

Out-of-Pocket Medical Expenses and Retirement Security

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The overall cost of health care for older Americans has grown significantly over time and will continue to grow in the future. Some of this cost is paid for by Medicare, some by Medicaid, some by employer-provided health insurance plans, some by privately-purchased health insurance supplements, some by privately-purchased long-term care insurance, and some out-of-pocket. There is an important financial obligation and risk to retirees associated with health care costs that are paid out-of-pocket, through both insurance premiums and direct payments to providers. This study explores recent trends in out-of-pocket medical costs, the implications of out-of-pocket medical spending for financial security in retirement, and what might be expected in the future.

The extent to which routine or median out-of-pocket health care spending increases in the future – and the extent to which the risk of very high out-of-pocket health care spending increases – could have very large effects on the financial resource needs of retiring households in the future. If, for example, out-of-pocket expenditures continue to rise at their historical rates, and if employers continue to drop retiree health benefits, then current baby boomers could be facing a “perfect storm” of less comprehensive insurance coverage at just the ages when chronic illness and health care service utilization are increasing.

There are several reasons why past estimates of out-of-pocket expenditures appear modest, and may be poor indicators of the future. First, many of the studies use data from past decades, when out-of-pocket expenditures were less. In this study, we analyze HRS data through 2006. Second, previous studies may have missed certain expenses associated with illness, such as additional domestic help or specialized and poorly documented end-of-life care. This study attempts to include these broader expenses by including in the analysis the “exit” interviews in the HRS, which (to our knowledge) have not been studied previously. Third, there remains a question of how much of out-of-pocket expenditures are for “necessary” services, and how much are for “supplementary” or “discretionary” services that may be means-dependent. We consider this last question by distinguishing among categories of out-of-pocket expenditures, some of which are likely to be independent of income and covered by insurance, such as hospital expenditures, doctor visits, or prescription drugs; and some of which may be income dependent and not covered by insurance, such as in-home nursing services, accommodations through ramps, housekeeping, and special beds.

The primary finding of the study is that out-of-pocket health care expenditures are both larger than previous estimates and growing over time. We find, in addition, that spending for hospital and nursing home care is largely independent of means, or inelastic; while spending on in-home medical services and special facilities varies more significantly with wealth. In sum, the estimates suggest that the burden of out-of-pocket expenditures is large, with evidence of continued growth. These results are suggestive that, should current trends prevail, current baby boomers might be encountering considerably more out-

of-pocket expenditure risk in the future, particularly among widows whose nest egg is depleted by caring for their spouse.

We recognize several limitations to the study. First, we have not explored the evolution of medical technology and the growing availability of medical services and devices that may be purchased with out-of-pocket funds in the future. Second, we have not considered the family as an insurance market, and the extent to which elderly households who do suffer medical setbacks may receive increased financial transfers from children or other relatives. Third, we do not know how reported out-of-pocket medical expenses by HRS respondents correspond to the costs actually incurred or billed, or the extent of charity care provided because of an inability to pay. Nonetheless, our results suggest that out-of-pocket medical expenditures are a very important component of financial need for a surprisingly large fraction of elderly people in the United States.

The full working paper is available on our website, www.nber.org/programs/ag/rrc/books&papers.html as paper NB07-03.

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