

Liquidity Constraints and Healthcare Expenditure

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Abstract:

Increasing healthcare costs are a big concern for the well-being of liquidity-constrained households. This paper evaluates the effect of binding liquidity constraints on healthcare spending decisions. Further, the paper compares the effect of liquidity constraints on healthcare expenditure with the effect on non-health consumption in particular on food consumption. I extend a standard incomplete markets model with a health capital in the felicity function. Theoretically, I show that households reduce their healthcare expenditure due to the binding liquidity constraints in the current period, whereas expenditure declines in the next period due to the expected binding constraints one period ahead. I use the extended model to test the incidence of binding liquidity constraints with a linearized Euler equation. Empirically, I show that the test of liquidity constraints for healthcare expenditure reveals different implications than a standard test of liquidity constraints for nondurable consumption. In particular, current binding constraints and expected binding constraints lead to the opposite direction of bias when the liquidity constraints are omitted. The resulting overall bias depends on which constraint has a stronger effect. Moreover, the income elasticity of healthcare expenditure varies significantly between asset poor and rich families, more than the elasticity of non-health consumption among wealth quintiles. Altogether, my findings show that the effects of liquidity constraints are heterogeneous across households and across expenditure categories.

Keywords: liquidity constraints, household finance, healthcare expenditure

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