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Thin Protections: High-Deductible Plans Provide Little Comfort for Asset Poor Middle-Income Families

A $5,000 Deductible could nearly wipe out worth of 40% of Consumers

Introduction

As part of an overall health reform package, some California policymakers are promoting, even mandating that all Californians have – at a minimum – health plans with high deductibles and high out-of-pocket costs. Proponents believe that this health coverage, as expensive as it is to use, at the very least can keep people from losing their assets or even filing for bankruptcy.

Such high-cost high-deductible plans have been popularized and promoted by the Bush Administration, which is attempting to make the plans more attractive by offering individuals a way to set aside money away, tax free, in Health Savings Accounts. Such accounts are only allowed if a person buys a high-deductible health plan.

Health Access, however, believes that a high cost, high-deductible plan would impose a bigger financial burden on consumers, without fulfilling the primary purpose of insurance: protecting them from financial ruin. The Health Savings Accounts are simply "asset protection plans'' for people with the extra income to salt away in such savings plans, and who have assets to protect.

Our research shows that many middle-income families, some who are uninsured and earn too much to qualify for subsidized coverage, have few assets and significant debt.

Paying full freight for premiums, in addition to potentially large deductibles and out of pockets costs of $5,000 to $10,000 or more could easily eliminate all of a family's savings, or tip a family that is already in debt into bankruptcy.

A deductible of $5,000 would wipe out 40% of Californians, forcing them to sell the car, clear out the savings account, and empty out any retirement savings, leaving them only with whatever equity they have in the house. Out of pocket costs of $10,000 would eliminate almost all the assets of 60% of Californians, again leaving them with only the equity in the house. Already, many Californians are priced out of owning a home.

In this paper, we show that forcing families to have a bare-bones, high-deductible health plan is of little comfort to the majority of middle-income families with few to no assets that need to be protected. Rather, we would advocate for plans that

have basic benefits, including prescription drugs, with lower deductibles that families can rely on.

Assets: Living on thin margins

Middle-income families are finding it increasingly difficult to set money aside after they pay for their necessities – food, utilities, housing, and loans. In the last quarter-century, living as a middle-income American has become more expensive. In fact, in current dollars, middle-income families have fixed costs that are 243 percent higher than similarly situated families 25 years ago, from $20,866 to $50,755.[i]

Income, on the other hand, has not kept pace with inflation. From 1981 through 2006, income grew by 46 percent.[ii] In real terms, it means a family that used to survive with just one income earner, now needs two.

After paying their fixed and necessary costs, Americans have little to set aside for savings. A recent survey found that 25 percent of workers report having no savings at all, *including* their retirement savings.

Almost 50 percent of workers report that their total savings and investments (not including the value of primary homes or defined-benefit plans) amount to less than $25,000.[iii]

Table A: Reported Savings and Investments by Age (excluding primary home or pension plans)

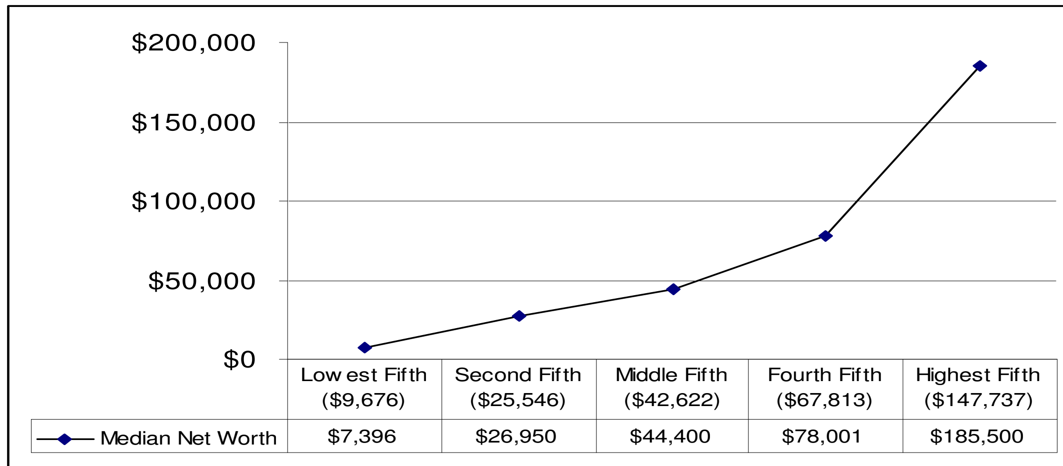
Savings	All Workers	25-34	35-44	45-54	55+
Less than $10k	35%	50%	36%	24%	26%
$10k-25k	13	18	16	10	5
$25k-50k	10	9	10	11	9
$50k-100k	13	10	14	15	11
$100k-150k	8	7	7	9	11
$150k-250k	7	1	9	10	9
$250k-500k	7	1	4	12	11
$500k+	7	4	4	9	17
TOTAL	100	100	100	100	100

