

Lifetime Cost of Bad Health

(Preliminary)

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Abstract

How costly is it to be unhealthy? And what makes good health valuable? In this paper, we investigate the pathways through which health affects lifecycle outcomes. We distinguish between instantaneous and accumulated effects of bad health: the latter effect depends on how long the sickness lasts and can be substantial when unhealthy status is highly persistent. To provide a detailed picture of these effects, we start by estimating the health shock process that allows for state-dependence and fixed heterogeneity and that is consistent with a wide range of data moments constructed from the PSID and the HRS. Next, we feed this health shock process into a rich structural life-cycle model. The estimated model is consistent with two important sets of empirical facts: i) the quantitative impact of bad health on earnings, medical spending, labor supply and life expectancy; ii) the large disparity in accumulated wealth over lifecycle between the healthy and the unhealthy. We show that the costs of bad health are steeply increasing with the number of years an individual spend being unhealthy over the working life. The largest component of these costs is the loss in productivity while the contribution of out-of-pocket medical spending is relatively small. To account for non-monetary effects of health, we evaluate the willingness to pay to stay healthy. Our decomposition exercise shows that by far the most valuable aspect of being healthy is the longer life expectancy.