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Healthcare USA: The big paycheck squeeze

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Employees in the U.S. feel that they can't get ahead. In recent decades, headline after headline has highlighted people's struggles with their paychecks not keeping up with the costs of housing, food and other basic needs. This problem is even more acute today in the face of the historically high inflation that is gripping many American families.

Total compensation, which includes wages and all benefits, has been growing steadily and tracking closely with increases in employee productivity. Economists would say that's what is expected, and that employees are getting paid what they are worth. But cash wages have not kept up, driving a wedge between total compensation and wage growth. This drag on wages is the squeeze that many Americans are feeling in their household budgets.

What is behind this trend? Many have identified globalization and automation as key factors behind wage stagnation. While these are certainly part of the story, the pain that many employees are feeling is due to rising healthcare costs, which have been chipping away at employees' take-home pay for decades. In 1980, healthcare premiums were 8% of take-home pay; by 2020, they had tripled to 25%. Higher plan costs have affected many other aspects of employees' rewards, squeezing the amount employers can contribute to merit increases and other important benefits, including employee retirement plans. The current cycle of higher trends in healthcare costs, not seen since the early 2000s, will exacerbate the pain employees are feeling today.

In this article, we show how rising healthcare costs are linked to stagnant wages, how they have affected other benefits and which employee cohorts are bearing the greatest burden. We developed a model using a variety of data sets that distributes wages and benefits across the income distribution from 1980 to 2020.[1] This model tracks wages, healthcare costs, retirement costs and payroll taxes over the past four decades and focuses on the winners and losers from changing pay dynamics due to rising healthcare costs. The results are concerning, particularly for lower-income employees who have been affected the most by rising healthcare costs. The wages of many more employees at middle and even higher income brackets will suffer if healthcare costs continue to grow unchecked.

Growing burden of rising healthcare costs over the past 40 years

It's no secret that healthcare in the U.S. is expensive. In 2000, the total health insurance premium for a family of four was around $6,500, according to the Kaiser Family Foundation's annual Employer Health Benefits Survey. By 2020, that cost had risen to more than $21,000.[2] That is an increase of 6% a year, more than double the rate of general inflation. For the average employee with family coverage, health insurance premiums made up about

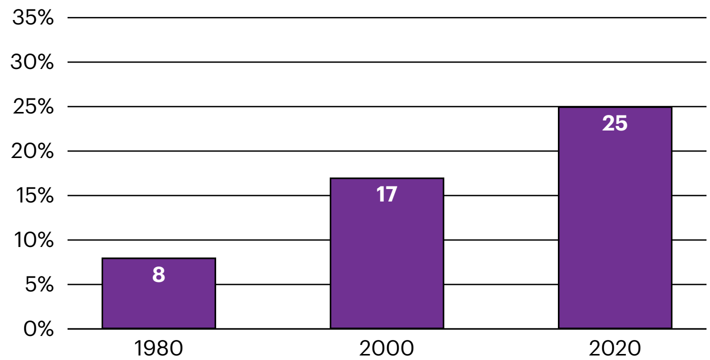
[1] Data sets used include: Current Population Survey – Annual Social and Economic Supplement, National Health Expenditures, Kaiser Family Foundation – Employer Health Benefits Surveys, Medical Expenditure Panel Survey, and Bureau of Economic Analysis – National Income and Product Accounts.

[2] KFF and Kaiser/HRET Annual Surveys of Employer-Sponsored Benefits. https://www.kff.org/health-costs/report/2022-employer-health-benefits-survey/ Accessed on January 1, 2023

one-third of take-home pay in 2020 compared with only 10% in 1980. For the average employee with single coverage, health insurance premiums were about $7,470 in 2020, which made up about one-fifth of take-home pay, compared with only 7% in 1980. Figure 1 reflects the blended average of the coverage tiers and shows that on average employees' total premiums represent about 25% of their take-home pay today.

