REAL WORLD MICRO

SEVENTH EDITION

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REAL WORLD
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edited by
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the Dollars & Sense Collective

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INTRODUCTION

Conventional microeconomic theory assumes that the market system, with minimal regulation, provides the best of all possible worlds. Consumers acquire exactly what they want (within their budgets) and firms produce the most socially desirable goods while making a profit. The articles in this book challenge such assumptions, demonstrating that markets are not producing ideal results for the majority of people in the world today.

The seventh edition of *Real World Micro* contains 43 articles that have appeared in *Dollars & Sense*, a bi-monthly economic affairs magazine. Together, they present an alternative vision of how markets work — a vision based on real markets and real people.

Chapter 1 explores privatization and deregulation, two major economic trends throughout the world today. Edward Herman gives an overview of the practice and consequences of privatizing government enterprises and services. We examine the current push to deregulate the electric utility industry, and the ongoing changes in how health care insurance is provided. Finally, we look at how democracy has become a market, for sale to the highest bidder.

The second chapter, "The Problem With Markets," looks at the imperfect functioning of markets as they respond to supply and demand. Traditional theory disposes of hard questions in this area by assuming that markets naturally maximize social welfare. The articles in this chapter analyze why this is frequently inaccurate, through case studies of child care, rental housing, "fringe" banks, and tobacco taxes.

Much of the conventional microeconomics curriculum is devoted to consumers, who account for the bulk of spending in the economy. Consumers are typically assumed to have complete and perfect information about both their own economic resources and the products they buy. In contrast, Chapter 3 demonstrates how consumers' choices are constrained by their resources or manipulated by external forces, most notably advertising.

Microeconomics treats firms as profit-maximizing enterprises. This is one assumption the editors of *Dollars & Sense* don't challenge. However, unlike most texts, the articles in chapters 4 and 5 of *Real World Micro* argue that profit maximization can be dangerous to an employee's health — and to the overall health of the economy. In Chapter 4, we examine firms and competition, showing how different management structures, from traditional top-down management to worker participation programs to co-ops, yield contrasting results for workers. In Chapter 5, the articles show how different market structures — monopoly, oligopoly, and competition — affect consumers and workers in such industries as supermarkets, trucking, and the media.

Chapter 6 covers labor markets, which differ sharply from markets for pizzas, haircuts, or airplanes. Unlike other factors of production, labor is a human input. These articles explore the human dimensions of labor markets, examining the low-wage labor market, unions, downsizing, temporary workers, "workfare," the minimum wage, and the debate over the labor market consequences of immigration.

Chapters 7 and 8 confront pressing issues facing society today: discrimination, poverty, and inequality; and the health of the environment. Chapter 7 uncovers the extent and origins of poverty and inequality in the United States, and documents the inadequacy of government responses. The articles also address racism and sex discrimination in the labor and mortgage markets.

Chapter 8 examines current controversies in worldwide efforts to reduce pollution and preserve natural resources. "Does Preserving the Earth Threaten Jobs?" debunks claims that environmental protection will cause large-scale job losses. The other articles look at mangrove forest destruction due to shrimp farming in Thailand, recycling, and "environmental justice" for low-income communities.

The final chapter examines the global economy, with the first article providing a basic critique of free trade and investment. Three concluding articles address the effects of the North American Free Trade Agreement both outside and inside U.S. borders.

As you'll see, *Real World Micro* is a lively and provocative supplement to your standard microeconomics textbook. We hope you enjoy it.

— The Editors of *Dollars & Sense* magazine

CHAPTER 1

Markets Everywhere: Privatization and Deregulation

ARTICLE 1 *March/April 1997*

PRIVATIZATION

DOWNSIZING GOVERNMENT FOR PRINCIPLE AND PROFIT

BY EDWARD S. HERMAN

The U.S. government is encouraging private HMOs to service much of the Medicare system, and the debate rages over whether Social Security should be shifted to private management. Privatization of such public functions is one of the mantras of the New World Order. Economic, political and media elites assume that privatization provides undeniable benefits and moves us toward a good society.

But while it sometimes reduces costs, privatization is often less efficient than public enterprise, and frequently is socially harmful, taking a disproportionate toll on women and minorities. Privatization also weakens democracy by bypassing unions and shifting power away from governments and nonprofit organizations, which can respond to democratic political processes. Instead, power moves to corporations that serve only the interests of their owners and financiers.

In summary

Privatization means the shift of activities from the government and nonprofit sectors to the market. It may take the form of the sale of public (or nonprofit) sector assets to private companies or the contracting out of services previously supplied by public employees.

Privatization is not new. In France before the Revolution of 1789, the King farmed out government tax collecting to individuals in a system notorious for corruption. Along with contracting out the provision of supplies for the French armed forces, private tax collecting was the basis of many great fortunes. Ending this system was one of the French Revolution's accomplishments.

Throughout the nineteenth century, the U.S. government engaged in massive privatization through the sale of millions of acres of public land (a domain greatly extended by the Louisiana and Alaska purchases and the seizure of Mexican territory). Many tycoons derived their fortunes from shrewd and sometimes fraudulent public land acquisitions. Abuses in the use and disposal of public property have continued throughout the twentieth century, manifested in both periodic scandals (such as Teapot Dome) and the subsidized use of public property, which continues today through, for example, underpriced sales of national forest timber, bargain-rate use of mineral lands, and commercial broadcasters' free use of valuable air rights.

Western European and Third World governments have commonly owned airlines, railroads, telecommunications and electric power systems, and sometimes banks, petroleum refining and other industrial enterprises. But in the United States government has been largely excluded from activities of interest to private business, and its periodic entry into these fields has been limited and often stripped away. The government did take over many private sector activities during both World Wars I and II, but it speedily privatized them after the wars.

