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THE WAGE SQUEEZE AND HIGHER HEALTH CARE COSTS

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Despite the fact that 2005 marked the fourth year of an economic expansion characterized by strong productivity growth, the inflation-adjusted wages of most workers' fell last year. The median (or typical) worker's wage fell by 1.3% (**Figure A**). The decline was even greater for those at the very bottom end of the wage scale, who saw their real wages fall by 1.9%. Only those at the very top of the wage scale had wage growth that outpaced inflation.

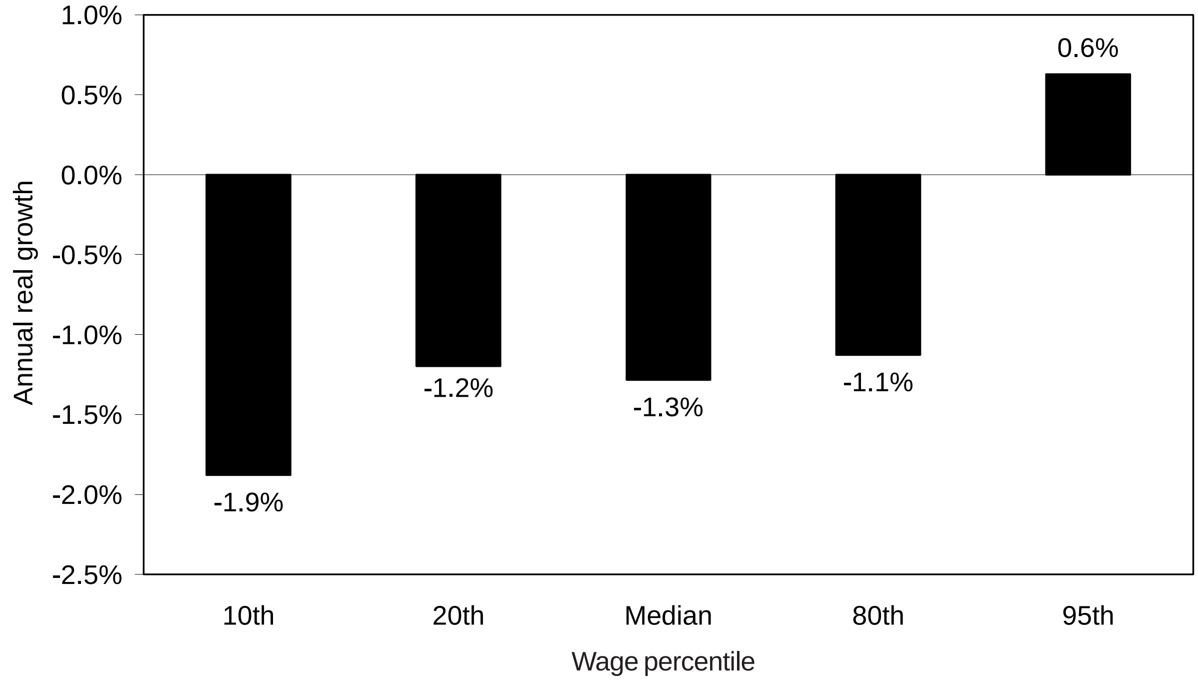
Some have stated that the reason for this unsettling result is that increasing health care costs are squeezing wage growth. Allan Hubbard, economic advisor to President Bush, stated in an interview with the *Wall Street Journal* that, "Employers are spending more money on health care, and that's robbing people of wage increases" (January 12, 2006).

The logic of this claim is that dollars that would have gone into wage increases have instead gone to pay the increased cost of employer-provided health care. According to the view espoused by Hubbard and others, workers' total compensation—wages plus benefits—continues to increase at a clip commensurate with the strength of the overall economy, even if their paychecks are admittedly not going as far.