Figure 1. **Total healthcare premiums as a percentage of take-home pay, fifth decile**

Healthcare takes up 3X as much take-home pay as it did 40 years ago



Sample: Full-time, full-year workers, ages 18 – 64, in the fifth decile of the income distribution, who worked at companies that offered health insurance
Source: Developed from the augmented CPS by WTW

In addition to more expensive premiums, employees' costs when using healthcare services have also been on the rise, especially with the uptake in high-deductible health plans (HDHPs) over the past two decades. In fact, nearly nine in 10 employers offer HDHPs today — many of which include tax-qualified health savings accounts with a minimum deductible of $3,000 for a family plan.[3] This means employees are not only paying higher health insurance premiums but also facing greater exposure to point-of-care costs through higher deductibles.[4]

Coverage rates decline

The rising cost of healthcare has also affected coverage rates and types of coverage. Employers have made many changes to their plans to control costs, and some have stopped offering coverage altogether. In fact, WTW research shows that employers have made changes in each of the past 20 years resulting in higher premium and out-of-pocket costs for employees.[5] Employees in turn have also made different enrollment decisions that have led to noticeable shifts in coverage.

Figure 2 (next page) shows that the percentage of employees covered by employer-sponsored healthcare plans (as contract holders or dependents) has declined by eight percentage points over the past 40 years. This has been driven by both a decline in the number of employees offered coverage and a decline in the number of employees who enroll. At the same time, there has been a sizeable shift from family coverage to single coverage. The share of workers with family coverage has declined precipitously, from 51% in 1980 to 29% in 2020. In part, companies have been using spousal surcharges (27% of employers in 2022[6]), which discourage some employees from taking up family coverage if their spouse is offered coverage. But it's notable that the average family size of those with family coverage has significantly increased from 2.65 in 1995 to 3.21 in 2020. The expanded coverage of younger employees under the Affordable Care Act (ACA) is likely a factor behind the increase in family size, but this trend pre-dates the ACA, and the average age of employees opting out has not changed over the past few decades.

This clearly shows there have been significant shifts in how employers and employees are responding to excessive increases in healthcare costs that have led to a noticeable, albeit somewhat slow, erosion in employer-sponsored healthcare coverage. Employees are choosing insurance arrangements that best meet their needs and their household budgets, and sometimes that leads employees to opt out of employer-sponsored insurance and enroll in more affordable options elsewhere.

Employees are unaware

Do employees really understand how much healthcare is affecting their household budgets? Many do not. They understand costs are rising, as evidenced by the increase in those who opt out of coverage. But many have not

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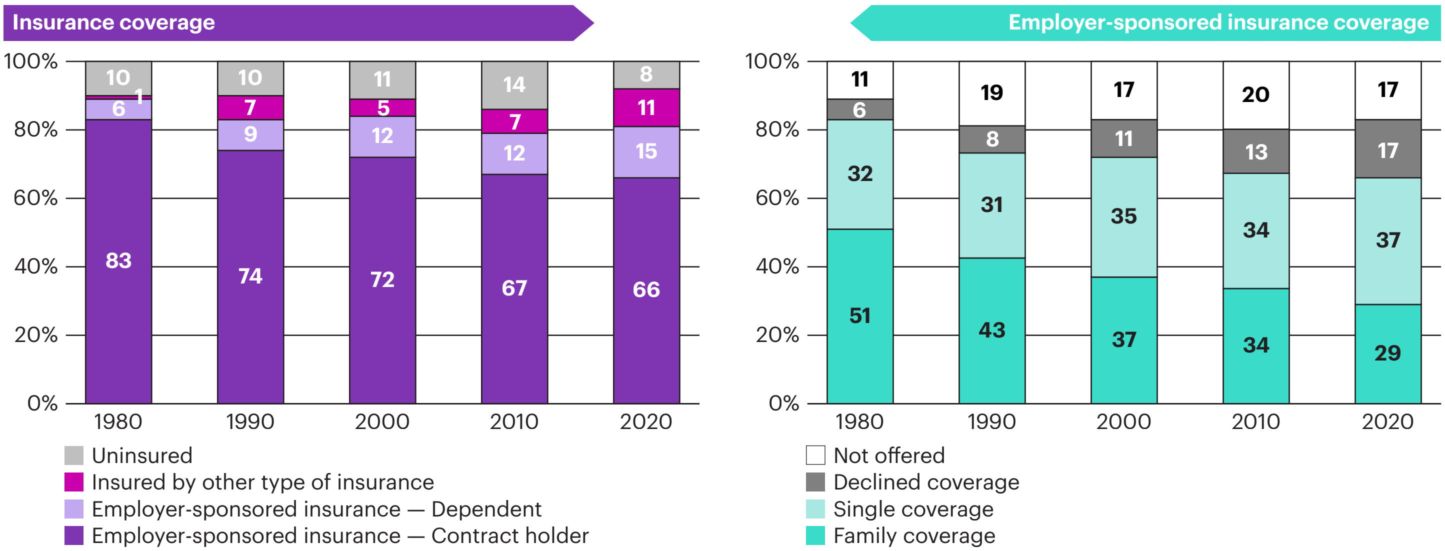
[3] WTW 2022 Best Practices in Healthcare Survey; companies with 1,000 or more employees

