Empowering Health Care Consumers through Tax Reform

By Grace-Marie Arnett, editor. 1999. Ann Arbor, MI: University of Michigan Press. Pp.320. $29.95, paper back, $42.50 hardcover.

This is a collection of papers presented at a conference that anticipated the em-ergence of serous discussions of tax credits for health insurance in Congress this year. The authors are members of the Health Policy Consensus Group of individuals from think tanks and other advocates of market-based health system change. All are like-minded in their support for conversion of the current tax treatment of employer-based health benefits (exclusion of the benefit from employees' gross income) to a tax credit for some or all who are covered by health insurance. Consequently, there is some overlap among the various papers. However, a number of key issues are addressed from several perspectives. It is relevant reading for those who want background on the current debate about tax credits for health insurance in the 107th Congress.

Robert B. Helms traces the attempts of economists to assess the impact of tax policy on health care. Excluding the amount of employer-provided health benefits from employees' gross income was allowed by the Internal Revenue Service in a special ruling in 1943 which was later codified by Congress in 1954. The original ruling's intent was to open a loophole in World War II wage and price controls. It allowed employers to increase employees earnings by providing health care benefits without those benefits being counted as taxable income to the employees.

The exclusion of employer-provided health care benefits from taxable income lowers the cost of health coverage to employees in proportion to their marginal tax rates. The discount is therefore larger for employees in higher tax brackets. The exclusion increases the demand for health benefits, for expanding the scope of benefits to include peripheral goods and services (e.g., eyeglasses), and for lower cost sharing. Because the benefits provided to employees diverge significantly from true insurance, it raises the demand for and price of health care generally. In turn, the increased prices caused health coverage costs to escalate in a vicious circle. The result is a dead-weight loss to the economy by the amount that health care consumption is greater than consumers would choose if they bore the full price, a sizeable economic inefficiency.

If a tax subsidy for health coverage produces such extreme inefficiency, why would the Health Policy Consensus Group favor shifting to a different form of tax subsidy? A number of arguments are presented throughout the book in papers by Michael Tanner, Robert Moffit, Mark Pauly, Eugene Steuerle and Gordon Mermin, John Hoff, David Kendal, Norman Ture and Stephen Entin, John Goodman, and others.

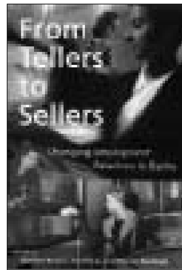
It has never been suggested in the history of U.S. health system reform debate that society should not subsidize the purchase of health insurance. The question has been, rather, what form should a subsidy take. We pay for free riders on the health system now through taxes and other subsidies, so we need to maximize efficiency and equity. The exclusion is highly regressive; a tax credit can be made properly progressive, and can be designed to accomplish almost universal coverage among those who are least likely to be insured now. The exclusion is a blank check on the Treasury; a credit can be better managed fiscally and designed to reduce incentives to over-insure. A tax credit for individuals can eliminate the "job-lock" problem that reduces job mobility of those who fear losing coverage if they switch employers. The exclusion places the power of choice in the employer's hands; an individual credit will be neutral with respect to individuals' choices, which would better reflect their personal preferences. In short, a tax credit for individuals is a better subsidy than the exclusion, given that we are going to provide a subsidy for health insurance. It would also enhance the market for individual insurance, but would not precipitate a decline in the role of employers in providing group-purchasing power.

I would add another reason: the tax credit may be the only politically feasible alternative to the current exclusion. While I recognize that the authors of this book represent a consensus around a tax credit approach, I would have been interested in the viewpoint of those who have supported alternative tax policy such as replacing the current income tax and its various exclusions and deductions with a flat income tax with no exclusions or deductions, or a national sales tax (even though these are not politically feasible at this time).

Jesse S. Hixson
American Medical Association
Chicago, IL

From Tellers to Sellers: Changing Employment Relations in Banks

By Marino Regini, Jim Kitay, and Martin Baethge. 1999. Cambridge, MA and London, England: The MIT Press. Pp. 341. $39.95 hardcover.



In the first two sentences of the preface, the editors of this book state succinctly its purpose: To "present research findings on the changing nature of employment relations in the retail banking industry in nine OECD countries from the early 1980s to the late 1990s. Although changes have swept through most industries in these countries, few examples can match the profound transformation of retail banks from stolid, strictly regulated organizations epitomizing lifetime employment to highly competitive enterprises with fragmented career structures and a new focus on sales and performance." The reader is given a bonus as well: because a discussion of employment relations must also consider the changing nature of banking in a multinational context, the book covers globalization, deregulation, technological change, and the broadening nature of interindustry competition.