Since 1932, Congress, under the prodding of business, has made periodic surveys of government activities that compete with the private sector, with a view toward minimizing government competition. Ronald Reagan's Office of Management and Budget formalized the pressure on government agencies to minimize in-house production, ordering government managers to consider contracting out all functions, including data processing, janitorial services and vehicle maintenance.

Despite this long-standing bias against public enterprise in the United States, with the rise of monopoly power in railroads, electric power, and telephones during the late 19th and early 20th centuries the government created a regulatory apparatus. It grew with urbanization and the need for water supply and waste disposal, and the coming of the automobile and road building. The public sector grew further with the social democratization that accompanied the Great Depression and World War II, including the growth of organized labor and a new governmental health and welfare apparatus.

Privatizers from the early 1970s onward have been selling off government property — mainly water and waste water facilities, parking garages, roads, airports, public lands and buildings, and mortgage portfolios. But privatization in the United States has focused mainly on the contracting out of government services, including the operation of government-owned facilities.

State and local governments carry out most public economic activity, and contracting out at these levels has soared over the past decade. The Mercer Group, an Atlanta consulting firm, estimates that between 1987 and 1995 the number of municipalities contracting-out services increased as follows: janitorial from 52% to 70%, street maintenance 19% to 38%, solid waste collection 30% to 50%, and data processing operations 16% to 31%.

This new wave of contracting-out ignores historical lessons. A great deal of current government provision of services originated in the failures of contracting during the late nineteenth century and into the 1920s, under political systems that were often corrupt. Ending such arrangements and turning them over to public agencies was a major accomplishment of the 1920s and later.

ROOTS OF THE NEW PRIVATIZATION WAVE

The privatization wave over the past twenty years is rooted in increased corporate power. This growth, based partly on greater capital mobility, has led to renewed aggressiveness by business, political successes (including the elections of Ronald Reagan, British Prime Minister Margaret Thatcher, and neoliberals widely), and a parallel weakening of labor.

Enhanced corporate power has also contributed to the triumph of neoliberal ideology. Central beliefs of this ideology include the efficiency of the private market, the inefficiency of government, and the dual menaces of inflation and budget deficits. With neoliberalism in place, helped by corporate domination of think-tank funding and the mass media, along with great influence within the ivory tower, scaling back government was an obvious policy thrust.

Part of the design of neoliberal politicians and intellectuals has been to weaken the state as a power center that might serve ordinary citizens and challenge the rule of the market. The success of these efforts is evident in both Britain and the United States, where formerly liberal parties now denounce big government, genuflect to market-based solutions, and contribute to eroding the welfare state.

Governments' budgetary problems gave further impetus to privatization. As the *Wall Street Journal* pointed out in 1995, referring to talk of selling the federal oil reserves, "Both Congress and the White House want to change budget-accounting rules so they can count money raised by selling assets toward reducing the deficit — even if such sales would reduce government income... in future years." At the state and local level, "cash-strapped cities, such as Wilmington, Delaware, want the upfront cash they can get by selling the local sewage-treatment plant, or look to private ownership as a way to finance improvements of existing facilities."

The new global economic order itself has contributed greatly to these financial difficulties. Capital has fled from urban cores, leaving them in fiscal straits, and corporations have bargained aggressively with governments to extract concessions as conditions for their keeping jobs in place (or to induce them to move). All governments have had to limit business taxes and spending on social benefits in order to provide a "favorable investment climate," leaving them under financial stress. Intel Corporation, for example, bargained so effectively in 1995 with Rio Ranchos, a small New Mexico town eager to be the site of an Intel plant, that the town was forced to sharply cut its school budget.

Another force for privatization has been the growing power of financial markets, which reward and penalize governments as they meet or fall short of market policy standards. Financial market players want low inflation and balanced budgets. They are keen on privatization because it yields short term revenues and is a mark of commitment to neoliberalism.

Privatization has also been pressed by innumerable entrepreneurs eager to buy up government property and provide services previously supplied internally. Partly in anticipation of privatization opportunities, many of them had obtained political leverage by funding the electoral campaigns of politicians now in office.

EFFICIENCY GAINS OR WAGE REDUCTIONS?

Although the privatizers claim that their objective is to increase efficiency, this is contradicted by their indiscriminate actions and their frequent disposal of public enterprises noted for efficiency. There is also evidence that they are often responding to financial and political pressure. Furthermore, many bids for government property and contract service base their savings largely on shifting from union to non-union and contingent labor.

Take, for example, contracting of the cleaning service for state buildings in Buffalo, New York in 1992. While initially claiming that the low contractor offer was based on efficiency improvements, state officials eventually admitted to the *Buffalo News* that the savings would come from the use of "more part-time workers at lower salaries and with fewer benefits." Study after study has shown that contractors offer lower wages and limited if any health and pension benefits. But gains from lower wages and benefits are not true "efficiency" improvements, which imply a reduction in the use of resources such as labor and materials. They are actually income transfers from wage earners to employers (profits) and to government managers and taxpayers.

Even the nominal savings in privatization may be illusory or short-lived. A common phenomenon in contracting out was made famous in the weapons contracting formula "buy in, get well later." The contractor bids low, knowing that he can obtain cost adjustments after the government gets locked in to the contract and would find it difficult to cancel and locate another source, or do the job in-house.

The most famous case was Lockheed's bid to produce the C-5A giant transport plane in the 1960s, which led to a huge cost overrun that doubled the price before a single plane was produced. Lockheed's contract had an automatic cost-based price escalation clause that was soon dubbed the "golden handshake."

Even fixed-price contracts could be raised through "improvements" offered by the contractor or demanded by the Pentagon — a process known as "gold-plating." One result of this abusive contracting system was that for decades the major contractors had profit rates on their Pentagon business roughly twice those in their commercial operations.

WHO WATCHES THE CONTRACTORS?

