Accepted Manuscript

Title: The design of long term care insurance contracts

Author: Helmuth Cremer, Jean-Marie Lozachmeur, Pierre Pestieau

PII: S0167-6296(16)30213-2
DOI: http://dx.doi.org/doi: 10.1016/j.jhealeco.2016.08.008
Reference: JHE 1966

To appear in: *Journal of Health Economics*

Received date: 8-9-2015
Revised date: 2-5-2016
Accepted date: 28-8-2016

Please cite this article as: Helmuth Cremer, Jean-Marie Lozachmeur, Pierre Pestieau, The design of long term care insurance contracts, *Journal of Health Economics* (2016), http://dx.doi.org/doi: 10.1016/j.jhealeco.2016.08.008.

The design of long term care insurance contracts[1]

Helmuth Cremer[2], Jean-Marie Lozachmeur[3] and Pierre Pestieau[4]

May 2015, revised April 2016

[1]This paper was presented at the EHEW in Toulouse. We thank all the participants and particularly our discussant, Jan Boone, for their comments and suggestions. We are also grateful to the editor Martin Chalkley and three referees for their constructive comments. Financial support from the Chaire "Marché des risques et création de valeur" of the FdR/SCOR is gratefully acknowledged.

[2]Toulouse School of Economics (GREMAQ, IDEI and Institut universitaire de France).

[3]Toulouse School of Economics (GREMAQ-CNRS and IDEI), 21 Allée de Brienne, 31000 Toulouse, France; e-mail: jean-marie.lozachmeur@tse-fr.eu.

[4]CREPP, Université de Liège; CORE, Université catholique de Louvain and TSE.

Abstract

This paper studies the design of long term care (LTC) insurance contracts in the presence of *ex post* moral hazard. While this problem bears some similarity with the study of health insurance (Blomqvist, 1997) the significance of informal LTC affects the problem in several crucial ways. It introduces the potential crowding out of informal care by market care financed through insurance coverage. Furthermore, the information structure becomes more intricate. Informal care is not publicly observable and, unlike the insurer, caregivers know the true needs of their relatives. We determine the optimal second-best contract and show that the optimal reimbursement rate can be written as an A-B-C expression à la Diamond (1998). These terms respectively reflect the efficiency loss as measured by the inverse of the demand elasticity, the distribution of needs and the preferences for risk sharing. Interestingly, informal care directly affects only the first term. More precisely the first term *decreases* with the presence and significance of informal care. Roughly speaking this means that an efficient LTC insurance contract should offer lower (marginal) reimbursement rates than its counterpart in a health insurance context.

JEL classification: I13, I18, H51.