Older Americans' Economic Security

Number 16, May 2008 THE RETIREMENT POLICY PROGRAM

Rising Health Care Costs Lead Workers to Delay Retirement

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Rising health care costs threaten many older Americans' financial security. Medical expenses now consume a substantial share of household spending in retirement, and that share is likely to rise as costs continue escalating. Cutbacks in employer-sponsored retiree health benefits add to many older Americans' difficulty paying for health care.

Many older workers are responding to these financial pressures by delaying retirement. For those receiving health insurance from their employers, continued work reduces the risk of high out-of-pocket health care costs. Working longer also increases retirement incomes—making health care costs more affordable—by raising earnings, boosting Social Security and employer-sponsored pension wealth, improving the ability to save, and reducing the years over which retirement wealth must be spread. Not all older adults, however, are able to continue working.

Health Care Costs at Older Ages

Although nearly all Americans age 65 and older are covered by Medicare, many face substantial out-of-pocket health care costs. The annual Medicare deductible for hospital stays in 2008 is $1,024. Medicare Part B, which covers outpatient services, requires a substantial premium, now about $1,157 for most enrollees (and more for singles with incomes above $82,000 and couples with incomes above $164,000). Part B carries an annual deductible of $135, plus a 20 percent coinsurance rate.

The standard Medicare Part D benefit for outpatient prescription drugs also requires hefty premiums (currently averaging about $324 per year), a $275 annual deductible, and 25 percent coinsurance. Once total drug costs exceed $2,510, however, beneficiaries must pay 100 percent until total out-of-pocket spending reaches $4,050 (after which enrollees pay only 5 percent of drug costs).

Additionally, older adults must pay for services not covered by Medicare, such as dental care, routine vision care, hearing exams, and most long-term care services.

These costs add up. Median out-of-pocket health care spending consumed 14 percent of income for adults age 65 to 74 in 2003 and 22 percent for those age 85 and older (Neuman et al. 2007).

To keep costs down, many older Americans obtain private supplemental coverage, either individual policies from insurance companies or group coverage from former employers. Individual plans are expensive, though, and many employers are cutting back on subsidized retiree health benefits. Low-income seniors may qualify for public assistance to pay their Medicare premiums, deductibles, and copayments. However, enrollment entails a complex application process at state welfare offices and a strict asset test. Relatively few eligible seniors apply for these benefits.

Impact on Retirement Decisions

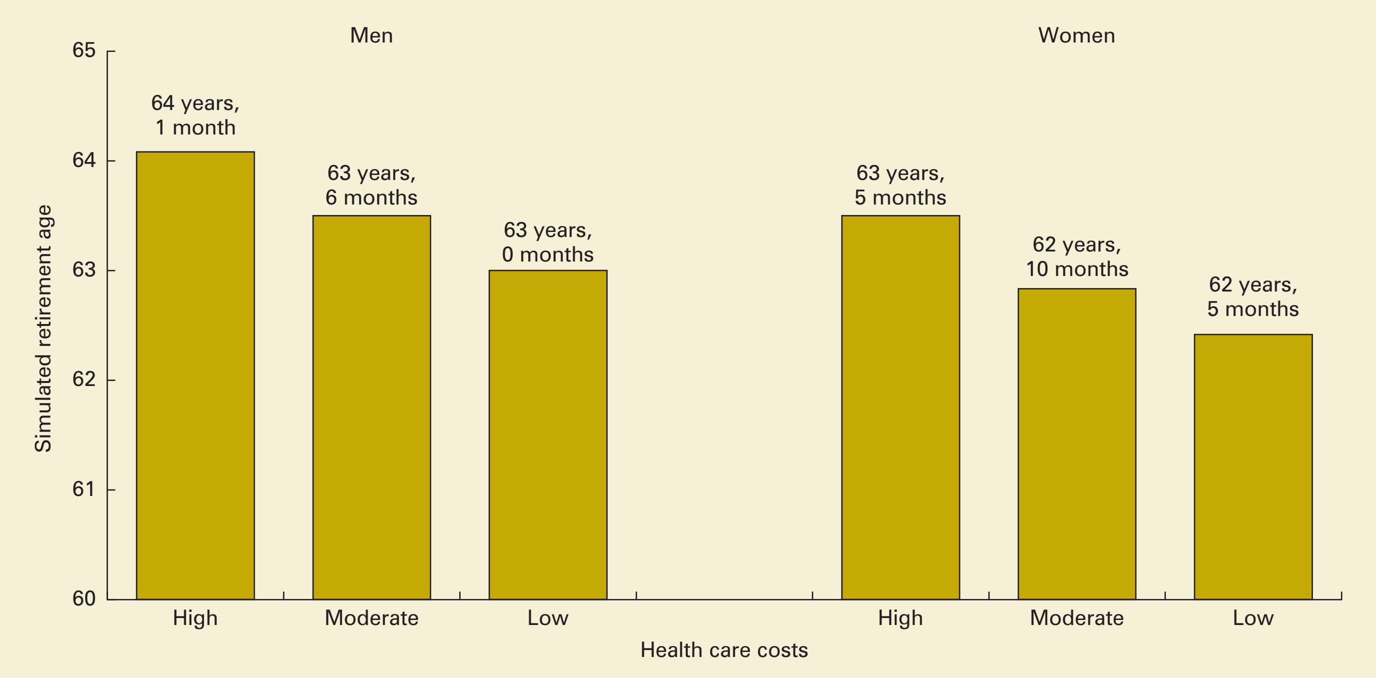
Workers react to increased health care costs by delaying retirement, according to our simulations based on the Health and Retirement Study (figure 1). Older men who expect high health care costs for themselves or their spouses after age 65 retire about 13 months later than those who expect low costs (64 years, 1 month, versus 63 years, 0 months). The difference for women is 12 months (63 years, 5 months, versus 62 years, 5 months). Health care costs include all insurance premiums and out-of-pocket payments to health care providers. Expectations about future costs are based on current health status and the availability of retiree health benefits from employers, and assume that recent medical inflation will continue into the future.

Implications

Health care spending now consumes 16 percent of the nation's gross domestic product, up from 7 percent in 1970 (Catlin et al. 2008). Current projections show that real per capita health care spending will increase at an annual average rate of 3.6 percent through 2016, when health care spending will consume nearly one-fifth of the nation's output (Poisal et al. 2007). The financial implications are startling. A typical older married couple could devote 35 percent of its after-tax income to health care in 2030 (Johnson and Penner 2004).

Many older adults are likely to respond to rising health care costs by delaying retirement, which will

FIGURE 1. Simulated Retirement Ages, by Expected Health Care Costs after Age 65



Source: Johnson, Penner, and Toohey (2008).

Notes: The analysis sets low health care costs equal to the 10th percentile of the distribution, moderate costs equal to the 50th percentile, and high costs equal to the 90th percentile. Simulations are based on retirement hazards estimated on a sample of Health and Retirement Study respondents ages 52 to 63 in 1994 who were followed until 2004 and employed full-time as wage and salary workers at study baseline. Respondents are considered to be retired when they first report not working or looking for work.

benefit the economy by reducing the costs of an aging population, spurring productivity, and increasing tax revenues. Those who continue working will boost their incomes, offsetting higher health care costs. But rising costs will especially squeeze those who are unable to work longer.

Curbing the growth in health care costs is essential. Soaring out-of-pocket payments may indicate the need for additional benefits for low-income households, but Medicare and Medicaid's budgetary pressures make new initiatives difficult to finance.

Note

This brief is adapted from Johnson, Penner, and Toohey (2008). The Rockefeller Foundation provided financial support for the brief.

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