There is a contradiction in conservative enthusiasm for contracting, glossed over by their assumption of vigorous contractor competition. Conservatives consider governments corruptible and incapable of efficient operation. But contracting-out demands exceptional knowledge and honesty on the part of politicians and government bureaucrats: they must negotiate contracts that defend the public interest, and they must monitor them carefully. If they are incompetent and/or crooked, contracting-out can be disastrous in terms of cost and performance.

Contracting-out causes competition to assume the form of skillful use of political influence, public relations, and even bribery. In addition, profits can be enhanced by carving loopholes in contracts, keeping monitoring weak and capturing regulators. It is true that with in-house government production political influence can also be damaging, but the lines of responsibility are clear. With contracting-out these lines are more obscure. This can yield the worst of both worlds (government and private enterprise), with limited efficiency incentives, high levels of politicization, and unclear responsibilities.

Many years ago the U.S. government did weapons research and produced many of its weapons in government arsenals. This was gradually phased out in favor of farming out research and production to private sellers. But without in-house production and research capabilities the government's bargaining position was reduced. It no longer had the option of producing for itself, and lacked the expertise to be a knowledgeable buyer, and so could be taken advantage of more easily. This point applies to other public functions — without a skilled body of managers and technicians the government is a ready victim in contract negotiations with knowledgeable private parties.

Contracting out is at an initial cost disadvantage compared to in-house production. It requires the additional expense of writing and evaluating contracts and then monitoring performance over their lives — the latter entailing a permanent bureaucratic apparatus on top of that deployed by the contractor. If that apparatus is skimped on, politicized, or corrupt, the road is open to massive cost escalation. Contracting out is often not able to overcome the disabilities of monitoring costs and potential corruption.

There is some truth to charges of inefficiency in public enterprises and nonprofit service activities. Many of these have become over-bureaucratized, over-staffed and politicized. Free market proponents speak of "state failure" to counter claims of "market failure" by the private sector. But many state and nonprofit enterprises and services have done well, and when they have done poorly it is often the result of conservative macroeconomic policy and crippling state intervention. When macro-policy is designed to keep a large reserve army of unemployed labor, labor strenuously resists staff cuts and public agencies find it harder to trim staff.

Underfunding, political appointments, and capture of regulatory agencies by corporate interests frequently undermine the functioning of government entities. Such damaging interventions are often deliberate, as in the case of the Reagan-era budget cuts and political appointments to the Environmental Protection Agency and the Corporation for Public Broadcasting, both designed to demoralize and weaken the organizations. In these cases and others the damage inflicted reflects corporate efforts to undermine public bodies through the political process.

PRIVATIZATION AND COMPETITION

Conservatives assume that government sells or contracts out its operations under competitive conditions, and that such competition then and later will restrain exploitation of the contracting authority and the public. This is sometimes correct, but often is not. There are frequently only a few local bidders for contracts, and they sometimes collude, divide markets and rig prices. One contractor testifying in a national antitrust action noted that "as far back as I can remember" Northern Virginia contractors met annually to carve up contracts that the Virginia highway department was expected to allocate during the year. Numerous suits have been brought and won against Waste Management Inc., Browning Ferris and SCA Services for collusion and price fixing in the trash disposal industries.

In major contracting-out businesses there has been steady growth of national operators, like Waste Management and Browning Ferris in waste disposal and ARA in food services. These large operators are able to undercut local firms, some or all of whom disappear, making it possible for the large firms to "get well" later. More generally, once contracts are won, systems installed, relationships cultivated, and rivals driven from the market, the power of the contractor is strengthened and it becomes costly for a public agency to shift the service elsewhere.

In contrast, changing from private to public ownership can *increase* competition. When the Tennessee Valley Authority (TVA) was organized in the 1930s, for example, it broke up the cartel-like high pricing policy of the private electric utilities in the Tennessee Valley, and private companies hated the TVA because it increased competition. As many U.S. and global markets have few sellers (oligopolies), and as private oligopolists often collude, publicly owned firms can disturb cosy private market arrangements.

CORRUPTION

Corruption is built in to the privatization process. Bidding on contracts is not carried out in perfect markets, and in real world markets, with only a few sellers, they almost always seek political influence as a rational business strategy. In a process dubbed the "revolving door," it is now standard procedure for companies seeking contracts to hire former politicians and managers of public agencies to lobby on their behalf.

The *New York Times* noted recently that one reason federal Justice Department and prison officials have warmed up to privatizing prisons, despite their experience that privately run prisons costs more, is that private industry's ranks "now include many former colleagues as senior and other law enforcement officials have taken positions at private corrections companies, Washington's latest revolving door profession."

Corruption operates at many levels: contributing to political election campaigns, cultivating politicians and other public officials, hiring them or their friends, relatives and staff, and straightforward bribery.

LESS SERVICE FOR YOUR MONEY

Another secret to the profitability of privatization is reductions in service. Contractors reap their "efficiency" savings by hiring cheaper and less well-trained labor, with higher turnover rates, and by cutting the quantity, quality and scope of service. There may be fewer service personnel or fewer trash collections or lavatory cleanings. Older, more polluting school buses may be used, and bus and train stops at out-of-the-way places may be terminated. Or charges may be imposed on services formerly provided free, thereby pricing poor customers out of the market.

Contracting out of hospital management and purchases of nonprofit hospitals by large HMO systems are classic cases of service reductions. These contractors and HMOs have strong incentives to exclude unhealthy customers and scale down usage for the remainder. To this end they systematically impose barriers to usage, through toughened standards for referrals to specialists, perverse incentives to doctors on their payrolls, and cuts in staff quantity and quality. To some extent these changes offset occasional lavish usage under cost-plus systems, but contracted and HMO systems have established a direct conflict between the interests of patients and medical servers. They also entail large bureaucratic expenses for evaluation, review and collection, plus incentives to exclude the poor.