Assets: Without a home, Americans are poor

Americans lock away assets in many ways – vehicles, retirement plans, stocks and savings. Combining all the assets that Americans have, the median net worth for US residents in 2000 was $55,000, but, as expected, this wealth is not evenly distributed.

As Table B illustrates, net worth increases manifold as income increases. The *combined* median assets of 80 percent of the population is still less than the wealthiest fifth of US residents.

Table B: Median Net Worth by Income level[iv], including home equity



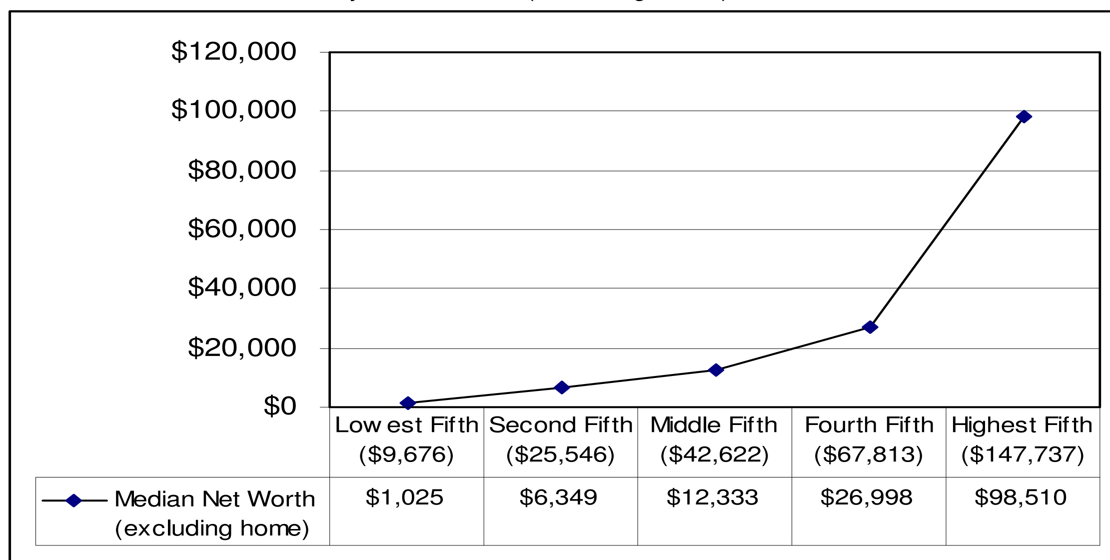
	Lowest Fifth ($9,676)	Second Fifth ($25,546)	Middle Fifth ($42,622)	Fourth Fifth ($67,813)	Highest Fifth ($147,737)
Median Net Worth	$7,396	$26,950	$44,400	$78,001	$185,500

**Average annual income for quintile in parentheses*

Excluding homes and home equity, median net worth sinks even lower. Additionally, were it not for the run-up in home prices the past decade, net worth for families would not have grown at all.

