Abstract

A nursing home stay towards the end of life is one of the biggest risks faced by Americans over the lifecycle. The annual cost of a nursing home stay in 2010 was $84,000. At age 50 the probability of a nursing home stay ranges between 50-59 percent and among those who have a stay, 20 percent will spend more 3 years in a nursing home. It is thus puzzling that only about 10 percent of U.S. retirees purchase private long-term-care (LTC) insurance. Previous research has emphasized that Medicaid crowds out the demand for private LTC insurance. However, rejection rates for private insurance are also high in the U.S. Nearly 40 percent of the potential pool of purchasers would be rejected if they applied for private LTC insurance using current screening guidelines. This paper explores the possibility that high rejection rates are due to adverse selection. We propose a model in which agents have private information about their risk of a nursing home stay and model the private and public provision of LTC insurance. Our model accounts for low coverage rates and high rejections of private LTC insurance and is then used as a laboratory for considering welfare enhancing reforms of private and public provision of LTC insurance.