The largest hospital system, Columbia/HCA Healthcare, is currently the owner of 350 hospitals in 38 states, and continues to gobble up public hospitals left and right. Its CEO, Richard Scott, says that "Healthcare is a business like anything else," and "Is any fast-food restaurant obligated to feed everyone who shows up?" His company has a 20% gross profit target, and he has been meeting that goal, partly by lower costs for large scale purchase of medical equipment and supplies, but more importantly by union avoidance, "reengineering" nursing personnel (increasing their workloads, substituting non-nurses), and "cream skimming" (taking billable patients, dumping non-billables on other hospitals).

The Department of Health Security in Indiana recently fined Columbia/HCA for understaffing, and doctors and nurses at the Good Samaritan hospitals in San Jose, California, have complained bitterly at the medical damage wrought by the "economies" installed following Columbia/HCA's takeover in 1996. Lee County, Florida officials calculated that in 1994 the public hospital there provided $13 million in "charity/uncompensated care," whereas Columbia/HCA's three hospitals in the county provided $1 million in such unprofitable service.

THE BENEFITS OF BEING PUBLIC

Public corporations, nonprofits, and in-house government activities can bring benefits to communities that are neglected by market-oriented businesses. They are more open to unions and provide more secure jobs than private companies. The security and benefits of such jobs are of great value to workers, but the market gives them no weight. The stability of government spending and jobs also helps mitigate recessions, since governments need not cut their spending when consumer demand and private investment fall.

In transportation there are enormous social costs associated with the growth of auto travel — pollution, congestion, and urban sprawl. Public transportation in the

January/February 1997

COMPETITION COMES TO ELECTRICITY

INDUSTRY GAINS, PEOPLE AND THE ENVIRONMENT LOSE

BY ROGER COLTON

"People will die." That's why Bobbi Bennett, an energy specialist at the National Training and Information Center (NTIC) in Chicago, opposes competition in the electric utility industry. "Many people simply can't afford to pay their bills," Bennett says. "Some of them will die if their protection is left up to a competitive utility."

It was nighttime and Philadelphia Electric had turned off the electricity to Gloria Blackwell's home. The kids were playing by candlelight in a back bedroom. Their eyes flickered shut but the candle didn't flicker out. The result? A seven year old child dead and a five year old scarred for life with third degree burns over 35% of his body.

"We don't like to shut people off," the utility's spokesperson was quoted as saying, "but if they're not going to pay, we can't keep giving them free electricity."

This scenario is likely to play out in increasing numbers as utilities "get tough" in their collection efforts. These efforts are necessary to be more competitive, the utilities say. In one case, Southern California Edison chose to treble its service disconnections, to one-half million customers in 1995 alone.

The lights blinked once... twice, and then went out. Suddenly, consumers were looking at computers that were not computing, lights that were not lighting, and refrigerators that were not refrigerating. At one point in July 1996, two million consumers in eleven western states and Canada were without power. Only six weeks later, two million customers of Pacific Gas and Electric Company lost power in California.

What happened? As electric utilities serving the region geared up (and scaled down) to meet competition, routine maintenance, such as tree trimming around power lines, was reduced in the name of cost-cutting. Then a storm battered the West coast, trees fell on the power lines, and the lights went out.

These threats to public safety and to reliable electric service, along with pending threats to air quality, are examples of what the current movement toward competition and deregulation of the electric industry may mean. Today, electric companies are state-sanctioned monopolies. They have "exclusive service territories" — geographic areas in which other companies are not allowed to compete. The utilities generate the electricity, transmit the power from their plants to local switching stations, and distribute the power to homes and businesses. In exchange for government protection against competition, electric utilities are subject to state regulation over the reasonableness of their rates and the quality of their service.

In the past, utilities could prevent industrial and commercial businesses from obtaining inexpensive power from non-utility generators, because the utilities had monopoly control over the transmission lines. But federal regulations now require that utilities provide fair access to such lines for all generators, not merely the utility's own plants. So while utilities will retain a monopoly over local distribution, they will have to compete with non-utility generators to produce the cheapest electricity. This threatens the financial stability of many electric utilities, especially those with billions of dollars in stranded costs from expensive nuclear plants.

THE FALL OF THE LAST GREAT MONOPOLY

The gain will be greater consumer choice, argues Central Illinois Lighting Company (CILCO) spokesperson Calvin Butler. Butler recently told a national gathering of consumer advocates in Chicago that "No one tells you where to shop for groceries. Why should they tell you where to shop for electricity?"

The power to choose will save money, according to CILCO. "In a state like Illinois — where [the vast majority] of residential electric consumers [are] supplied by investor-owned utilities [and] pay 20% to 25% more than the national average — the lack of consumer choice is costly to everybody." Other benefits, CILCO claims, will include better service as well as new and expanded services.

Nonsense, says University of St. Thomas (Minnesota) professor Steve Hoffman. The fuss is about the exercise of power, both political and economic. Today's threats to switch to competitive suppliers of electricity are simply the next generation of big industry's threats to move to new locations in order to get lower rates. Because alternative generators now have the legal right to transmit electricity over the local utility's lines, companies need not move their plants in order to switch suppliers.

The recent conflict between Raytheon, a major defense contractor, and Massachusetts Electric Company is one example of how corporations exercised power even under the old system. In response to threats by Raytheon to leave Massachusetts, the local electric company offered rate discounts of 20% and more for five years, with lower discounts being offered in subsequent years. Even then, Raytheon refused the discount in 1995, arguing that the deeper discount should last longer.

Ultimately, a discount was agreed to and approved in January 1996. Raytheon would say only that its deal with Mass. Electric would yield "significant savings" on its $20-million-plus annual electric bill. The state Department of Public Utilities ordered that the precise terms of the discount be kept confidential. The secrecy was necessary, the Department said, because the rates were "competitively sensitive." Several dozen similar deals on both gas and electric rates for large industries had been approved at the time of the Raytheon agreement, with more pending.