The book is part of a broader research project on industrial relations and human resources management practices in major industrial countries. The editors, although not that well known in the United States, are well qualified for their task. Marino Regini is Professor at the Institute of Labor Studies, Faculty of Political Sciences, University of Milan in Italy. Jim Kitay is Senior Lecturer in the Department of Industrial Relations, Faculty of Economics, University of Sydney, Australia. Martin Baethge is Co-Director of the Sociological Research Institute of Gottingen and Professor in the Department of Sociology, University of Gottingen, Germany.

The organization of the book also is helpful for the reader. The editors wrote an excellent summary of the findings of this study in the first chapter as well as a summary chapter at the end. In between are nine chapters of individual country studies, by some twenty experts in the countries concerned, that provide the details of the studies in the United States, Australia, New Zealand, the United Kingdom, Italy, France, Spain, the Netherlands and Germany. The findings are not the result of a survey of banking in each country but rather of intensive interviews conducted with managers and employees of individual institutions of different types and sizes, as well as union and government officials, supplemented by documentary material.

The national reports indicate the profound transformation in banking unleashed by deregulation, privatization, and technological change. Banks were highly regulated in the early 1970s, with the central bank of each country defining the kinds of business the different categories of banks could conduct. Interest rate ceilings and trading practices were controlled as well. Financial markets were compartmentalized, and competition was low. But banks' competitive positions were eroded by inflation; abandonment of fixed foreign-exchange rates; increasing internationalization of banking; and the entry of new competitors, such as mutual funds, securities firms, credit card companies, and quasi-banks.

Deregulation was designed to reduce the competitive advantages given to some forms of financial institutions and also to stimulate competition among the various types of financial institutions. As a result of deregulation, the structure of national banking institutions changed, competition increased, mergers and acquisitions accelerated, the number of banks shrank, and—especially in the United States—other financial institutions penetrated the banks' core markets.

Technology also changed the face of banking. Data-based customer relations permitted banks to develop cross-selling strategies, to segregate customers by profitability, and to shift the mix of self-service and personal service at branches. In addition, more services could be centralized, downgrading the importance of branches and the authority and autonomy of the branch manager. Branch staff shifted from service providers to a sales force. But technology also increased costs, so staff reductions and downgrading of staff functions resulted. Training of staff was targeted to specific job skills, and job security levels fell. Compensation became more performance-oriented in place of general pay increases. Decentralization weakened union collective bargaining in those countries where industry-wide collective agreements were strongest (Germany, the Netherlands, and Italy). However, no one "best practice" emerged as differences among countries reflected attempts to adhere to traditional human relations practices. The three major transformations were: (1) a growing distinction between front office and back office employees; (2) a sales culture replacing a hierarchically based, bureaucratic organization; and (3) banking products and services, and hence clients, increasingly segmented.

Organizational strategies can be divided into product quality (not just price competition) versus cost reduc-

tion (holding prices down by mass producing a variety of goods and by containing labor costs). But management rarely pursues either of these strategies exclusively; they are more likely to coexist, with resulting tension. The one certain conclusion of the book is that traditional banking is dead, but the future is uncertain.

Who would find this book interesting? Certainly, anyone employed in the financial services industry would gain a lot of perspective, not just about personnel practices in the United States and other major OECD countries but also about the organization and operations of banks as they have changed and responded to the challenges of globalization and technology. Banking has been more widely impacted by these changes than most industries, so their experiences may provide examples for other industries. Finally, anyone who is a bank customer—and just about all of us are—will get some insight into the way you are treated by your local bank and why, which will be an indication of how you stand in the bank's customer pecking order!

Edmund A. Mennis
Palos Verdes Estates, CA

Millennium Book II: 101 Years of Investment Returns

By Elroy Dimson, Paul Marsh and Mike Staunton. 2001. London: ABN-AMRO and London Business School. Pp 284. £100 soft cover.

Every so often, new research is so significant that it changes our view of the past and alters our perspective of the future. *Millennium Book II* is such a book. It provides a broad perspective of the record of total investment returns (income plus capital appreciation or depreciation) for the past 101 years of stocks, bonds, bills, inflation, and currency movements for fifteen countries that make up eighty-seven percent of world market capitalization. With growing internationalization of financial and direct investment, the book provides new international norms as a basis for comparisons.

