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The Burden of Health Care Costs for Working Families

Editor's note: Health care spending represents a growing share of our national income, and based on current projections, will increase from 16% of the gross domestic product today to 20% by 2018. What does this mean for typical working families with private health insurance, who shoulder the financial burden of maintaining the current system? In this Issue Brief, Polsky and Grande construct a typical health care budget for working families of various income levels, calculate the percentage of total compensation devoted to health care over time, and project how rising health care costs will affect standards of living in the future. Their findings remind us that what works today also has to work tomorrow. Sustainability depends critically on successful cost containment.

Growth of health care spending outpaces income growth and threatens future standards of living

Although the need to contain health care costs is widely recognized, the full burden of rising costs to working families and households is not well understood.

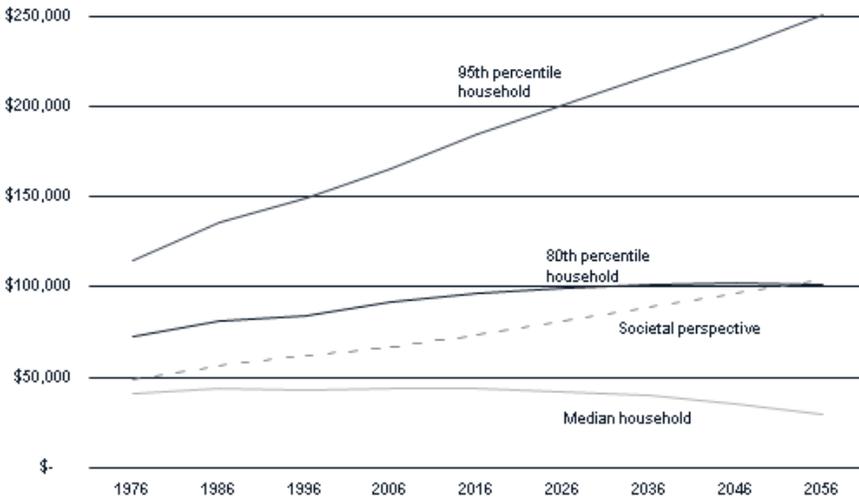
- Certain categories of health care spending—such as out-of-pocket spending and premium contributions deducted from workers' paychecks—are visible and easily calculated. Other categories are less transparent, but even more costly. These include the forgone employee wages that employers divert to the “employer share” of premiums, and the share of income taxes devoted to public insurance programs.
- The Medicare Technical Advisory Panel defines growth as affordable so long as the rising percentage of income devoted to health care does not reduce standards of living (that is, spending on all other goods and services).
- Based on 30-year historical trends, health care spending has grown at 3% per year. This growth has outpaced real income growth for households with median incomes (0.6% growth), households at the 80th percentile of income (1.0% growth), and households at the 95th percentile of income (1.5% growth).
- An important question is whether continued growth in health care spending is sustainable, for society as a whole and for households of different income levels. What would happen to standards of living in the US if current trends in health care costs continue?

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Growth of health care spending is already eroding standards of living for the middle class, and will do so for many upper-income families in the future if trends continue

Polsky and Grande used data from 1976-2006 to calculate the amount of income devoted to health care and the amount left over after health care expenditures in families of varying income levels. The following graph displays their results and projections for the next 50 years.

- As shown, the curve representing the societal perspective reveals that income available for non-health care related spending rises over time, which suggests that current trends in health care spending could be sustained for the next five decades.



Compensation remaining after health care expenditures, for US households

- However, this societal average is misleading. Although health care spending meets this affordability standard for the country as a whole, it is unaffordable for an increasing number of families.
- Growth in health care spending is disproportionately felt by middle income families and is already eroding standards of living for the middle class. Money available to median households (reflecting the middle of the income distribution) is declining because of health care's growing cost. Yet many of these costs (e.g. "employer" contributions) are generally invisible to workers and are only apparent as stagnant wages.

- Although living standards for households in the upper half of the income distribution have not yet declined, they will do so in the coming decades if current trends continue.

To put a human face on the figures graphed above, the authors present the following vignettes describing the impact of health care spending on typical working families with private health insurance at different income levels.

