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# RPC BULLETIN

U.S. Senate Republican Policy Committee

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## Health Care Costs and Their Impact on Middle-Class Wages

Middle-class Americans are working harder and longer, yet rising health care costs silently siphon off much of the pay increase these workers should see in their paychecks each year. Even though Americans are producing more and tax cuts passed by a Republican Congress lowered the effective tax rates for middle-income Americans, middle-class Americans still clearly feel the squeeze. If Americans better understood how health care costs have consumed an ever-increasing share of their take-home pay, and how these costs continue to grow year after year, they would demand market-based reforms that would give them more control over this money and their overall health care spending.

### The Role of Health Care Costs in Bringing Down Take-Home Pay

Americans are working harder and longer, but are not seeing the results in their paychecks. A primary reason for this is that their wages are being transferred to insurance companies to pay for rising health spending. As the Kaiser Family Foundation found in a study, “The share of employee compensation going to health benefits has risen substantially over time, while the share going to wages has fallen.”<sup>1</sup>

The economic anxiety of the middle-class is often blamed on larger economic conditions without appropriate recognition for the impact of higher health care costs. While macro-economic issues are certainly significant, the connection between wages and health care costs is less obvious. For example, during the 2000-2008 period, the cost of the average health care plan for a family doubled from \$6,348 (\$7,643.48 in inflation-adjusted dollars) to \$12,680.<sup>2</sup> The \$6,300 increase in health care costs over this period ultimately comes out of workers’ wages, regardless of whether it is paid by the employer or with employee contributions.

This persistent rise in health care costs has slowly but steadily eaten into the take-home pay for American workers. A recent article in the *Journal of the American Medical Association*

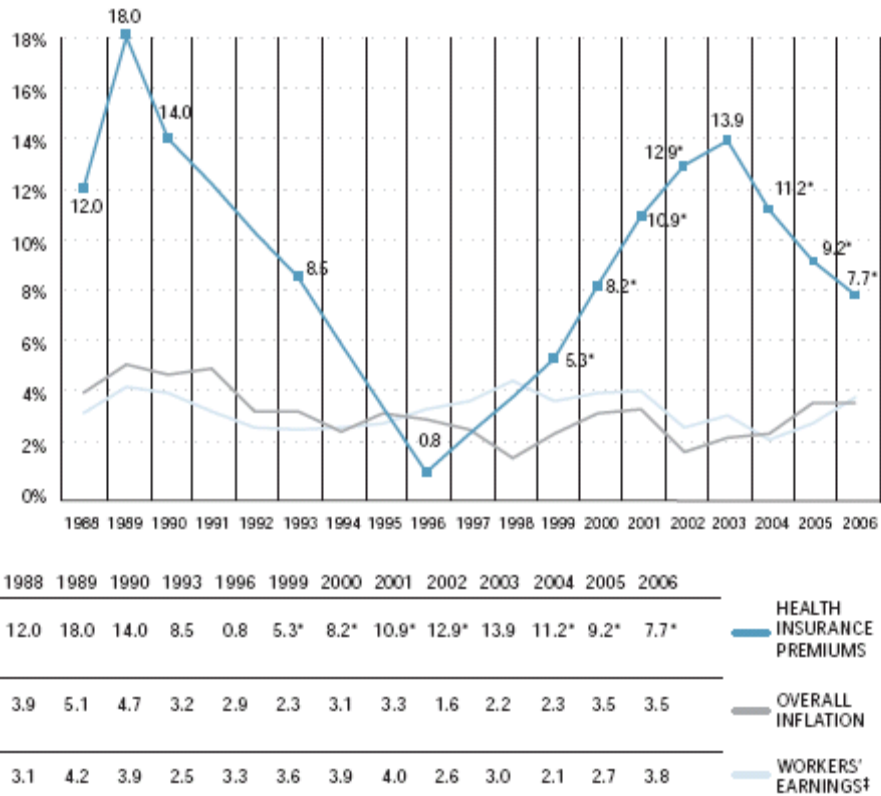
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<sup>1</sup> The Kaiser Family Foundation reports that, “Although wages are consistently the largest component of worker compensation, the shares paid to employees for health care benefits and other fringe benefits/payroll taxes have increased as a share of GDP, while the amount paid as wages has fallen.” Kaiser Family Foundation, “Wages and Benefits: A Long-Term View,” February, 2008.

<sup>2</sup> The cost of health insurance for individuals also has almost doubled from \$2,424 to \$4,704. Yearly surveys available at: <http://www.hret.org/hret/programs/annual.html>.