The evidence presented below refutes this claim. First, nearly half (47%) of the workforce do not get health coverage through their job. Second, employers' health care costs rose more slowly in 2005 than any year since 1999, in part because rising costs have led to less coverage (Gould 2005). Third, not only did wage growth slow last year, but overall compensation growth also slowed and by the third quarter, it too lagged inflation. Finally, the growth of corporate profits in recent years has solidly outpaced that of compensation as employers are trading away wage and benefit increases for higher profits.

FIGURE A

Real hourly wage changes, by percentile, 2005



Source: Bureau of Labor Statistics, Current Population Survey.

About half of all workers don't even receive employer-provided coverage

According to the U.S. Bureau of Labor Statistics (BLS), 47% of workers did not participate in employer-provided health care benefit plans in 2005 (see **Figure B**). Thus, there is no health care squeeze that would explain the wage losses of nearly half the workforce. In addition, the BLS data show that among workers whose average wage was less than $15 per hour last year, only 39% participated in employer-provided health plans.[1] As shown in Figure A, low-wage workers also lost the most ground in terms of real wages. Thus, those least likely to get health care experienced the greatest loss in real wages, the opposite of what the trade-off explanation would predict.

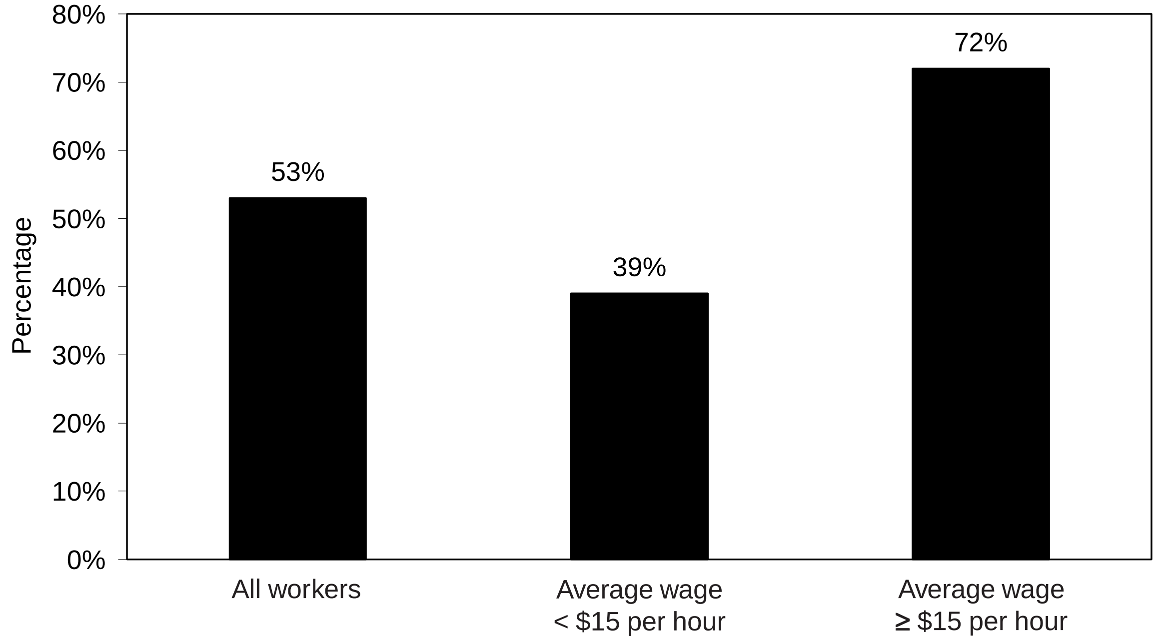
Benefits, wages, and compensation all grew more slowly last year

The "health-care-squeezes-wage-growth" scenario has many implications. First, it implies that, while wage growth may lag inflation, total compensation does not. Second, it suggests that employers' benefits costs—specifically health care costs—have grown faster in recent years as wage growth has slowed.