[4] While the model supports an out-of-pocket cost analysis, we focus in this paper on the before-income-tax components of compensation.

[5] WTW 2022 Best Practices in Healthcare Survey

[6] Ibid.

Figure 2. **Changes in health insurance coverage, 1980 – 2020**



Sample: Full-time, full-year workers, ages 18 – 64
Source: Developed from the augmented CPS by WTW

made the connection that rising healthcare costs are a reason behind stagnant pay. Our 2019/2020 Global Benefits Attitudes Survey data show that while employees have a sense that their take-home pay is stagnant, they don't know what's to blame. When asked how much total health insurance premiums (including the employer and employee portions) typically cost in a year, 64% of employees with employee-only coverage and 91% of employees with family health plans either didn't know or underestimated how much their premiums cost.[7] Since the amount an employer pays for health insurance is not reported on an employee's paycheck or tax statements, it's easy to see how this goes unnoticed. The key question is, how much is healthcare eroding employees' paychecks?

Estimating the impact of rising healthcare costs

In this analysis, we focus on those employees who were offered employer-sponsored health insurance to see how rising healthcare costs have affected the pay gains of system participants. The cost estimates provided below reflect how much of the change in pay is going to fund more expensive benefits. To get a complete picture of how much employees are taking home (before federal and state income taxes), we estimated employer costs for retirement benefits, employer and employee payroll taxes, and total health insurance premiums, including the employer and employee portions. Aggregate employer costs for healthcare and retirement plans were allocated throughout the income distribution based on coverage and wages within each cohort and were calibrated to aggregate expenditures on these benefits in the National Income and Product Accounts. Payroll taxes were estimated using rates stipulated by law. Employee costs for health insurance were estimated using the cost-sharing percentages from National Health Expenditure Data. The employee portion of retirement contributions and out-of-pocket healthcare costs were excluded from take-home pay for this analysis.[8]

We distributed aggregate costs across employees who are offered health insurance. When employees are offered health insurance but decline to enroll, they are in effect subsidizing their colleagues who do choose to enroll. Very few employers offer opt-out credits, so by foregoing the healthcare plan, employees give up the employer subsidy to the healthcare premium and sacrifice compensation gains that have been affected by more expensive benefits. More specifically, merit pools have been squeezed by the rising cost of health insurance.

Compensation and benefit costs were distributed across the earnings distribution and are reported by income decile. For example, the fifth income decile refers to

The key question is, how much is healthcare eroding employees' paychecks?

[7] WTW 2019/2020 Global Benefits Attitudes Survey

[8] Estimates of employee retirement contributions and out-of-pocket healthcare costs can be found in an extended analysis.