(JAMA) argues that the “health care cost-wage trade-off” has resulted in relatively flat wages for 30 years.<sup>3</sup> While health care premiums have gone up 78 percent from 2001-2007, workers’ earnings have only risen by 19 percent.<sup>4</sup> The chart below shows how health care cost growth has far exceeded wage growth, particularly since 1999.<sup>5</sup>

**Percentage Increase in Health Insurance Premiums Compared to Other Indicators, 1988–2006**



The impact of health care costs can also be seen in hourly wages. The Kaiser Foundation reports that among workers with access to health benefits, from 1999 to 2005, average employer costs for health insurance per employee hour rose from \$1.60 to \$2.59, an increase of nearly \$1 per hour.<sup>6</sup> This is effectively a \$1 per hour, or \$1,800 per year, cut in take-home pay that workers would otherwise earn.<sup>7</sup> This figure only considers the employer share of health care costs, and not the employee share, which has grown at a similar rate to the employer share.<sup>8</sup>

<sup>3</sup> Ezekiel J. Emanuel, MD, PhD and Victor R. Fuchs, PhD, “Who Really Pays for Health Care Costs,” *Journal of the American Medical Association*, March 5, 2008.

<sup>4</sup> Kaiser Family Foundation, “Health Care Costs,” February, 2008.

<sup>5</sup> Kaiser Family Foundation, 2006 Survey of Employer Health Benefits.

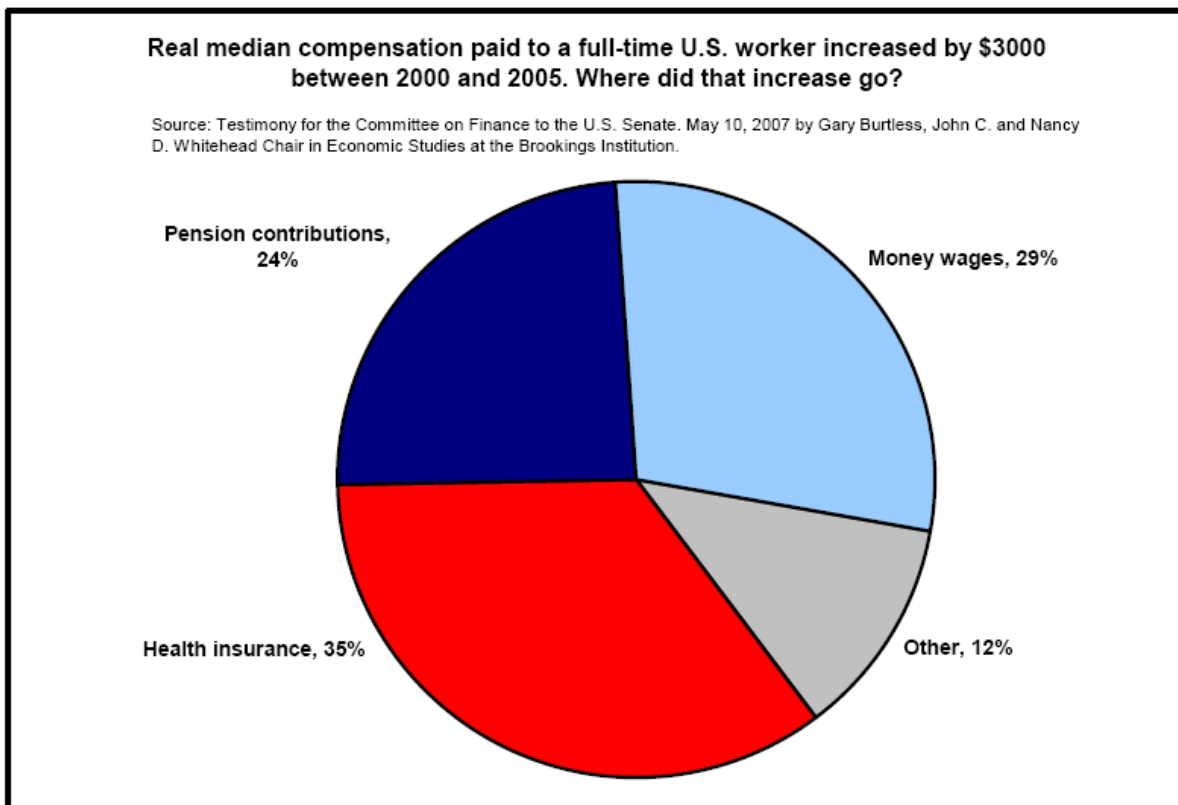
<sup>6</sup> More than half of employers now pay more than 10 percent of payroll to the costs of health care. Kaiser Family Foundation, “Employer Health Insurance Costs and Worker Compensation,” March, 2008.

