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The role of life experience in long-term care insurance decisions

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ABSTRACT

This study uses data from a unique survey of the retirement planning behaviors of late middle-aged individuals living in New York State, to test hypotheses regarding the role of earlier life experiences on the demand for long-term care insurance. Our primary focus is on previous provision of informal long-term care, which some studies have found to be correlated with demand for long-term care insurance. We add to the literature by providing a test for causal relationships between previous care-giving and insurance demand, and by exploring the more generally the mechanisms through which previous life experiences are linked to insurance demand. Results are robust to a variety of empirical specifications and estimation methods, including consideration of current care-giving roles and endogenous selection into previous care-giving, and strongly support a causal relationship between previous long-term care-giving and demand for insurance. Our estimates also provide evidence that lifetime health trajectories and family relationships are associated with long-term care insurance demand, and suggest that both emotional and informational forces influence demand.

1. Introduction

Long-term care is one of the major future liabilities of the aging population in many countries. In the U.S., annual expenditures on long-term care are $203.1 and are projected to rise to $399.7 billion per year by 2019 (Centers for Medicare and Medicaid Services (CMS), 2010). Expenditures on long-term care averaged 1.5% of GDP among the OECD countries in 2008, and are expected to double by 2030 (Colombo, Llena-Nozal, Mercier, & Tjadens, 2011, de la Maisonneve & Martins, 2013). Public expenditures on long-term care greatly outweigh private expenditures in all countries, and sustainability in the face of projected cost growth is an important public policy concern. Some countries have social insurance programs for long-term care but these often have strict eligibility thresholds and require user cost-sharing; moreover, most do not cover the costs of board and lodging associated with institutionally-provided care (Colombo et al., 2011). Continued cost-shifting to private individuals seems likely as public funding pressures increase (e.g. Mayhew, Karlsson, & Rickayzen, 2010).

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Private long-term care insurance is a potential funding mechanism for the costs of long-term care that must be borne by individuals. However, despite the insurable features of the risk and the availability of private long-term care insurance in many countries, relatively few of the elderly and near-elderly have purchased insurance.[2] Private insurance penetration is highest in the U.S., but even there only 7.6% of current long-term care expenditures are funded by private insurance (CMS, 2010) and only 10% of the population at risk for future long-term care own private insurance (Kim, 2010). Low rates of private insurance purchase have also been noted as a public policy concern in other countries (Comas-Herrera, Butterfield, Fernandez, Wittenberg, & Wiener, 2012, chap. 4; Courbage & Roudaut, 2008; Zhou-Richter, Browne, & Grundl, 2010).

This study adds to the literature aimed at understanding the determinants of private insurance demand. Previous studies of the low ownership rate in long-term care insurance suggest that the most important issues may be those related to consumer demand (Brown and Finkelstein, 2007). They find that while long-term care insurance policies are characterized by high prices and limited benefits, these do not appear to be the main drivers of the low rate of insurance purchase. Indeed, Cramer and Jensen (2006) find that the demand for long-term care insurance is relatively price-inelastic. Other authors have found that individual differences in risk preference, knowledge, or attitudes influence long-term care insurance demand. Finkelstein and McGarry (2006) conclude that 'cautious' individuals are more likely to purchase long-term care insurance, but are no more likely than others to utilize long-term care services. Zhou-Richter et al. (2010) conclude that downwardly-biased risk perceptions account for the low rate of long-term care insurance purchase in Germany. McCall, Mangle, Bauer, and Knickman (1998) and Coronel (2000) find notable differences between purchasers and non-purchasers in knowledge of and attitudes toward long-term care use and financing.

What is lacking in the literature is understanding of the factors that contribute to these differences across consumers. To shed light on this issue, this study examines the role that earlier life experience with providing informal long-term care to others may have in determining demand for long-term care insurance. The near-elderly are often care-providers to family members, or may have previously provided care to their own parents. Spillman and Black (2005) estimate that 93% of U.S. elderly with disabilities who live in the community receive some informal care; and nearly two-thirds of them rely solely on informal care. Kaye, Harrington, and Laplante (2010) report that family members make up the vast majority of informal care providers. OECD reports document this same pattern in other countries as well (Fujisawa & Colombo, 2009).

Previous research studies have found an association between prior experiences with long-term care and decisions to purchase long-term care insurance. McCall et al. (1998) find a direct relationship between knowing someone (a close friend or a relative) who needed long-term care and purchase of long-term care insurance. Analyzing demand for long-term care insurance in France, Courbage and Roudaut (2008) find that having provided informal care to family positively affects the probability of purchasing long-term care insurance. Our study adds to this literature by providing a stronger test for causal relationships between previous long-term care-giving and the demand for long-term care insurance, and by exploring the mechanisms through which previous care-giving is linked to insurance demand.

Psychological literature in insurance suggests that an individual's previous experience may affect insurance decisions by changing knowledge, attitudes and risk perceptions. For example, informal care-giving may increase awareness of long-term care risk, affecting insurance demand by raising the perceived probability of needing care (Courbage and Roudaut, 2008). Alternatively, care-giving may affect insurance demand through emotional responses which increase the salience of long-term care risk. Ranyard and McHugh (2012) argue that emotional responses create a link between past risk and future insurance purchases, and provide experimental evidence confirming this link. Our study looks for evidence of these linkages in insurance demand using household survey data.

The study uses data from a unique survey of the retirement planning behaviors of late middle-aged individuals living in the state of New York. The survey includes information on respondents' life histories of work, family, health and leisure, in addition to measures of demand for long-term care insurance. These richly detailed data provide a window into individual's experiences prior to (being at risk for) long-term care insurance purchase. This permits examination of links between previous long-term care-giving and demand for long-term care insurance. Availability of other variables – including current care-giving roles, engagement in service activities, lifetime health trajectories and family relationships – provides an extensive set of controls that help to identify causal relationships and facilitates greater understanding of the related to insurance demand.

The remainder of the paper is organized as follows. Section 2 discusses theoretical perspectives on the determinants of long-term care insurance demand with a focus on the institutional context in the U.S., and presents the main hypotheses to be tested. Section 3 describes the data, empirical models, and estimation strategies and Section 4 previews the respondent sample. Section 5 describes the results of estimation. The final section of the paper presents interpretations and conclusions.

2. Demand for long-term care insurance in the U.S

2.1. Traditional models of insurance demand

Long-term care risk resembles other types of risks that are made privately insurable through long-term contracts: it has a low probability of realization early in life, the lifetime risk varies greatly across individuals, and its realization involves high

[2] Analysts note that an important reason for the lack of private long-term care insurance in some countries is crowd-out by public insurance schemes (Kessler, 2008, Mayhew et al., 2010).