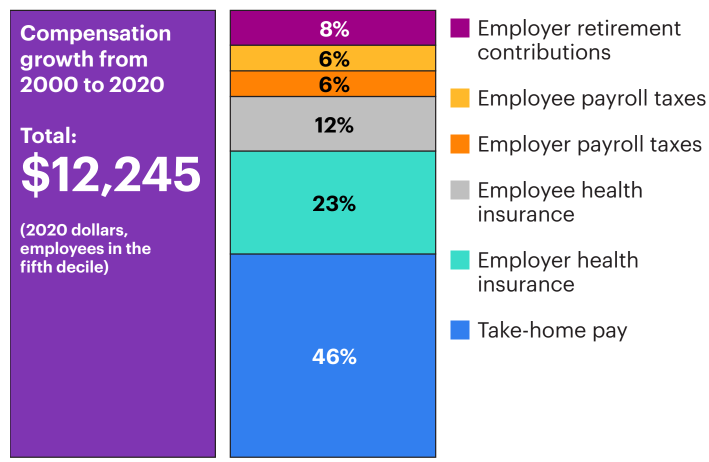
employees with earnings between the 40th and 50th percentiles. A lower percentile denotes lower earnings, and higher percentiles reflect higher earnings. The top 1% of earners were excluded due to dollar caps often applied in source data.

The big paycheck squeeze

The average American earned $12,000 (adjusted for inflation) more a year in total compensation (pay plus cost of benefits) in 2020 than he or she did in 2000, less than half of which went to take-home pay (Figure 3). The remaining 54% was spent on benefits, with most of the incremental benefits spending going to pay for health insurance. This clearly shows why so many Americans feel they are not getting ahead financially. Their compensation has been increasing at a rate of around 1.0% a year (adjusted for inflation), but health insurance premiums have increased by more than 2.5% a year over the past two decades. Healthcare is eating up more and more of incremental compensation, leaving increasingly less available for take-home pay. It's notable that while retirement benefits have increased over the past 20 years, the magnitude is small — from 4.9% to 5.4% of total compensation — and much of this increase is due to an aging workforce. But healthcare benefits have taken up four times more of the gains in compensation than retirement programs.[9] So, it is not a surprise that WTW's employee research reveals widespread concerns from employees about their long-term financial security; employees consistently identify their retirement benefits as the area in which they most want employer assistance.[10]

Rising health costs have not affected employees equally. Figure 4 shows how rising costs are contributing to disparities in income. From 2000 to 2020, increases in healthcare costs took up 40% of compensation gains for those in the second decile of the earnings distribution.

Figure 3. **Growth in benefits and pay as a percentage of total compensation from 2000 to 2020, fifth decile**



Note: Changes in compensation and benefits are in 2020 dollars.
Sample: Full-time, full-year workers, ages 18 – 64, in the fifth decile of the income distribution, who worked at companies that offered health insurance
Source: Developed from the augmented CPS by WTW

[9] Even if we include employee contributions to retirement plans, which would represent around 4% of total compensation gains, healthcare benefits would still take up three times more of the compensation gains than retirement benefits. We assumed an employee at the fifth income decile contributed 6% of his or her pay over the 20-year period.

[10] WTW 2022 Global Benefits Attitudes Survey

Figure 4. **Growth in hourly compensation, take-home pay and benefits by income decile, historical and projected**

		2nd decile		5th decile		8th decile	
		2000 – 2020	2020 – 2030	2000 – 2020	2020 – 2030	2000 – 2020	2020 – 2030
Growth in compensation	Hourly (2020 dollars)	$3.23	$1.87	$5.75	$3.36	$10.07	$5.98
	Annual growth rate (inflation adjusted)	1.0%	1.0%	1.0%	1.0%	1.2%	1.2%
Growth in take-home pay as a percentage of compensation growth		45%	14%	46%	31%	55%	48%
Growth in healthcare as a percentage of compensation growth		40%	71%	35%	52%	24%	33%

Note: Changes in hourly compensation and benefits are in 2020 dollars.
Projections used a real growth rate of 3% (net of inflation) for healthcare growth and a compensation growth rate similar to the past two decades.
Sample: Full-time, full-year workers, ages 18 – 64, who worked at companies that offered health insurance
Source: Developed from the augmented CPS by WTW

Healthcare made up 35% of the compensation gains of those in the fifth decile and about a quarter (24%) of those gains for those in the eighth decile. After accounting for rising costs in other benefits, lower-wage employees only took home 45% of their compensation gains as pay.