<sup>7</sup> In 2004, American employees worked an average of 1,792 hours, or 34.5 hours per week, factoring in holidays and vacations. *Wall Street Journal*, “U.S. Wealth Tied More to Work than Productivity, Report Says,” July 8, 2004.

<sup>8</sup> See Exhibit D. <http://www.hret.org/hret/media/content/06summary.pdf>

Employee take-home pay is also effectively reduced by employee premiums. Additionally, the increased cost of health care is felt even more by middle-class workers than higher-wage workers because health care costs represent a larger percentage of payroll for workers in low-wage occupations than for workers in high-wage occupations.<sup>9</sup>

Other data from the Bureau of Economic Analysis also confirms that health insurance costs have eaten into wage increases. As is demonstrated by the chart below, health insurance premiums consumed more of workers' increased compensation than any other category, including wages.



### **Who Really Pays for Health Care? It's All Out of Pocket Costs...**

Most Americans fail to understand the basic concept that workers with employer-sponsored health care still pay for their insurance, not their employers. As Ezekiel Emanuel and Victor Fuchs wrote in the *Journal of the American Medical Association*, "It is essential for Americans to understand that while it looks like they can have a free lunch—having someone else pay for health insurance—they cannot. The money comes from their own pockets.

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<sup>9</sup> Kaiser Family Foundation, "Employer Health Insurance Costs and Worker Compensation," March 2008.

Understanding this is essential for any sustainable health care reform.”<sup>10</sup> Similarly, governments don’t pay for health care, taxpayers do. While some policymakers talk of shifting more of the “fair share” of health care costs onto businesses, this rhetoric could be costly to workers.

Economists are nearly universally in agreement that employer health care costs are really just a component of workers’ wages. Congressional Budget Office (CBO) Director Peter Orszag said in recent testimony that, “The economic evidence is overwhelming, the theory is overwhelming, that when your firm pays for your health insurance you actually pay through reduced take-home pay. The firm is not giving that to you for free. Your other wages or what have you are reduced as a result. I don’t think most workers realize that.”<sup>11</sup> Similarly, a study by respected MIT health care economist John Gruber found that “the costs of health insurance are fully shifted to wages.”<sup>12</sup>

In 2008, the average employer contributed \$3,983 for an individual health insurance policy and \$9,326 for a family policy for each employee. That money is therefore properly considered as part of a worker’s paycheck that they do not see in take-home pay. This is also money that the worker does not choose how to spend. Additionally, that amount does not include the additional \$721 that an average individual and \$3,354 that an average family pays out of pocket for their health insurance premiums.<sup>13</sup>

Policymakers also cannot overlook the cost of government-sponsored health care and the increasing share of both the federal and state budgets it consumes. In 2006, health care costs made up 32 percent of state budgets on average.<sup>14</sup> Emanuel and Fuchs note that these increased costs are passed on to consumers in the form of higher taxes and other fees, potentially including increased tuition to state universities: “[T]he increasing cost of Medicaid and other government health care programs are a primary reason for the substantial increase in tuition and fees for state colleges and universities. Middle-class families finding it more difficult to pay for their children’s college are unwittingly falling victim to increasing state health care costs. Not an easy—but a necessary—connection to make.”<sup>15</sup>

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<sup>10</sup> Ezekiel J. Emanuel, MD, PhD and Victor R. Fuchs, PhD, “Who Really Pays for Health Care Costs,” *Journal of the American Medical Association*, March 5, 2008.

<sup>11</sup> CBO Director Peter Orszag Testimony before the Senate Finance Committee, June 17, 2008.

<sup>12</sup> Cited in Ezekiel J. Emanuel, MD, PhD and Victor R. Fuchs, PhD, “Who Really Pays for Health Care Costs,” *Journal of the American Medical Association*, March 5, 2008.

<sup>13</sup> When individual contributions to their health insurance premiums are included, the average annual total premium cost for a health care plan in 2008 was \$4,704 for single coverage and \$12,680 for family coverage. Kaiser Family Foundation, “Employer Health Benefits Survey,” 2008.