As Table C (below) shows, about 40 percent of consumers have a net worth of about $6,000 or less. The table does not include primary homes, but does include cars, 401k plans and savings accounts. Judging by these numbers, a $5,000 deductible would essentially force a family to sell off their cars, borrow against their 401ks, and wipe out their savings. An out of pocket maximum of $10,000 per family as proposed by the Governor would wipe out almost all the assets of 60% of Californians, leaving them only with the equity in the house—assuming they could afford a house.

Table C: Median Net Worth, by income level (excluding home)



	Lowest Fifth ($9,676)	Second Fifth ($25,546)	Middle Fifth ($42,622)	Fourth Fifth ($67,813)	Highest Fifth ($147,737)
Median Net Worth (excluding home)	$1,025	$6,349	$12,333	$26,998	$98,510

Liabilities: One-third of the state does not earn enough to cover basic needs

Federal poverty level was established in the 1960s to give policymakers then an idea of how much families needed to earn to pay for food. The calculation is based on a basic food budget, multiplied by three. With housing, child care and transportation costs eating a higher proportion of income, poverty is an antiquated way to calculate a family's basic needs.

The California Budget Project and Economic Policy Institute have come up with a different measure – a basic family budget – which shows a two-parent family where both parents work would need to earn $63,921 annually (2005). That is nearly seven times what 100% of poverty level was in 2005.

Liabilities: Even With a Home, Americans are Poor

To help make ends meet, families are turning to higher-interest means – such as payday loans and credit cards – to tide them over. Not only has housing become more expensive, eating up more of a family's disposable income, but levels of consumer debt are also rising affecting the lower- and middle-income most profoundly. Table D shows that families are dedicating a larger chunk of their paychecks to both pay the mortgage and pay off debt.

Table D: Household debt & Total debt as a percentage of Personal Income[v]

	Mortgage Debt	Total Debt
1980	8.28%	13.33%
1985	9.4	14.91
1990	10.28	15.48
1995	9.56	15.17
2000	9.29	15.76
2005	11.29	17.90
2006	11.71	18.20

In dollars, families filing for bankruptcy had a median credit card debt level of $11,038 between 2000 and 2002. The average debt level, however, was far higher at $17,738.[vi]

The following table illustrates how average credit card debt regularly equals one-third to one-half of a middle-income family's annual take-home pay. Experts say a typical middle-income family could dedicate about 20 percent of their income each month to paying off debt.

Table E: Annual Income and Level of Credit Card Debt of Families Filing Bankruptcy (2000-2002)

Annual Income	Average Credit Card Debt	Median Credit Card Debt
0	$22,867	$12,951
Up to $12,000	$14,298	$8,485
Up to $24,000	$14,707	$8,273
Up to $36,000	*$15,850*	*$10,231*
Up to $48,000	*$19,387*	*$13,849*
Up to $60,000	*$21,050*	*$16,291*
Up to $72,000	$26,153	$20,067
More than $72,000	$41,978	$33,542

Source: Credit Card Debt in Chapter 7 Cases

The Consumer Bankruptcy Project, which questioned consumers filing for bankruptcy in 1981, 1991, and 2001 found that the median *non-mortgage* debt (credit card, utility bills, car loans, etc) was equal to about 14 months of a debtor's total income. In other words, "it would take the median family more than a year to pay off their…short-term debts, even if somehow interest stopped running, they applied all their income to principal payments, and *someone else* paid their rent and bought their food, gas and the other necessities of life." [vii]

Table F: Debt by Income Level[viii]

Quintile	Average annual Income within Quintile	% of Households with high debt burden	% Debt as a share of income
Top Fifth	$147,737	2.1%	13.3%
Fourth Fifth	$67,813	7.1	18.5
Middle Fifth	$42,622	13.7	19.4
Second Fifth	$25,546	18.6	16.7
Bottom Fifth	$9,676	27	18.2

Assets: Dream Home a Dream for Many Middle-Income Families

For the vast majority of Americans, their savings are tied up in home equity. Californians, however, are less likely to own a home, thus minimizing their savings base.