In contrast to these actions toward big business, Hoffman says, electric industry competition will almost surely leave the small and less powerful in the dark. These consumers are simply not big enough and economically attractive enough to gain the interest of electric industry competitors. Instead of receiving the promised benefits they will instead receive the harms of increased disconnections, reduced service quality, and higher rates.

With typical residential bills for Mass. Electric Company at just over $700 a year, for example, it would take nearly 30,000 customers having 30,000 meters read each month, resulting in 30,000 monthly bills and the accompanying credit and collection activity, to generate the same revenue as Raytheon's pre-discount bill of $20+ million. The utilities are likely to make up the lost revenue by increasing prices to residential and small-business customers.

For example, in Michigan, one of the states which has experimented with electric competition, during 1995 Consumers Power Company raised electricity rates for its 1.4 million residential users by 8.2% ($42 on a typical annual bill), while lowering rates for the state's 9,000 industrial users by an average of 4.2%. Like Raytheon in Massachusetts, the largest and most powerful Michigan industrial consumers such as General Motors and Dow Corning got rate cuts of up to 20%.

Two developments have led to the push for deregulation of the electric industry. First, competition in the industry will help the big and powerful in society obtain lower energy bills. Many utilities have built more generating capacity than their customers now need, and often they rely heavily on outrageously expensive nuclear power plants. As a result, they have electric rates far higher than their potential competitors, often termed non-utility generators, or "NUGs." Such competitors can run new or existing power plants, usually fired by natural gas, at costs much lower than the average costs of a utility that is saddled with its historical mistakes.

These mistakes — excess capacity and nuclear plants — constitute as much as $200 billion in "stranded costs." Large commercial and industrial users of electricity want to escape from paying for these costs through their electric rates, and have found two methods for doing so. One is bargaining with the utility to provide discounted rates, as in the Raytheon case. The second is competition — having the freedom to buy their power from non-utility generators (or utilities in other states) who have lower costs.

Second, technological changes in the generation of electricity, allowing relatively small plants to operate more cheaply, helped to provide large users with an alternative to the utilities. In the telecommunications industry, the advent of microwave and satellite transmission allowed companies to compete with then-monopoly supplier of telecommunications services AT&T. Similarly, technological improvements have allowed smaller companies to build and operate power plants, making it unnecessary to treat utilities as a "natural monopoly."

The poor, the payment-troubled, and other customers who the electric industry considers less than desirable will suffer from a deregulated free market. Hoffman notes that experience in other deregulated competitive industries shows that the poor and hard-to-serve are disadvantaged by business actions taken to help meet competition. In 1982, for example, Congress largely deregulated the inter-city bus industry. Within ten years, the number of rural locations receiving regular route inter-city bus service had shrunk by more than 50%. A 1992 study by the U.S. General Accounting Office concluded that "the riders who

DEATH AND DESTRUCTION

Increasing the operation of old coal-fired power plants will directly lead to increased deaths. According to the ME3 report, "simply put, the more often a plant runs, the more pollution it will emit." ME3 then cites estimates that 64,000 people may die prematurely from heart and lung disease each year due to emissions of particulates.

Those deaths are likely to be concentrated among people of color and lower income groups. The political power of such customers is usually far less than that of large industries and more affluent residents. As a result, when electricity generators make facility siting decisions, they will search for low-income neighborhoods to locate their plants in.

have been losing service are those least able to afford and least likely to have access to alternative modes of transportation."

DOES COMPETITION BRING NIRVANA?

Even in industries that have never been regulated, competition often imposes higher prices and reduced services on those customers least able to protect themselves, including the poor. Competitive grocery stores in low-income urban neighborhoods, for example, charge prices up to 20% higher than in suburban areas because of claimed higher costs. Appliance and furniture prices in inner-city neighborhoods run 50% higher. Institutions financing mortgages for mobile homes charge far more in interest than for loans on more conventional housing, based on claimed higher default rates.

Competitive industries provide fewer services to poor people as well. One study in Los Angeles found 19 branch banks in South Central Los Angeles, a predominantly poor black community having a population of 587,000 people. In contrast, the study found 21 branch banks in nearby Gardena, a middle class white community of only 49,800 persons. A separate study in Washington, DC found that residents in predominantly white neighborhoods have three times as many branches available, per person, as do residents of predominantly African American neighborhoods.

Similarly, consumer advocate Bobbi Bennett asserts that even if competition "works" in the electric industry, it will not address concerns that are important to society but yield no profits. These include the ability of low-income customers to afford power, and protection of the environment. Such concerns, often termed "externalities," are not of direct interest to businesses, since the businesses neither pay the cost nor receive the benefit of seeing the social goal achieved.

Some vital goods and services, such as electricity or water, should be available at affordable rates to all who seek them, regardless of ability to pay. But since the damage from a lack of universal service is imposed on society, not on the company, a competitive electric utility has little incentive to ensure affordable power. In addition to affordability a competitive market does not ensure that electric utilities will have fair procedures in the denial or termination of service.

Is there any way to make a deregulated electric industry palatable for small users? Some would say yes, if mechanisms are developed to combine small users into large buying blocks that can bargain with power producers. Such aggregation methods might include allowing communities to bargain on behalf of everyone who lives within their boundaries. Large membership organizations such as the American Association of Retired Persons (AARP) and the American Automobile Association (AAA) have set a precedent for this by negotiating discounts on life and auto insurance for their members. Others say that small users simply cannot be aggregated into large enough blocks to convince competitive electric companies to pay sufficient attention to their needs.

DIRTY AIR AND TOXIC NEIGHBORHOODS

Environmental damages are also externalities, so that a competitive firm will not voluntarily try to minimize them. Statutes or regulations can mandate the clean-up of pollution, since the regulated utility now has to pay for them. But a competitive, unregulated environment leads firms to more strongly resist cost increases, and to ignore environmental issues.

A report done for the National Association of Regulatory Utility Commissioners (NARUC) agrees, concluding that "industry restructuring will likely result in competitive pressures to increase the operation of currently underutilitized coal facilities with relatively high air pollution emissions, and to extend the operation lives of these facilities."

