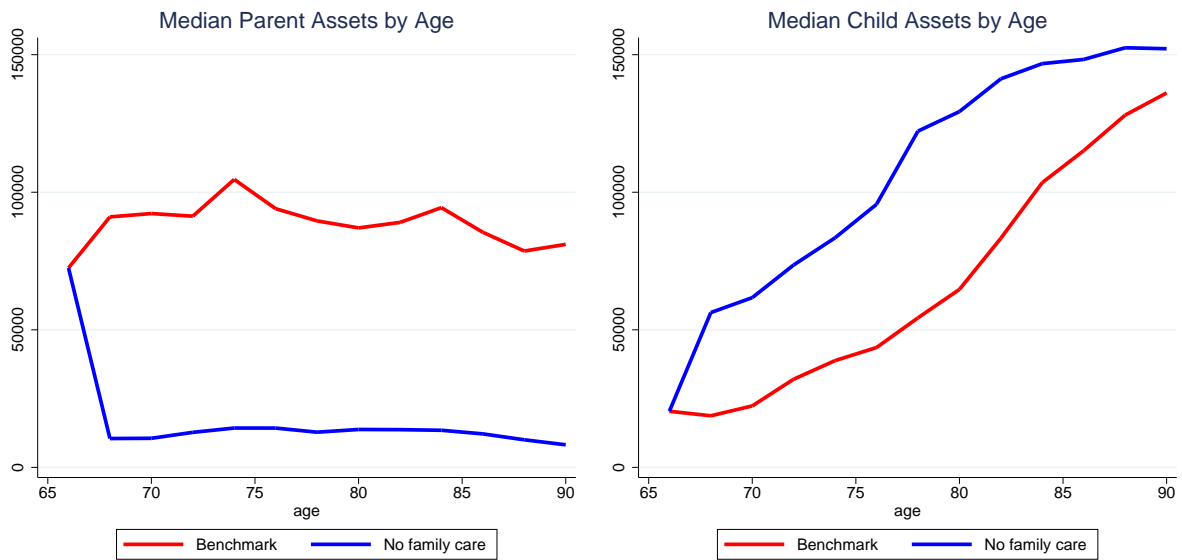
Note: The sample includes single individuals aged 60-69 in the pooled 1998-2010 Health and Retirement Study. The red line graphs the percent of individuals *with children* who own a life insurance policy, by wealth quintile (from the poorest quintile on the left to the wealthiest quintile on the right). The blue line graphs the percent of individuals *without children* who own a life insurance policy.

Appendix Figure 3: Wealth of parent and child, with and without cohort effects



Note: The left figure reports median parent wealth (in \$1,000s) in the HRS. Wealth is defined as total assets less debts. The dashed line denotes the raw wealth data and the solid line denotes median wealth controlling for cohort effects. The right figure reports the same measures for child wealth (in \$1,000s) from the PSID.

Appendix Figure 4: Counterfactual wealth paths: the impact of family care



Note: The left figure reports median simulated parent wealth. The red line denotes median matched wealth as shown in Figure 2. The blue line denotes median wealth when family care is unavailable ($fam_t = 0$). The right figure reports the same measures for child wealth.

Appendix Table 1: Model Notation

Symbol	Definition
Functions	
U_t^P, U_t^K	Utility functions of parent, child
V_t^P, V_t^K	Value functions of parent, child
V_{T+1}^K	Terminal value function of child
Z_t^P, Z_t^K	Non-cooperation value functions of parent, child
State variables (ω_t)	
a_t^P, a_t^K	Assets of parent, child
y^P	Permanent income of parent
w_t^K	Wage of child
h_t	Long-term care need of parent
l_{tci}	Insurance policy holder indicator
θ_t^P, θ_t^K	Pareto weights
Decision variables (q_t)	
c_t^P, c_t^K	Consumption of parent, child
a_{t+1}^P, a_{t+1}^K	Next period assets of parent, child
ℓ_t^P, ℓ_t^K	Leisure of parent (set), child
L_t	Hours worked for child $\in \{0, 1000, 2000\}$
F_t	Formal care $\in \{0, 1\}$
fam_t	Family care $\in \{0, 1000, 2000\}$
NC_t	Non-cooperation $\in \{0, 1\}$
μ_t^P, μ_t^K	Adjustments to Pareto weights
Model Parameters	
z	Formal care preference
η	Parent altruism
g	Child guilt
α	Consumption-leisure trade-off
ϕ	Terminal value multiplier
γ	RRA
r	Interest rate
β	Discount rate
ξ_t	Child permanent wage shock
Policy environment	
m_t, SSI_t	Medicaid, SSI benefit
\underline{c}	Consumption floor
l_{tct}	Long-term care cost
λ_t	Net insurance benefit
\mathcal{T}	Total hours in a year

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