The authors are all on the faculty of the London Business School, which is part of the University of London. Elroy Dimson is Professor of Finance and Chair of the Accounting Subject Area; Paul Marsh is Esmee Fairbairn Professor of Finance; and Mike Staunton is Director of the London Share Price Database at the School.

In 1976, Roger Ibbotson and Rex Sinquefield published year-by-year historical returns since 1926 for U.S. stocks, bonds, Treasury bills, and inflation. This work is updated each year by *Stocks, Bonds, Bills and Inflation,* a book published by Ibbotson Associates, Chicago, IL. Financial analysts, corporate financial officers, and regulators use this book extensively to measure investment performance, investment hurdle rates, and regulatory norms. However, Millennium II is much broader in scope and challenges some current thinking on past and expected investment returns.

Early in the book, the authors set out the criteria they use in evaluating equity and bond indexes. In particular, they emphasize the use of total return and market capitalization in index preparation. They also did their very best to avoid selection bias, for example, including only companies that were in existence when an index was established and avoiding companies that had disappeared over time. They also seek to avoid time-period bias, that is, excluding difficult periods such as wars and their aftermath. Avoiding these two biases of company inclusion and time periods, results in comparative estimates of returns that are lower than they would otherwise have been.

A contrast of the world's stock markets between 1900 and 2000 reveals that the United State's share has increased from twenty-six percent to forty-six percent of total world market capitalization, Japan has increased from four percent to thirteen percent, while the United Kingdom has shrunk from fourteen percent to eight percent. France and Germany have shrunk from nine and eight percent, respectively, to four percent each. Another striking shift was India, which had twelve percent of world markets in 1900 but was not even listed in 2000. Railways (49.2 percent) and banks (15.4 percent) headed the sector composition in 1900; by 2000 banks were the largest sector (18.1 percent), and telecommunications (16.6 percent), oil and gas (12.8 percent) and pharmaceuticals (12.7 percent) were the only other industries in excess of ten percent. How the corporate landscape changed in the century!

Reviewing 101 years of stock market history, inflation-adjusted returns in all fifteen countries achieved annualized real returns within two to three percentage points of the world average of 5.2 percent; the U.S. figure was 6.7 percent, the UK 5.8 percent. Returns on bonds and bills were considerably smaller, due to the recurrence of significant bouts of worldwide inflation during the period.

One of the most interesting sections in the book is the discussion of equity risk and the equity risk premium, that is, the historical reward investors have enjoyed for bearing the greater volatility risk of equity investment relative to an investment in Treasury bills, a riskless invest-

ment. As the authors point out, "The equity risk premium is an extremely important economic variable. An estimate of the premium is central to projecting future investment returns, calculating the cost of equity capital for companies, valuing companies and shares, appraising capital investment projects, and determining fair rates of return for regulated utilities."

Based on the 101 years of the study, the arithmetic mean equity risk premium relative to bills was 7.5 percent for the United States and 6.5 percent for the United Kingdom, compared with the average risk premium across the fifteen countries of 7.5 percent. Large risk premium were achieved during the second half of the twentieth century, the authors argue, because of unprecedented growth in productivity and efficiency, improvements in management and corporate governance, and extensive technological change. Corporate cash flow grew faster than investors anticipated and was built into higher stock prices. Stock prices have risen also because of a fall in the required rate of return, due to diminished investment risk.

As for the future, the only premium that can be measured is the historical risk premium, while the applications require an estimate of the prospective risk premium. The authors estimate the expected risk premium to be lower, because of the assumed absence of extreme inflation and world wars, which caused extreme market volatility. As a result, they estimate the equity risk premium as four to five percent, markedly below previous estimates of other researchers. The good news is that, with a markedly lower risk premium, hurdle rates for future capital investment should be lower than historically, and further investment thus is encouraged. But with lower equity risk premiums, equity investment returns are likely to be lower than those experienced recently.

The second half of the book provides a country-by-country review of the long-term performance of equities, bonds, bills, and inflation as well as real exchange rates against the U.S. dollar. Returns are displayed in ten-year intervals, with the returns between any two ten-year periods illustrated. For each country, the sources of the data are described, so that the reader can judge their reliability.

Throughout the book, excellent colored charts illustrate critical points, and the text is clear and concise. The arguments are persuasive, and the conclusions illuminating. This work and its successors should be of considerable appeal to investors, financial executives and regulators, whether their interests are of a purely domestic nature or are worldwide. ■

Edmund A. Mennis
Palos Verdes Estates, CA

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