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RESEARCH SUMMARY

EARNINGS INEQUALITY
The Implications of the Rapidly Rising Cost of Employer-Provided Health Insurance

Concern about income inequality has dramatically shifted public attitudes toward economic and fiscal policy, and the subject of inequality has increasingly dominated the political debate. In fact, President Obama called inequality "the defining challenge of our time." But the discussion has focused almost exclusively on comparing the earnings of lower- and higher-paid workers, and on promoting redistributive policies aimed at "correcting" this disparity. This focus has been fueled by the works of economists such as Thomas Piketty. New research finds, however, that both scholars and politicians have largely overlooked a key contributor to earnings inequality: the role of rapidly increasing healthcare costs.

A new study from the Mercatus Center at George Mason University analyzes the link between earnings inequality and rising healthcare costs using unpublished data from the Bureau of Labor Statistics. The study finds that the increasing cost of employer-provided healthcare benefits accounts for a significant portion of rising earnings inequality. The study urges policymakers interested in addressing earnings inequality to shift their focus from failed redistributive policies to policies aimed at lowering the cost of healthcare benefits.

To read this study in its entirety and learn more about its author, Mercatus Senior Research Fellow Mark J. Warshawsky, please see "Earnings Inequality: The Implications of the Rapidly Rising Cost of Employer-Provided Health Insurance."

KEY POINTS

- Most previous analyses of inequality focused exclusively on earnings, ignoring total compensation (including healthcare benefits). This oversight significantly inflated the perceived severity of workers' earnings inequality.

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- While dollar earnings have grown significantly faster for higher-income workers than for lower-income workers, total compensation (including increasingly expensive healthcare benefits) has not.
- Surging healthcare costs have depressed the annual earnings growth rate for lower-paid, full-time workers four times as much as for the top 1 percent of workers.
- Redistributive policies do not address the root cause of the apparently increasing inequality, and may be counterproductive because of their negative implications for overall economic growth.
- The key to lessening earnings inequality is to reduce the rate of increase for healthcare costs.

A FUNDAMENTAL CRITIQUE OF THE CURRENT EARNINGS INEQUALITY DEBATE

Most employers pay workers a combination of earnings and benefits, which include retirement plans and health insurance coverage. Both economic theory and empirical findings indicate that there is a trade-off between earnings and benefits: **if benefits become more expensive, earnings growth will suffer.** Indeed, the fact that employer costs for family health insurance coverage exploded from around $4,200 in 1999 to nearly $12,600 in 2015 provides a reasonable explanation for why earnings have stagnated in recent years.

However, not every employee is affected in the same proportion by rising healthcare costs. For an employer, the dollar cost of health coverage is the same for higher- and lower-earning workers, which means that health care makes up a far larger share of total compensation for lower earners than for the top 1 percent of workers. Though rising healthcare costs eat away at earnings growth for everyone, the effects will be largest for members of the working middle class because their healthcare costs are so large relative to the rest of their compensation package.

A 2013 Brookings study that looked at data for 1996–2008 also found that health insurance costs contributed to earnings inequality. However, the data used by Brookings required imputations and smoothing with other datasets, an issue this study avoids by using newly acquired data.

NEW EMPIRICAL EVIDENCE

This study analyzes unpublished compensation data from the National Compensation Survey, published by the Bureau of Labor Statistics, for the period from March 1990 to March 2014. This dataset is useful because it comes from employer responses to a long-standing survey conducted by a respected, nonpartisan agency, and there is no need to manipulate the data. The job of the 30th percentile worker (earning $12,244 annually in 2006) is used as the low end for full-time, low-earning workers because jobs below this earning level presumably include many part-time or otherwise incomparable earners.

This dataset confirms the conclusion that a significant share of earnings inequality is due to rising employer healthcare costs.

- Inequality in total compensation did not change between 1996 and 2008.

- While dollar earnings for the top 1 percent worker grew 15 percent faster than dollar earnings for the 30th percentile worker, total compensation for the two groups grew at the same rate.

- The increase in dollar earnings inequality is due to the surging cost of providing health benefits, which impacted lower-income workers more than higher-income workers.

Running the same analysis over a longer timeframe shows a similar effect, although more modestly.

- Data from 1992–2010, a span beginning and ending one year after recession troughs, show dollar earnings for the top 1 percent worker grew 20 percent faster than dollar earnings for the 30th percentile worker.

- However, total compensation for the top 1 percent worker grew only about 12 percent faster than total compensation for lower-earning full-time workers.

According to simple regression analysis, increases in healthcare costs depress the dollar earnings growth of lower-earning workers four times as much as that of higher-earning workers.

- For the 30th percentile worker, annual earnings growth is almost one percentage point lower because of healthcare cost growth, but annual earnings growth is only a quarter percentage point lower for the top 1 percent.

- As a rule, for every one percentage point increase in the healthcare cost share of compensation, the annual rate of growth in earnings declines by 0.23 percentage points.

CONCLUSION

It is hard to overstate the influence that economic research on inequality has had on public and political discourse.

- Analysts and policymakers have accepted as fact the propositions that income inequality has increased dramatically and that further redistributive policies must be undertaken to correct the situation.

- These propositions, however, are based on research that focuses on dollar earnings and reported income rather than total compensation and ignores the impact of the rapidly rising cost of health care on reported income in the United States.

- Redistributive policies may not address the root cause of the apparently increasing inequality, and would be counterproductive because of their negative implications for economic growth.

If policymakers are interested in addressing earnings inequality, the best course is to focus on policies that will control the growth of healthcare costs. Such policies should include the following:

- Reduce how favorably healthcare spending and insurance are treated for tax purposes.

- Strictly enforce antitrust law in the healthcare sector.
- Encourage employers and government programs to provide insurance coverage options with more scope for workers' sensitivity to costs.