Competitive electric utilities that achieve increased sales are likely to rely on old, inexpensive, highly polluting coal-fired power plants. As a result, the public, especially urban dwellers, will be stuck with damaging increases in air emissions as a result of utility sales to new markets.

A report by Minnesotans for an Energy Efficient Economy (ME3) finds that Minnesota's largest utility has four coal plants in the Minneapolis/St. Paul metro area that could increase their output. According to that report: "The plants have several common characteristics, the most important being that they are all aging, coal-burning generators operating in densely-populated areas." In addition, because old plants do not need to meet the pollution control standards of new plants, emissions from the metropolitan plants "are extraordinarily high compared to current standards governing new power plants," ME3 concludes.

Past reliance on improving energy efficiency, instead of building new plants, as a way to control this environmental damage is not likely to continue in a competitive electric industry. According to one industry analyst, Robert Smock of the publication *Electric Light & Power*, "survivors of ruthless competition will not be doing much to reduce electricity sales. They'll be doing their best to sell more of their product." The numbers bear this out. A survey of 50 utilities found that planners expected a 2% growth rate in energy efficiency programs between 1995 and 1998. This is far less than the 17% annual growth rate from 1990 to 1995.

Coke or Pepsi? MCI or AT&T? K-Mart or Walmart? Ford or Chevy? Consumer choice. Substantial bill savings. This is the mantra of competition advocates in the electric industry. But consumer advocates say the real choice is whether to protect the interests of the big and powerful, or those of the small and dispossessed. The electric industry should not be just another business, but rather an industry responsible for serving the public interest. The choice is whether to create an industry whose decisionmaking is governed only by the profit motive, or to maintain regulations that ensure universally affordable electricity and protection of the environment. ■

Resources: Coal Plants in the Neighborhood: Stopping Increased Air Pollution from the NSP Merger, Kevin Bengston, Michael Noble and J. Drake Hamilton, Minnesotans for an Energy Efficient Economy (St. Paul, Minnesota) 1996; *Competition in the Electric Industry: Assessing Impacts on Residential, Commercial and Low-Income Customers*, Roger Colton, National Conference of State Legislatures (Denver, Colorado), 1996.

March 1996

THE SICK HEALTH CARE SYSTEM

ARE CORPORATE HMOs THE CURE?

BY EDIE RASELL

While policymakers have abandoned the idea of comprehensive health care reform, the private health care system has been undergoing revolutionary change. The industrial revolution has come to the health care sector. The practice of medicine is being transformed from a cottage industry of many independent crafts-men and -women, to an industry where health care is provided by corporations employing thousands of people. The goal of the "corporatization" of health care, just as in the early days of the industrial evolution, is to facilitate control of workers (doctors and other providers) by managers, and capture profits for the owners of the corporation.

Health Maintenance Organizations (HMOs) will not solve the problems of the US health care system — high costs, millions of people without access to health care, and large disparities in outcomes and treatment between the rich and the poor. But HMOs are a useful diversion for people who refuse to acknowledge that only fundamental reforms can address the problems of both the public and private health care sectors. Costs, uninsurance and lack of access to care, and disparities in outcomes will continue despite the growth of HMOs. They can be eased only through a universal health care system, financed by a "single payer" (a government agency) — something like an improved Medicare system for all.

PROBLEMS PERSIST AND WORSEN COSTS

National health expenditures continue to rise rapidly, much faster than overall growth in the economy. Peak rates of growth were prior to 1985, but between 1992 and 1993, the most recent years for which we have data, spending rose 7.8% — an unacceptably high rate. Some analysts even worry that once talk (or the "threat") of comprehensive reform has faded, spending growth rates could rise even higher.

Even for employer-sponsored health insurance (insurance received on the job), where the media have reported stories of successful decreases in growth rates, the numbers are not encouraging. In 1994, in both traditional fee-for-service type plans and HMOs, costs per employee rose 10%. Although the level of cost was 13% lower in HMOs than in fee-for-service plans ($3,663 compared to $4,229) this is not necessarily because HMOs provide care more efficiently, as I will describe below.

Since HMOs, on average, cost less than traditional plans, as beneficiaries shift to HMOs, there often is a one-time savings. But evidence shows that in subsequent years, costs continue their uphill climb, unchecked.

INSURANCE COVERAGE AND ACCESS TO CARE

The number of uninsured continues to grow. Between 1989 and 1993, the number of below-65-year-olds without health insurance grew from 34.4 million to 40.9 million, an increase of 6.5 million. This rise would have been even larger had not Medicaid coverage of the poor also increased by 10 million people in this period. Nonetheless, in 1993 one-third of the nonelderly poor — 12 million people — remained uninsured.

The growth in the number of uninsured is largely driven by an ongoing decline in employer-sponsored coverage. Between 1989 and 1993, 16 million more people below age 65, of whom 7 million were children, found themselves without employer-sponsored coverage. In 1993, employer-sponsored health insurance — the backbone of the system for people under age 65 — covered just 61% of all people under age 65, down from 66% in 1989.

Over half of the uninsured are full-time, full-year workers or live in families with such workers. An additional one-third of the uninsured are workers or family members of workers who are employed part-time. Only the elderly who are covered by Medicare have health care security (and the recent proposals to "save" Medicare would have weakened this security).

QUALITY OF CARE

Despite high spending, health outcomes are worse in the United States than in many other countries. This is due both to the structure of our health care system — lack of access to care and disparities in treatment — and to the extreme income inequality and prevalence of poverty in the United States.

Life expectancy at age 40 (the average number of years of life remaining for 40 year-olds) is lower in the United States than in six other countries. Infant mortality (the likelihood of death in the first year of life) is higher here than in 14 other nations. Infant mortality is nearly two and one-half times higher for blacks than whites and this difference is growing. Death rates are higher among people with lower incomes and less education compared to those with higher incomes and more education, and these disparities are widening, not shrinking.