If this trend in rising healthcare costs continues over the next decade, the ripple effects are expected to consume a much greater portion of employees' pay throughout the income spectrum. The projections from 2020 to 2030 show the change in compensation and in its components if compensation and healthcare growth track the same patterns as the past 20 years (Figure 4). This means a real growth rate for compensation, retirement and payroll taxes of 1.0% for the second and fifth deciles and 1.2% for the eighth, and a real growth rate of 3.0% for healthcare for all. Over the next decade, lower-paid employees are projected to see healthcare consume most (71%) of their compensation gains. After taking out very small contributions to retirement plans and payroll taxes, their take-home pay will increase by only 14%. Employees in the fifth decile will only see a 31% increase in their take-home pay, and those in the eighth decile will take home 48% of their compensation gains as pay. Standards of living across all deciles will erode due to higher healthcare costs, with the biggest burden falling on the lowest paid.

A diversity, equity and inclusion perspective

Disparities in outcomes due to rising healthcare costs are clearly affecting lower-income employees the most. The share of Black and Hispanic employees in lower-income

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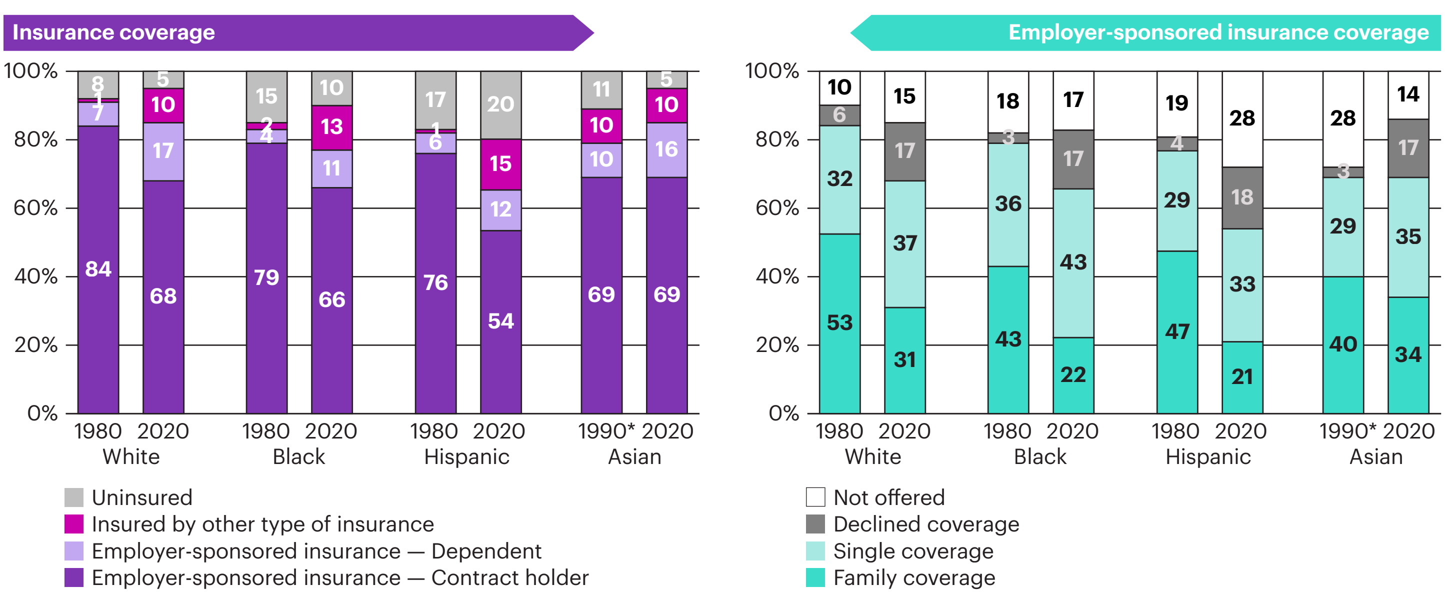
groups tends to be much higher than for other segments of the workforce. An important question is, to what extent are such employees more negatively affected by rising healthcare costs?