These trends are not reflected in the BLS index of employers' costs, the most relevant data to explore these relationships (**Figure C**). To the contrary, the most recent data show health costs, wages, and total

FIGURE B

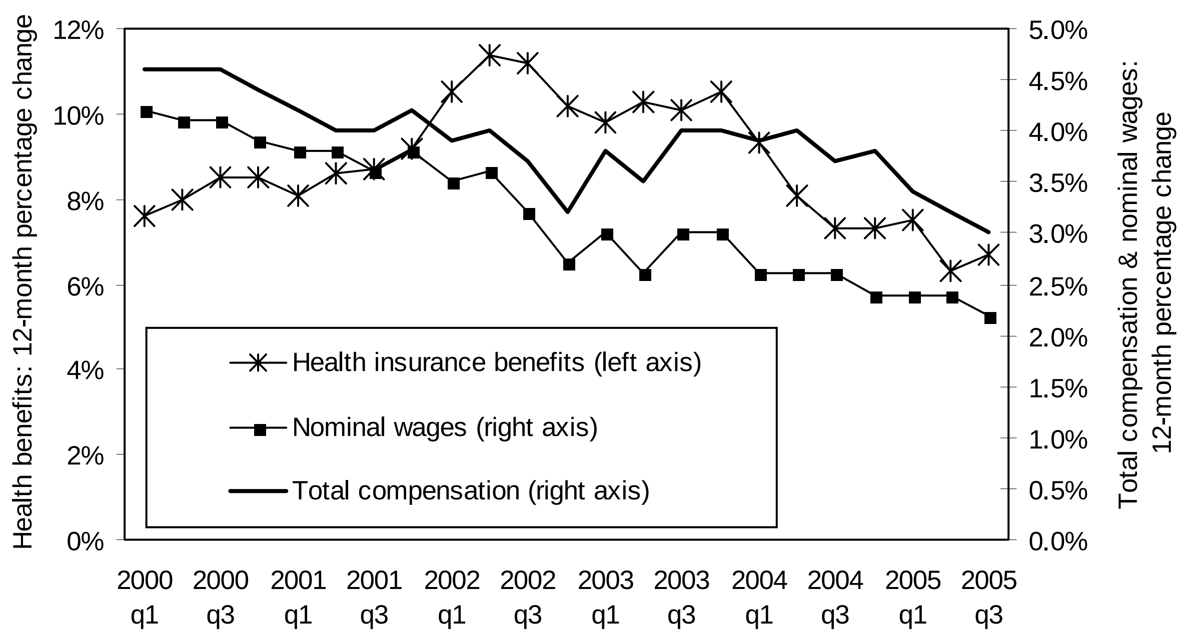
Percent of workers participating in health care benefits, private industry



Source: Bureau of Labor Statistics, National Compensation Survey.