The likelihood of being alive five years after being diagnosed with cancer is 30% to 40% greater for whites than blacks, and this disparity is growing. These racial differences have little to do with genetic differences, but are primarily related instead to socioeconomic status and access to health care. In addition, research shows that within the health care system, treatment may differ according to race or class even among people with the same type of health insurance.

CORPORATE HMOS

Many policymakers and employers are looking to HMOs to solve our health care problems — but they are likely to be disappointed. The fastest-growing HMOs today are very different from traditional HMOs that were widely admired in the past. The first Health Maintenance Organizations began in the 1930s and 1940s. These HMOs promised, for an annual fee, to provide enrollees with all necessary health care. They were typically not-for-profit institutions run by governing boards which included patient representatives to speak in the interest of those who would be most affected by the decisions made.

Unlike many fee-for-service plans, preventive care was covered and encouraged. It was thought that if the HMO kept its enrollees healthy, it would be able to contain costs and more successfully attract additional members. Since all necessary care was covered, patients and doctors did not have to worry about whether a medically-desirable treatment was covered or affordable and could instead focus on optimum health care. These HMOs usually owned their own offices and hospitals, and their medical staffs worked only for the HMO. Doctors were often salaried; unlike in fee-for-service care, there were no financial incentives for doctors to over treat in order to raise their incomes.

Unfortunately, today's fastest-growing HMOs are far removed from this tradition. These HMOs are for-profit corporations that contract with a loose network of doctors, usually practicing in their own offices, who have agreed to treat HMO enrollees in return for specified reimbursements. Providers often sign up with multiple HMOs. They may be paid a fee for service (i.e., receive a fee for each service performed) or, alternatively, they may receive a lump sum, set in advance, for each HMO patient that they agree to treat for a 12-month period.

In addition to agreeing on a base rate of payment, for more than half of all doctors signed up with HMOs, some portion of their reimbursement depend on the number and cost of referrals they make for services they cannot provide themselves. Under these arrangements, a doctor with a higher than specified referral rate to specialists will face a financial penalty (see the box).

Many HMOs also require doctors to sign "gag clauses." For example, US Healthcare, one of the largest HMOs in the country, requires doctors to sign a contract that enjoins them against making "any communication which undermines or could undermine the confidence of enrollees, potential enrollees, their employers, their unions, or the public in US Healthcare or the quality of US Healthcare coverage."

On the surface, HMOs can appear to be less costly than other types of plans. There are several reasons for this, but it is not necessarily because they deliver care more efficiently. First, healthier people tend to choose HMOs while sicker people, if they have the option, tend to remain in fee-for-service plans so they can keep the doctor they may have had for many years.

Second, HMOs commonly negotiate discounts with hospitals and doctors. This reduces costs for HMOs, but can lead to additional costs being shifted to fee-for-service plans as providers try to maintain their incomes by raising fees that have not been negotiated downward. Third, HMOs provide fewer services. Since we know that too many unnecessary services are provided, this could be beneficial for patients and save money also. However, it may be that necessary as well as unnecessary services are being denied.

DESPITE HIGH SPENDING, HEALTH OUTCOMES ARE WORSE IN THE UNITED STATES THAN IN MANY OTHER COUNTRIES.

When HMOs move into a region and begin to market themselves to employers and sign up doctors, a majority of employers may switch to the HMO within just a few years. This occurs because HMOs are often cheaper than fee-for-service plans. But if many employers contract with HMOs, this means that doctors, too, must sign up or they will have few patients. Moreover, if doctors are dropped by their local HMOs, they can lose their capability to make a living. This gives HMOs enormous power over providers. Arguably, financial incentives to restrict access to care, gag clauses, and HMOs' excessive power over providers' ability to practice medicine create an environment in which patients may not receive needed care.

In recent years, these new corporate HMOs have been very profitable, as described in one *Wall Street Journal* headline: "Money Machines: HMOs Pile Up Billions In Cash." During 1994, four of the largest HMOs netted over $1 billion and "nine of the biggest publicly traded HMOs are sitting on $9.5 billion in cash."

This occurs, at least in part, because so little of HMOs' revenues are actually spent on health care — as little as 70 to 75 cents of each dollar in fees received. During the early

1990s there was also phenomenal growth in the value of HMOs' stock. Since these high-flying days, profit rates have somewhat moderated, but HMOs remain one of the nation's most lucrative industries.

WILL HMOS SOLVE OUR PROBLEMS?

Many people who obtain their health care from HMOs are very satisfied; others are not. Quality and attentiveness to patients' concerns vary widely. Many of the new for-profit corporate HMOs lack most of the attractive features found in the traditional type of HMO. Financial incentives have returned, but now they serve to encourage undertreatment. Providers and patients worry whether particular services will be covered or whether providers can even inform patients of their options.

Given these concerns, consumers need to question whether HMOs will solve, or even ameliorate, the problems of high health care costs, high numbers of uninsured, limited access and disparities in outcomes.

• Costs: HMOs' potential to contain costs, even with the draconian measures they employ, is still uncertain. And once a few HMOs in any region enroll the majority of patients, this bodes poorly for cost containment — oligopolies rarely engage in strong price competition. Even if HMOs do manage to rein in spending, will the cost in terms of reductions in quality be too great?

• Access: Despite the growth in HMOs, the erosion in employer-provided coverage will continue. This decline is driven by the growth in health costs (which will continue with HMOs), desire for high corporate profit rates (currently at 25-year highs), and the weakening of corporate commitments to be responsible members of the community. Moreover, as hospitals and other health care providers deliver ever-larger shares of their services to patients covered with rates negotiated by HMOs, there is less excess revenue to pay the costs of treating the uninsured. We can anticipate that the rising number of uninsured will have greater difficulty finding providers who are willing to deliver care for which they are unlikely to be reimbursed.