<sup>14</sup> Ezekiel J. Emanuel, MD, PhD and Victor R. Fuchs, PhD, “Who Really Pays for Health Care Costs,” *Journal of the American Medical Association*, March 5, 2008.

<sup>15</sup> Ezekiel J. Emanuel, MD, PhD and Victor R. Fuchs, PhD, “Who Really Pays for Health Care Costs,” *Journal of the American Medical Association*, March 5, 2008.

## **Voters Want Lower Health Care Costs**

A closer look at voters' opinions shows that they intuitively understand that the most pressing problem with health care is the continued rising costs. Voters understand this despite the lack of transparency in how much health care is really costing them. In an August Kaiser Foundation poll, 53 percent of voters said that reducing the cost of health care was their most important health care priority—more than expanding health insurance coverage (18 percent) or improving the quality of care (10 percent).<sup>16</sup> Another Kaiser Foundation poll found that 64 percent of Americans said that lowering the cost of health care would improve the country's economic situation.<sup>17</sup> The public therefore agrees that lowering health care costs is the necessary first step in reforming our health care system. Lowering health care costs will help address the problem of wage stagnation, and also make health insurance more affordable and therefore accessible to the uninsured.

## **Providing More Transparency Will Lower Costs**

One of the best ways to deal with the rising costs of health care may be one of the most simple. Right now the majority of American workers who receive their health care through their employer do not see how much of their total wages go towards health care. A simple yet powerful solution to this problem would be for employers to disclose on an individual's W-2 the amount that they pay each year for health care.<sup>18</sup> As discussed above, the share the employer pays for health insurance should be properly considered employee wages—which are disclosed on W-2s. This simple and easy step would make the amount Americans pay for health care transparent, with important implications for the health care debate.

The Congressional Budget Office has recently, and repeatedly, suggested that disclosing the full amount of wages that go towards health insurance could represent an important step in containing health care costs. For example, CBO Director Peter Orszag wrote in the Long-Term Budget Outlook:

“One factor perpetuating inefficiencies in health care is a lack of clarity regarding the cost of health insurance and who bears that cost, especially employment-based health insurance. ... Although both theory and evidence suggest that workers ultimately finance their employment-based insurance through lower take-home pay, the cost is not evident to many workers. Workers may demand less efficiency from the health system than they would if they knew the full cost that they pay via forgone wages for coverage or if they knew the actual cost of the services being provided. Making the underlying costs associated with employment-based insurance more transparent might prove to be quite important in containing health care costs.”<sup>19</sup>

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<sup>16</sup> Kaiser Family Foundation Health Tracking Poll, August 2008.

<sup>17</sup> Kaiser Family Foundation Health Tracking Poll, March 2008.

<sup>18</sup> Senator Enzi introduced legislation to do this in S. 1783, the Ten Steps to Transform Health Care in America Act.

<sup>19</sup>Statement of Congressional Budget Office Director Peter Orszag before the Senate Finance Committee, “Long-Term Budget Outlook and Options for Slowing the Growth of Health Care Costs,” June 17, 2008.

<http://www.cbo.gov/doc.cfm?index=9385>. Additionally, Orszag said in his unprepared testimony, “[I]magine what

The analogy to the recent increase in gas prices is instructive. Increased health care costs represent a more significant issue than gas prices in maintaining disposable income over the long term. The difference is that people see the impact of rising gas prices every time they go to the pump, while the rising costs of health care are hidden from view. The recent increase in gas prices has directly led to changes in behavior such as using more fuel-efficient cars, as well as demands on policy-makers for immediate action to lower the price. Making health care costs more transparent to consumers would likely generate similar behavioral changes and demands for reform of the health care system to lower costs.

### **Conclusion**

Because voters have made the economy their top concern, there may be a tendency for policymakers to lose their focus on the need to reform the health care system to control costs. However, the data shows that increasing health care costs are a significant and persistent factor in limiting take-home pay for American workers. Focusing on costs will not only increase access to health insurance by making insurance more affordable, but it could also act as an important economic reform by allowing workers to keep more of their take-home pay. If workers understood how much they lost each year in take-home pay to health care costs, they would demand market-based reforms that provide more control over this spending. This change would benefit taxpayers because it will help them keep more money in their pockets and help the government lower costs that are ultimately passed on to the taxpayer.

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the world would be like if workers [understood] that today it was costing them \$10,000 a year in take-home-pay for their employer sponsored insurance and that could be \$7,000 and they could have \$3,000 more in their pockets today if we could relieve these inefficiencies out of the health system. Making those costs more transparent may generate demand for efficiency....”