FIGURE C

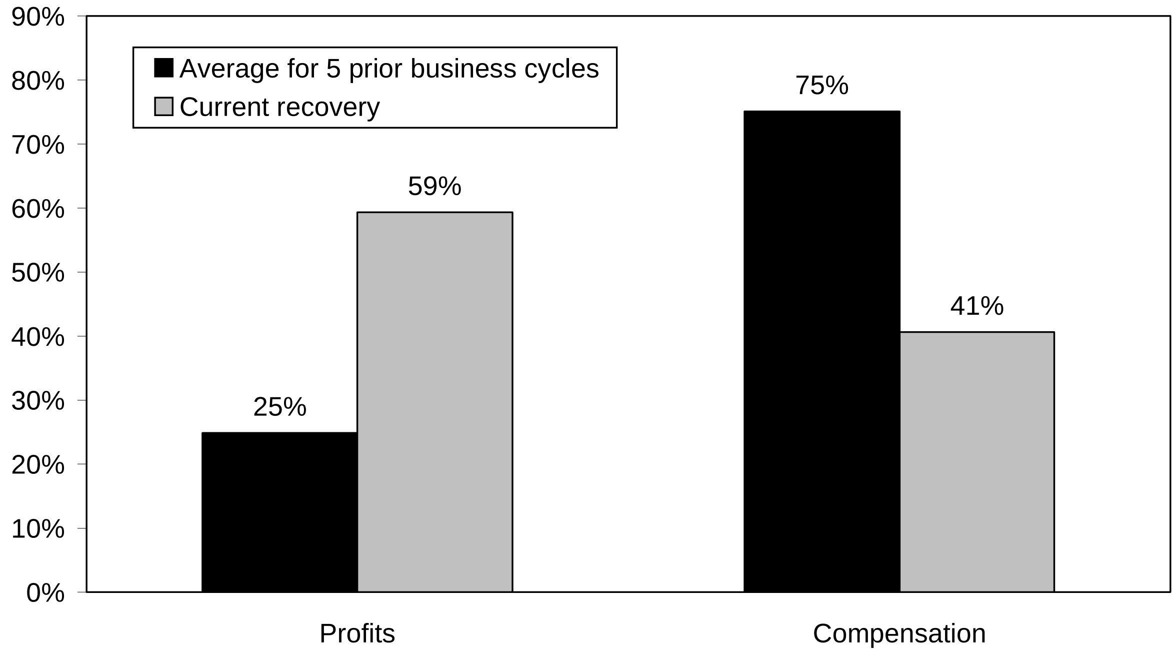
Total compensation, health insurance benefits, and nominal wages: 12-month percentage changes, private industry



Source: Bureau of Labor Statistics, Employment Cost Index.

FIGURE D

Share of corporate income growth accruing to profits and to compensation*



*Data are through 2005 quarter 2; quarter 3 data were not included because of the anomalous effects of Hurricane Katrina.
Source: Bureau of Economic Analysis, NIPA.

compensation all growing more slowly than in prior years.

Figure C shows the annual nominal growth rates in employers' average costs for wages, health insurance, and total compensation, from 2000q1 through 2005q3. Between 2000 and 2002, employers' health insurance costs rose quickly, rising from an annual rate of around 8% to just below 12%. Wage growth decelerated over this period much as the squeeze scenario would predict, and compensation growth held relatively steady at around 4%.

But since then, the growth rate of benefit costs has fallen steeply, in part due to declining employer coverage in the face of higher costs and weaker labor markets (Gould 2005). By 2004, the increase in total compensation began to slide as well, hitting 3% by 2005q3, below the 3.8% rate of inflation for that period.

Corporate profits unusually strong; compensation unusually weak

While wages have stagnated or fallen behind inflation, corporate profits have remained strong. Compared to previous business cycles, the share of corporate income accruing to compensation is lagging far behind historical trends, while the share going to profits is way ahead of its historical average (**Figure D**).

There should be no illusion that the slowdown in both wages and total compensation is the result of rising health costs. While compensation gains have slowed, profits have continued to grow strongly. In other words, the recent squeeze on wage growth appears to be coming much more from profits than from health care costs.[2]

The fact that health costs have risen so quickly in recent years surely creates serious economic challenges for American businesses. It does not, however, account for the shrinking real paychecks for many in the workforce. Close to half of the workforce lack employer-provided health care, and those who have lost the most in real wages are the least likely to even have health coverage, the opposite of the trade-off suggested by Hubbard. In addition, over the last few years, as wage growth has declined, growth in health care benefits and total compensation also declined. These trends reflect the fact that strong productivity growth has done little to better the living standards of working families which has been a hallmark of the current economic expansion.

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Endnotes

1. BLS data show that approximately 58% of the workforce had an average wage of less than $15 per hour in 2005.
2. From 2001 to 2004, BEA NIPA data show that corporate health insurance costs have risen by 38%, while corporate profits increased by 51%.

References

Gould, Elise. 2005. *Prognosis Worsens for Workers' Health Care*. Economic Policy Institute Briefing Paper #167. Washington, D.C.: EPI.