• Quality and Disparities in Care: HMOs probably do reduce unnecessary services. But satisfaction with this positive outcome must be tempered with a concern that necessary services are also being denied. Moreover, will doctors' primary responsibility — to provide health care in the best interests of their patients — be compromised through gag clauses and financial conflicts of interest?

The greatest threat to quality comes from HMOs that enroll only or primarily Medicaid patients, a growing practice. There is evidence that race and class affect treatment decisions even in our current system of care where rich and poor, white and nonwhite, for the most part receive care side by side, often through the same providers. The potential for disparities in treatment skyrockets when only people with low incomes, many of whom may be minorities, are treated in any particular system.

TOP-SECRET CONTRACTS

One HMO's "incentive" contract with a physician, who agreed to care for 925 of the HMO's enrollees, contains these provisions:

Hospital Stays — If the doctor's patients collectively stay fewer than 178 days in the hospital per year, the doctor receives a bonus of $2,063 per month. If the patients collectively spend more than 363 days per year, the doctor receives no extra bonus.

Referral to Specialists — If specialist costs per patient average less than $14.49 per month, the doctor gets a monthly bonus of $1,323. If the costs exceed $30.49 a month, the bonus falls to zero.

WHAT SHOULD BE DONE?

Americans need universal health care coverage, financed by a single payer — something like an improved Medicare program expanded to cover the entire population. Universal coverage is unlikely to be achieved with an employer-based system unless employers are required to provide coverage. But even if such a mandate were imposed, we would still have a crippled system. People change jobs frequently (eight job changes during one's working life is now being suggested as the norm), unemployment rates are high, and there is growing use of part-time and contingent workers. These trends mean that if access to health care is tied to employment, frequent changes in coverage and lack of continuous care, if not outright periods of uninsurance, will take place.

Health insurance must be separated from employment. Enrollment of everyone, as a right, in Medicare would break the already tenuous link between insurance and employment, and provide universal, continuous coverage for everyone.

We need cost containment and a reduction in the growth rate of spending. Medicare has been a pioneer in cost containment. In seven of the last ten years, the growth of per person costs in Medicare has been below the rate in the private sector. More cost containment must be achieved. In the past, to remain compatible with the realities in the private sector, Medicare's cost containment options wre limited. When cost containment can be applied to the system as a whole, it can be much more effective.

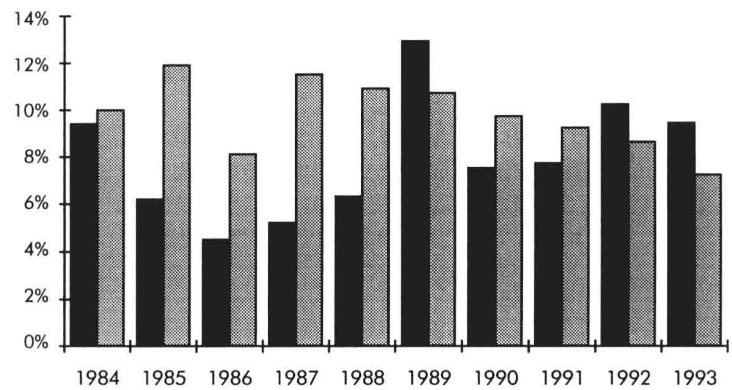
Medicare also has low administrative costs. The U.S. General Accounting Office has estimated that if a system like Medicare were to replace our piecemeal network of over 1200 private insurance companies, some $100 billion in administrative overhead would be saved in 1995 alone.

Given the dangers of segmenting population subgroups into different systems of care, we need one health care delivery system in which everyone can participate. Medicare provides such a system. Once everyone has equal access to high quality care, we can turn our attention to the other factors — such as poverty and unemployment — that create disparate health outcomes.

The current infatuation with HMOs is potentially dangerous. Politicians, providers, and insurance companies who do not want to contemplate comprehensive health care reforms hide behind the illusion that HMOs will solve the problems of the health care system. Meanwhile, the number of uninsured continues to grow, costs continue to rise, and disparities in outcomes continue to widen. Comprehensive health care reform must return to the top of the political agenda. This time around, a simple solution — Medicare for all — should be the goal. ■

Resources: National Center for Health Statistics, *Health, United States, 1994,* Hyattsville, MD, Public Health Service, 1995.

HEALTH CARE COST INCREASES
Annual Growth in Spending per Person



Source: "Are private insurers really controlling spending better than Medicare?" Marilyn Moon and Stephen Zuckerman, Henry J. Kaiser Family Foundation, 1995.

ARTICLE 4

July/August 1996

GOVERNMENT OF, BY, AND FOR THE WEALTHY

It's not easy to directly tie campaign contributions from special interests to votes by members of Congress on their behalf. Since buying votes is illegal, there is never a written record showing that a Senator or Representative made their choice on the basis of money.

But several progressive organizations, including Common Cause and the Center for Responsive Politics, have specialized in "following the money" — showing that large contributions to public officials have coincided with votes and other actions to help the contributing industries. The officials often respond that this is guilt by association, and that in reality they have always supported the policies in question, so that contributors are simply supporting like-minded politicians.

Judge for yourself. The evidence, while "circumstantial" for those of us accustomed to watching TV crime dramas, should be enough to convict our political system of serving the interests of the wealthy. Whether the subject is health care reform, environmental regulation, farm subsidies, weapons production or trade policy, it is difficult to even get a hearing in Washington without spreading around a lot of dough.

SELLING THE ENVIRONMENT

Despite the takeover of Congress by anti-government, anti-regulation Republicans in 1994, opinion polls have shown overwhelmingly public support for continued strong efforts to protect the environment. But this power of public opinion is counterbalanced by the greater access of anti-environment forces to money. During the three years from 1992 to 1994, while pro-environment advocates gave $2 million in national political contributions, corporations and PACs opposed to environmental regulation gave $24 million, twelve times as much.