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DO OUT-OF-POCKET HEALTH CARE COSTS DELAY RETIREMENT?

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Rising health care costs threaten many older Americans' financial security. Health care costs have been increasing rapidly in recent decades, and much of these costs are paid by consumers of all ages. Medical expenses now consume a substantial share of household spending in retirement and that share is likely to rise in the future as costs continue to escalate. Cutbacks in employer-sponsored retiree health benefits add to the difficulty that many older Americans face paying for health care.

People may respond to these financial pressures by delaying retirement. For those receiving health benefits from their employers, continued work reduces the risk of high out-of-pocket health care costs. Working longer also increases retirement incomes — making health care costs more affordable — by raising people's earnings, boosting their Social Security and employer-sponsored pension wealth, and improving their ability to save, as well as by reducing the number of years over which retirement wealth must be spread. Employment rates for older men, in fact, have been rising in recent years, after falling sharply for most of the last century. Future increases in health care costs could further delay retirement in coming years.

This paper examines the impact of expected future out-of-pocket medical spending on retirement decisions. The analysis considers two types of out-of-pocket health care costs — real health insurance premium costs associated with retirement before age 65, and the expected stream of future real health care costs from age 65 until death. The premium cost of retirement is defined as the increase in health insurance premium expenses that workers would pay if they retired, relative to what they would pay if they remained at work. The measure equals the net present value of this stream of costs from the age at which workers are first observed until they reach the Medicare eligibility age of 65, because the premium savings associated with employer coverage is modest for those eligible for Medicare. These premium costs vary with health insurance coverage, and are especially large for workers with employer-sponsored health benefits that do not continue into retirement.

The study also computes the increase in spousal premium costs associated with retirement before age 65. Many workers (especially men) provide employer health benefits to their spouses, and the loss of these spousal benefits increase retirement costs.

The lifetime stream of expected future out-of-pocket health care costs beginning at age 65 consists of Medicare premiums, premiums for supplemental private insurance, and direct payments to health

care providers. For married workers the cost stream also includes expected future out-of-pocket premiums and provider payments for the spouse. The computations assume that everyone offered retiree health benefits from their employer will participate in the plan, and that everyone without access to employer-sponsored retiree benefits will purchase Medigap coverage to supplement Medicare. Expected out-of-pocket payments to health care providers are estimated are based on age, health insurance coverage, and health status while working. The analysis assumes that people expect recent changes in health care costs to continue indefinitely.

The study estimates discrete-time hazard models of the retirement decision as functions of the premium costs associated with retirement before age 65, the increase in spousal premium costs associated with retirement, and the expected stream of future real health care costs after 65. Controls include overall health status, health-related work limitations, pension coverage, annual earnings, household net worth, race, education, marital status, and age. The analysis defines retirement as complete withdrawal from the labor force. The sample includes respondents from the Health and Retirement Study age 52 to 63 in 1994 who are employed full time as wage and salary workers. The survey extends through 2004. Models are estimated separately for men and women.

The results show that the premium costs associated with retirement before age 65 and expected out-of-pocket health care costs after 65 substantially delay retirement.

- When calculated using a 3-percent discount rate, a \$1,000-increase in the own premium cost of retirement before age 65 lowers the likelihood that both men and women retire by about 0.1 percentage points, implying an elasticity of about -0.058 for both groups.
- The spousal premium cost of retirement does not significantly affect retirement decisions for either men or women. Because few husbands rely on their wives for health insurance coverage, this result is not surprising for women, but somewhat surprising for men. The lack of a significant effect may reflect the imprecision of the measure.
- The present discounted value of expected post-65 health care costs reduces retirement probabilities. The effect is marginally significant for men and women ($p < .10$) when computed using a 10-percent discount rate, and marginally significant for men only when computed using a 3-percent discount rate. The effect is not significant for women with the 3-percent discount rate computation, although it approaches marginal significance ($p < .13$). The estimated elasticities range from -0.16 to -0.20 for men, and from -0.14 to -0.16 for women.
- Men with relatively low premium costs of retirement before age 65 — set equal to the median value among those with retiree health insurance offers from their current employers — retire about nine months earlier than men with relatively high premium costs — set equal to the median value among those with employer health benefits that do not continue into retirement. For women the difference is about 11 months.
- Men with expected post-65 health care costs equal to the 90th percentile of the overall distribution retire 11 months later than those with health care costs equal to the 10th percentile of the overall distribution. For women, the difference is 12 months.

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