In 2005, California ranked 49th in homeownership nationwide (with 59.7% of Californians owning homes.) The Golden State was trailed only by New York, where only 56% of residents owned their own home. By contrast, nearly 70% of US residents own their own home, according to Census statistics. [ix]

With the rapid run-up in home prices early this decade, many middle-income families across the nation found it increasingly difficult to gain a foothold in the homeownership cadre.

In California, higher-than-national-average housing prices exacerbated this problem. Table G compares how much a person/family would have to earn to

afford a median priced home. These “affordability indices’’ from national and state realtors measures how many first-time buyers can afford an entry-level home.

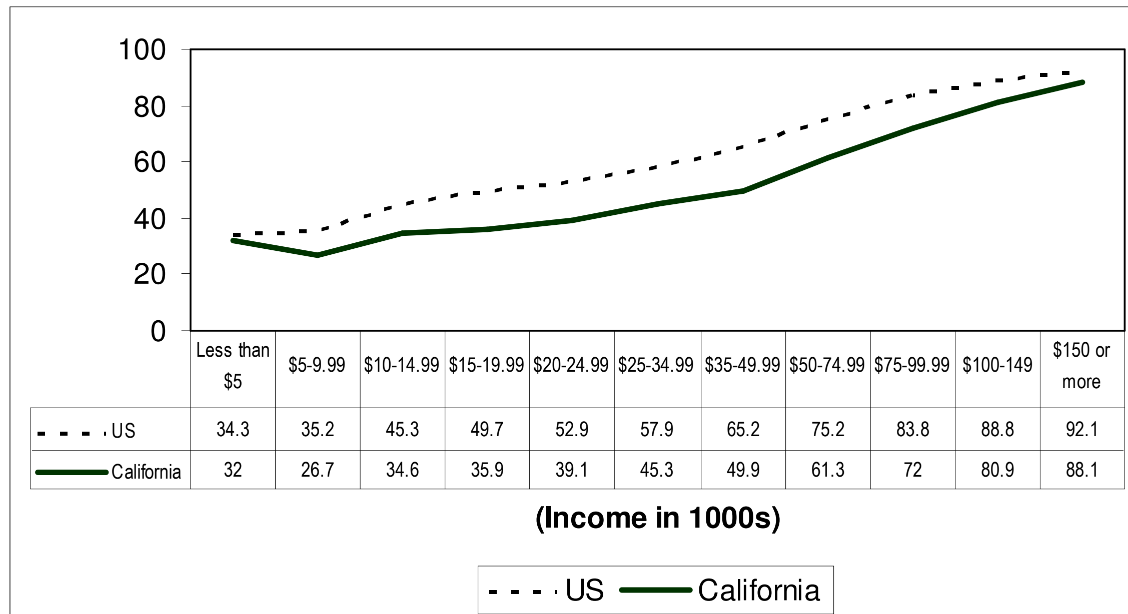
Table G: First-time homebuyer affordability; first quarter of 2007

	Affordability Index	Median Home Price	Minimum Qualifying Income	Median Income
U.S.[x]	76%	$180,500	$50,160	$63,800[xi]
California[xii]	25%	$480,670	$96,910	$69,377[xiii]

As Table G shows, only 25 percent of first-time buyers were able to afford an entry-level home in California. For a typical family to qualify – and afford – a starter home in California, it would need to earn 39 percent more than the median income of $69,377.

Given the wide disparity between the median income and qualifying income, it comes as no surprise that middle-income Californians are having a hard time buying homes.

Table H: Percent Owner-Occupied Homes by Income[xiv]



As Table H illustrates, across all income levels, Californians are less likely to own homes than families earning an equivalent amount in the rest of the country. The widest gap in ownership occurs in the middle-income ranges -- $35,000 to $75,000 a year – with families 15.6 percent *less likely* to own a home in California than the rest of the nation.