Families with median income spend 25% of compensation on health care

Thomas Jones is a 42-year-old cable television technician. He receives employer-sponsored health insurance for his family for which he pays a portion of his premiums. He earns \$37,000 a year excluding health benefits, and his wife earns an additional \$11,000 as a part-time retail sales associate.

- Mr. and Mrs. Jones are at the median level of income in the US, meaning that about half of US families earn more than they do, and half earn less. Health care accounts for 25% of the compensation for this median-income family. Only 8.6% is visible as employee contributions to premiums (\$3,100) and out-of-pocket expenses (\$1,952). The rest (16.5%) is paid by an employer in compensation that Thomas does not see in his paycheck (\$6,482) and by the government from tax revenue (\$3,175).
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- After health care expenses are accounted for, the Jones' compensation is already showing signs of decline (see graph). Their income has been growing at 0.6%, while per capita health care expenditures have grown at 3%.
 - Within the next decade, Mr. and Mrs. Jones will face a precipitous decline in their standard of living, as health care costs consume a growing fraction of their compensation.

Higher middle income families spend 16.7% of compensation on health care

Susan Smith is a Web-site developer for a medium-sized firm. She has a salary of \$54,000 and receives employer-sponsored health insurance for her family. Her husband is an independent contractor in the construction business and earns \$43,000.

- Health care accounts for 16.7% of the compensation for this family in the 80th percentile for income. Of the Smiths' compensation, 12.2% is in the less visible form of employer contributions and taxes, in contrast to employee premium contributions (2.8%) and out-of-pocket expenses (1.8%).
- Although their family income has grown at a slower rate (1%) than the growth of their health care expenditures (3%), they have been able to absorb the disproportionate rate of growth because health care represents a smaller share of their income. As a result, they continue to see increases in the portion of their compensation available for non-health care goods and services. However, within 20 years, households like the Smiths will no longer have a rising standard of living; within 30 years, their standard of living will start to decline (see graph).

Highest income families (top 5%) spend 13.9% of compensation on health care

Jim Davis is a senior account manager at a large investment firm. He has a salary of \$175,000 and receives generous benefits including employer-sponsored health insurance for his family.

- Health care accounts for 13.9% of the Davis family's compensation—11.3% is in the less visible form of employer contributions and taxes.
- Although their compensation has also been growing at a slower rate than health care expenditures (1.5%, as compared with 3.0%), households like the Davises will be able to absorb health care increases and maintain growth in the compensation they have available for non-health care goods and services for at least another five decades and probably well beyond (see graph).

POLICY IMPLICATIONS

This analysis demonstrates that what is true for the nation as a whole is not true for all of the individual families within it. Even with growing income, the rapid growth of health care spending is already eroding standards of living for middle class working families with private health insurance. Because Americans in the upper half of the income distribution devote a smaller share of their income to health care, their standards of living have yet to decline. But even those standards will decline in the coming decades if current trends continue.

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POLICY IMPLICATIONS

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- Middle class workers face two immediate challenges. They are less able than higher-income workers to solve the problem of rapidly growing health care costs by earning more money, because their wages are growing more slowly. And the rate of spending growth hits their household finances harder, because health care makes up a larger proportion of their budget. For many families, one inevitable solution will be dropping private health insurance coverage altogether.
- If health care reform based on private health insurance is to be sustainable, it has to achieve more than just affordability today. It has to be affordable in years to come, and it has to be reachable by all. Achieving this goal will require both substantial cost containment and shifts in the distribution of health care costs within the population.
- A sustainable solution faces political challenges. Those deriving incomes from the health care sector may resist policies aiming to curb the growth of costs, and those who may face higher taxes may resist redistributive tax policies. However, this analysis underscores the need to build political support for, and take decisive action on, cost containment to realize the goal of affordable health care for all Americans.

This Issue Brief is based on the following article: D. Polsky and D. Grande. The Burden of Health Care Costs for Working Families: Implications for Reform. New England Journal of Medicine, July 30, 2009, vol. 361, pp. 437-439.

Dr. Polsky reports receiving consulting fees from SDI Health and GlaxoSmithKline and serving as a senior economist at the Council of Economic Advisers from 2007 to 2008. Dr. Grande reports serving as an expert witness on behalf of the State of Vermont in a case concerning regulation of pharmaceutical marketing and serving on the Board of Directors of the National Physicians Alliance. No other potential conflict of interest was reported.

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Issue Brief



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