As noted above, coverage rates in employer-sponsored healthcare programs have been declining for much of the past 40 years. Hispanic workers report the lowest employer-sponsored enrollment rates in 2020, declining by over 20% since 1980 (from 82% to 66%). Enrollment among Black and white employees has declined much less — roughly 7% — over the same period. Asian employees are the only cohort to report an increase in enrollment in employer-sponsored healthcare plans, from 79% in 1990 to 85% in 2020 (Figure 5).

The coverage mix has also been changing. The share of employees with family coverage has been steadily declining for all cohorts. Both Hispanic and Black employees report the most significant declines, while Asian employees report only a small shift in the single-family coverage mix. The small changes in coverage mix

Figure 5. **Changes in health insurance coverage by race, 1980 vs. 2020**



Note: *1980 data not available for Asians.
Sample: Full-time, full-year workers, ages 18 – 64
Source: Developed from the augmented CPS by WTW

and the increase in enrollment in employer-sponsored coverage for Asian employees is likely directly linked to the more significant compensation gains Asian employees have made relative to other segments of the workforce.

Over the past two decades, Black and Hispanic employees saw comparable total compensation gains to white employees. But the increases were not enough to keep up with rising healthcare costs, leaving Black employees with only 45% of their compensation gains added to their take-home pay (Figure 6). Asian and white employees added similar amounts of their compensation gains to take-home pay, 45% and 47% respectively. Hispanic employees fared the best, taking home just over half (52%) of their increases in compensation. Notably, while Hispanic employees added more of their compensation gains to their paychecks, they were also the group with the most significant declines in employer-sponsored coverage, which resulted in more money flowing to their take-home pay. Conversely, Asians were able to sustain their coverage and family enrollment rates due to their higher pay increases. But Asian take-home pay increases are comparable to other groups because their increases in retirement savings were twice that of the other cohorts.

Over the next decade, take-home pay gains are projected to erode even further, with rising healthcare costs becoming an even greater burden. After another 10 years of healthcare cost increases exceeding inflation and employee productivity growth, Black, Hispanic

To keep healthcare costs down, employers have been taking many steps with their plan designs.

and white employees are projected to take home less than one-third of their compensation gains. Black and Hispanic employees are expected to see the biggest declines in take-home pay gains, dropping 36% and 46%, respectively, compared with 34% for white employees. Asian employees are expected to do quite a bit better and bring home more than one-third of their compensation gains as take-home pay.

Employer considerations

The above analysis shows that the impact of rising healthcare costs has led to a perception of economic stagnation by American workers, particularly those with lower incomes. Employer reward strategies have been upended for much of the last half century, with employers attempting to squeeze budgets and revise pay to absorb the ever-growing healthcare benefits.[11]

To keep healthcare costs down, employers have been taking many steps with their plan designs. Notably

[11] See Harvard Business Review – Making Healthcare Affordable for Low-Wage Workers

Figure 6. **Growth in hourly compensation, take-home pay and health insurance by race, historical and projected, fifth decile**

		White		Black		Hispanic		Asian	
		2000 – 2020	2020 – 2030	2000 – 2020	2020 – 2030	2000 – 2020	2020 – 2030	2000 – 2020	2020 – 2030
Growth in compensation	Hourly (2020 dollars)	$5.70	$3.33	$5.53	$3.21	$5.53	$3.21	$6.61	$3.93
	Annual growth rate (inflation adjusted)	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.2%	1.2%
Growth in take-home pay as a percentage of compensation growth		47%	31%	45%	29%	52%	28%	45%	37%
Growth in healthcare as a percentage of compensation growth		35%	52%	34%	53%	29%	55%	26%	44%

