

## **Abstract**

The paper studies the following issue: Can the Social Security play a role in the health-related out-of-pockets expenses at old-age? Senior citizens in many Western countries face inadequate health insurance coverage. Supplemental health insurance is needed for protection against random expenses that Medicare (or other governmental old-age insurance coverage) does not cover. Under the current uncertain circumstances one possible solution may be to alter the Social Security distribution of benefits among eligible recipients. The current empirical evidence justifies a modification of the Social Security program to provide mandatory supplemental health coverage, using some of the current funds of the Social Security. The current distribution of benefits of the Social Security system takes into account the level and length of the contributions made by each individual over the lifetime period. Since the Social Security program is a compulsory annuity plan aimed at increasing ex-ante well-being of individuals it does not take into account the 'true' state of nature (in terms of current well being when old) of Social Security recipients; i.e., the financial burden that each person encounters, for example due to illness, is not incorporated fully at the benefits level, namely, not taking health status and out of pocket health expenditures into account.

Using the existing data it is demonstrated that the out-of-pocket expenses of seniors who face medical problems are significant and are increasing over time. This can be shown even when we take into account the availability of some supplemental health insurance (such as Medigap). Due to the large financial stress faced by the Medicare system, high cost users on average are paying the most out-of-pocket fees, but the burden of high out-of-pocket expenditures is greatest for those who can least afford it. The paper demonstrates that the suggested changes in the Social Security benefits (that includes the compulsory supplemental health insurance) has two Pareto-enhancing welfare implications:

- (a) The introduction of such supplemental insurance, financed by Social Security (as part of the benefits), improves the ex-ante well-being of all Social Security recipients.
- (b) Such an intervention by the Social Security administration dominates (in ex-ante well being sense) the regime in which the supply of such supplemental insurance is carried out by private Insurance Companies.