

How Much Does Out-of-Pocket Medical Spending Eat Away at Social Security Benefits?

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The general public and most policy analysts tend to evaluate the adequacy of Social Security benefits based on the total level of retirement income they provide. More relevant to retirees' purchasing power, though, is their Social Security income net of out-of-pocket (OOP) medical costs, which are often considered nondiscretionary. By this measure, the adequacy of Old Age and Survivors Insurance (OASI) benefits has been on a decades-long decrease due to rising OOP costs. Until a slowdown during this decade, OOP costs for Medicare beneficiaries rose dramatically – costs increased by 44 percent between 2000 and 2010 (Cubanski et al., 2014) – and they are expected to continue to rise faster than overall inflation. Further growth in OOP costs would resume the decline in the share of retirees' Social Security income available for everyday, non-medical expenses.

This project examines how Social Security income net of OOP medical costs differs across individuals using the *Health and Retirement Study* (HRS) from 2002 to 2014. This recent time period, for which the HRS has complete data on premiums and other out-of-pocket medical spending, also allows for the examination of the change in OASI income net of OOP costs before and after the 2006 introduction of Medicare Part D.

This project's approach is similar in spirit to the information presented in the Medicare Trustees Report (see Figure II.F.2 of the 2017 report), which shows the average portion of care covered under Medicare Parts B (physician and outpatient care) and D (prescription drugs) for which the beneficiary is responsible relative to average Social Security income. But this project differs in two important ways. First, it uses individual-level data rather than averages. The individual data allow for addressing questions such as whether medical costs comprise a larger share of OASI benefits for the near-poor who do not qualify for Medicaid but have a difficult time purchasing supplemental insurance, or whether benefit adequacy is a bigger problem for seniors with the most health complications or for the oldest old. Second, the OOP measure used in this investigation is expanded to include all costs borne by Medicare beneficiaries, including OOP spending on hospital care (usually covered under Part A) and other uncovered health expenses that eat into retirees' Social Security income. The analysis also accounts for supplemental insurance coverage from Medicaid, Medicare Advantage, and retiree health insurance. This analysis is important to the Social Security Administration because premiums

and cost sharing at the average, and OOP costs limited to medical care covered under Parts B and D, provide an incomplete picture of individual benefit adequacy.¹

Data and Methodology

The sample consists of Social Security beneficiaries ages 65 or older enrolled in Medicare. The outcome of interest is the post-OOP benefit ratio for Social Security beneficiary i in year t :

$$Post\ OOP\ benefit_{it} = \frac{(OASI\ benefit_{it} - OOP_{it})}{OASI\ benefit_{it}} \quad (1)$$

This ratio captures individual i 's share of OASI benefits available for non-medical spending. The project uses the 2002-2014 waves of the HRS to compute this ratio, where OOP spending is constructed from the core module questions about medical spending over the previous two years, and Social Security income is based on self-reported monthly benefits.² To exclude long-term care costs, the sample excludes individuals who reported spending time in a nursing home at some point.³

Results

Medical spending and the post-OOP benefit ratio. The typical (median) Social Security retirement beneficiary has about 85 percent of his benefit remaining after paying for premiums and cost sharing, as of 2014. But because medical spending is quite high for some individuals – median OOP spending was about \$2,400 in 2014, but was \$3,100 at the mean and \$4,400 at the

¹ The project builds on several previous studies that were interested in the OOP burden on retirees but did not focus on how this burden compares to Social Security income or did not fully reflect the differences by sources of supplemental insurance (Webb and Zhivan 2010; Cubanski et al. 2014; Akincigil and Zurlo 2015; Favreault and Johnson 2016).

² The analysis begins in 2002 to provide a consistent measure of out-of-pocket costs accounting for premiums; the HRS only began collecting premiums for Medicare Advantage in 2002. The analysis also includes premiums from up to three private supplementary plans, and – beginning in 2006 – Medicare Part D. The analysis also adds the premium for Part B (for respondents who do not report Medicaid), which is not reported in the HRS. The measure of OASI benefits is constructed from the reported Social Security check amount plus the Part B premium (where applicable), since the self-reported Social Security amount is net of deductions. The next draft will include Social Security income calculated from administrative records.

³ As a next step, the project will incorporate *Consumption and Activities Mail Survey* (CAMS) data on medical spending.

75th percentile – the post-OOP ratio varies greatly across retirees. The average post-OOP ratio is 75 percent, implying that only about three-quarters of OASI income remains for the average retiree. For approximately 3 percent of the sample, OOP costs actually exceed OASI income.

Heterogeneity by type of supplemental insurance, income quintile, age, and health status.

Because they have to pay extra premiums, Medicare Advantage enrollees have less of their OASI income left after medical spending (77 percent) than those with only Medicare coverage (84 percent). The post-OOP ratio is fairly constant by household income quintile, though the highest income quintile spends a slightly larger percentage of their OASI income on medical OOP, likely because they have income outside of Social Security to support their other needs. Post-OOP ratios are slightly higher for the youngest retirees but generally do not vary much by age (in part because individuals who have spent any time in a nursing home are excluded from the analysis). The post-OOP ratio has historically been lower for those with at least one chronic health condition.

Post-OOP ratio before and after Part D. This project's results are similar to the Medicare Trustees Report: though OOP spending was on the rise until 2006, it has fallen slightly in real terms in more recent years. The results suggest that Part D is responsible. Prescription drug spending has fallen sharply since 2006 (in line with Akincigil and Zurlo 2015), and the groups that stood to gain the most from the introduction of Part D – those with no supplemental coverage and those with at least one chronic condition – saw the largest increases in the post-OOP ratio.

Conclusion

This project shows that only 75 percent of the average retiree's Social Security income remains after spending on medical care, after accounting fully for Medicare and supplemental insurance premiums, cost sharing, and any uninsured expenses. A substantial share of other households have even less of their benefits left over. Of course, retirees face budgetary pressure from other non-discretionary expenses as well; Farrell and Greig (2017) find that housing expenses, taxes, and non-housing debt represent about 30 percent of retirees' household income. Although OOP medical spending has declined somewhat since the introduction of Part D – as

well as the closing of the “donut hole” beginning in 2011 – these findings suggest that Social Security beneficiaries’ lifestyles remain vulnerable to a likely revival in medical spending growth.

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