Medical Debt contributes to overall debt

In January 2007, Demos and the Access Project released a report detailing the levels of credit card debt among those with and without medical debt. The report showed that families *with* medical debt had credit card bills were 46% higher ($11,623 versus $7,964).

Table I: Debt-to-income ratios by annual household income[xv]

Income	With Medical Debt	Without Medical Debt
Less than $20,000	44%	44%
$20,000-$30,000	39%	24%
$30,000-$40,000	29%	19%
$40,000-$50,000	30%	19%
$50,000-$60,000	26%	15%
$60,000-$70,000	21%	12%
Higher than $70,000	23%	13%

Bankruptcy: Just a hair-trigger away for middle-income families

The 2001 Consumer Bankruptcy Survey[xvi] found that 87 percent of personal bankruptcies are attributable to three factors:

* Medical problems;
* Divorce or separation;
* Job loss.

Medical debt steals the largest piece of the pie, with 54% of those filing for bankruptcy claiming medical debt as part of the reason. What's more, three-quarters of those whose medical debt contributed to bankruptcy *had* health insurance.

Conclusion: Middle-Income families cannot afford the additional burden

As we have shown, middle income families are being crushed under the weight of basic living costs and debt.

Middle income families – earning as much as $70,000 a year -- are:

- Struggling to buy and hold onto a home,
- Saving few dollars in the bank and for retirement, and;
- Tying up as much as one-third of their income in credit card debt.

An individual mandate would have the opposite of its intended effect – exposing middle-income families to even more financial burden. Now, a family that is already spread too thin would be exposed to another obligation.

An individual mandate for health insurance could cost at least $100-a-month in premiums (if you're a young man in Los Angeles). The bare bones plans that are

being recommended could add up to $7,500 in costs for an individual $10,000 for a family. Some would argue that such high-deductible plans would be an desirable option for healthy, high-income, high-asset Californians who can afford to pay out-of-pocket for routine care and have their homes and savings protected.

But many Californians – even the middle-income – would not benefit by such plans. Their incomes are just enough to allow them to live, paycheck-to-paycheck, with little left over to save or acquire assets. Forcing these families to spend money on health coverage when they have no assets to protect would be unfair. That is why consumer advocates would not recommend these plans, let alone require them.

As we have shown, the high deductible plans would only add more stress to the thin financial resources of middle-income families and do little to protect families from significant medical debts of thousands of dollars. An individual mandate for a high-deductible plan would have perverse result of bringing a middle-income closer to bankruptcy, not protecting it. Rather, policymakers should consider setting "minimum plans'' with lower deductibles. Such plans would provide coverage and security to middle-income Californians who are struggling to hang on to their lives.

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[i] Warren, E & A. Warren Tyagi. *The Two-Income Trap*. 2004.
[ii] Analysis of California Department of Finance per capita income data in current dollars.
[iii] Helman, R., Matthew Greenwald & Associates; J. VanDerhei, Temple University and EBRI Fellow, C. Copeland, EBRI. "the Retirement System in Transition: The 2007 Retirement Confidence Survey." *EBRI Issue Brief. No. 304.* April 2007.
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[v] Federal Reserve Board 2006 data
[vi] Flynn, E. and G. Bermant. "Credit Card Debt in Chapter 7 Cases." US Trustee Program/Department of Justice. December 2003.
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[viii] Bureau of Labor Statistics and *State of Working America, 2006-07 edition*, Economic Policy Insitute
[ix] U.S. Census
[x] "Quarterly Housing Affordability Index for First-Time Buyers." National Association of Realtors. 2007.
[xi] U.S. Department of Housing and Urban Development
[xii] "C.A.R. reports entry-level housing affordability at 25 percent in California.'' California Association of Realtors. May 17, 2007.
[xiii] U.S. Department of Health and Human Services
[xiv] Calderon, Olivia. *"Expanding Access to Homeownership for Low-to-Moderate Income Families In California." New* America Foundation, Asset Building Program.
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[xvi] Warren, E & AW Tyagi. *The Two-Income Trap*. 2004.