Note: Changes in hourly compensation and benefits are in 2020 dollars.
Projections used a real growth rate of 3% (net of inflation) for healthcare growth and a compensation growth rate similar to the past two decades.
Sample: Full-time, full-year workers, ages 18 – 64, in the fifth decile of the income distribution, who worked at companies that offered health insurance
Source: Developed from the augmented CPS by WTW

employers have been moving their populations to HDHPs, which on the one hand helps to keep premiums down but on the other hand exposes employees to greater cost sharing when using healthcare services. WTW research shows that employers have increased out-of-pocket cost sharing for their health plans almost every year for the past two decades.[12] But employers recognize the strain these costs are putting on their workforces. While not abandoning these programs altogether, more than 25% of companies that at some point only offered HDHPs have added back a traditional plan option with lower out-of-pocket costs.[13]

Companies have also been structuring premiums to reduce costs or adjusting plan design features such as out-of-pocket maximums or deductibles for low-wage employees to relieve the burden for those most vulnerable. In fact, today about 32% of employers have specifically tailored their designs based on pay.[14] Employers have expanded their portfolios to include a range of voluntary benefits and other family-friendly benefits to help employees address their financial risks and to support various caregiving needs, which are a financial burden for many households. Companies have also taken a broader approach to support employee financial resilience through their wellbeing programs and other measures to help employees manage debt and financial emergencies.

Employers are also taking steps within their healthcare programs to steer employees toward the most cost-effective care. Value-based plan design features — including low- or no-cost coverage for primary care, behavioral health or clinic visits, and lower cost sharing for select Rx products — are options to ensure employees are getting the care they need. For example, one-third of employers today offer low- or no-cost coverage for certain types of care, and more than half are planning on offering this feature by 2024.[15]

Employers are increasingly looking at social determinants of health factors. Community-based barriers can be impediments to employees' access to care and their ability to improve or sustain their health. WTW's 2022 Global Benefits Attitudes Survey results show that low-income employees are more likely to have poor access to providers, for both general medical and mental health professionals. But virtual care, especially for mental health issues, has shown to be a great way to improve access for low-wage and rural employees. Lower-income and rural employees are about 25 percentage points more likely to feel they are receiving the care they need if they use virtual care for mental health concerns.[16]

Wages and employer contributions to retirement would be higher if our healthcare costs were not so expensive.

The way in which care is delivered in the current healthcare system is also contributing substantially to rising healthcare costs. Countless popular healthcare treatments are both expensive and ineffective, but this goes well beyond what can be covered in this short summary. For a more in-depth review, Syl Schieber's *Healthcare USA: American Exceptionalism Run Amok* examines many inefficiencies in the healthcare system that are driving healthcare costs for employers.

Conclusion

Virtually all Americans have felt the sting of medical costs, either at the doctor's office, at the pharmacy, for an unexpected surgery or for any number of encounters with the medical system. We have also felt that same sting over the past few decades when our paychecks just don't seem to go as far. But few are making the connection between the two. Wages and employer contributions to retirement would be higher if our healthcare costs were not so expensive.

Rising healthcare costs have also exacerbated income disparities, as lower-income employees with healthcare coverage have seen a greater portion of their paychecks go to healthcare. While there are notable disparities between various racial cohorts, income groups most clearly highlight the growing burden that rising healthcare costs have on workers' prosperity. Worse yet, many low-wage employees are beginning to be pushed out of the employer-sponsored insurance market entirely, either by employers not offering healthcare benefits or by opting out due to premiums or copay costs that are prohibitive given their tight household budgets.

Our healthcare problem has been disruptive for businesses and is a major impediment to our future

[12] WTW 2022 Best Practices in Healthcare Survey
[13] Ibid.
[14] Ibid.
[15] Ibid.
[16] WTW 2022 Global Benefits Attitudes Survey

prosperity. Employers recognize that rising healthcare costs can have negative impacts on employees, including worse outcomes due to deferring care, insufficient retirement savings and longer working careers, all of which can be disruptive to their workforce and its performance. Employers have taken many actions to address the cost challenges, including plan design changes and steerage to higher value providers, which have been successful in reducing inefficient member utilization. But until we can address the main driver of the problem — high healthcare unit prices — employees can expect further tightening of paychecks and possible erosion of benefits in the decade ahead.

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