

# Health Shocks, Portfolio Choice and Inequality\*

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## Abstract

We study the dynamic effects of health shocks on savings, portfolio choice and wealth accumulation over the life cycle. We first document empirical facts that exposure to negative health shocks during the golden ages of the average lifecycle earnings profile shapes the pattern of savings and wealth portfolio composition, which has a long lasting impact on the wealth gap in retirement. Next, we quantify the dynamic effects of bad health on wealth inequality, using a lifecycle model of portfolio choice with household heterogeneity in terms of health status, earnings ability, health expenditure and insurance, and wealth portfolio. We find that the presence of multiple assets with heterogeneous returns significantly amplify the adverse effects of negative health shocks on the wealth gap in retirement. Finally, we highlight the contribution of public health insurance to improving wealth inequality by mitigating exposure to health expenditure shocks.

**JEL:** G41, G51, G52, E21, H21, I13, I14

**Keywords:** Health and income risks, Health insurance, Risk aversion, Wealth inequality, Household savings, Stock and bond investment, Asset portfolio.

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