Consumer Economics

The Consumer in Our Society

TENTH EDITION

Stewart M. Lee
Mel J. Zelenak

CONSUMER ECONOMICS: THE CONSUMER IN OUR SOCIETY

TENTH EDITION

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PREFACE

The landslide elections of a conservative, President Reagan, in 1980 and 1984, the substantial cutbacks in federal and state consumer programs throughout the 1980s, and the election of President Bush over a liberal Democrat in 1988 have caused some to suggest that consumerism is no longer the potent force it was in the 1960s and 1970s. However, because consumerism is an economic force, it will always be an integral part of our economy. As long as there is a healthy adversary relationship between the buyer and seller in our economy, there will be a need for consumerism, consumer economics, and consumer education, whose major purpose is to place the consumer on a more equal basis with the producer and seller.

This book shows how the marketplace operates to serve the consumer and also how it operates at times to disserve and even defraud the consumer. In addition, each "consumer" of this book should have a better understanding of himself or herself as a consumer, and some answers to the question of why one consumes in the way one does.

Consumer Economics: The Consumer in Our Society, authored by Stewart M. Lee and Mel J. Zelenak, represents a substantial revision over the preceding nine editions. The nine editions of the text, previously titled *Economics for Consumers* and *Personal Finance for Consumers,* have been called "forerunners of much of what is happening in the consumer movement today." The book is not only an introductory text on consumer economics, but also a reference book for consumers. Its focus is on how the consumer functions in the marketplace, and it identifies the social, economic, and political forces that shape consumer demands. The book examines how an individual may become a better educated "mature" consumer citizen, and what the government is doing and can do in the field of consumer protection.

The text is written for those who believe that consumer economics is much broader than just personal finance, and that it should be much more than just a "how-to-buy" course. If consumers are to really understand the subject, they need a brief background of our economic system and an understanding of factors influencing their buying decisions. Consumers need to be aware of the pressures of fashions, customs, and peer groups and the influence of advertising.

This edition of *Consumer Economics: The Consumer in Our Society* includes a number of significant features. These include, but are not limited to, the following:

- The text is unique in its emphasis on patterns of consumer behavior—the tugs and pulls that consumers feel, how they respond to these pressures—both external and internal, and how advertisers influence consumer decisions.
- An entire chapter is devoted to the area of seller frauds, and the text offers many examples of how sellers may take advantage of consumers. It also offers advice to consumers on how to protect themselves against fraud.
- There is in-depth coverage on local, state, and federal consumer protection laws and agencies which enforce these laws. The discussion of the government's role in consumer protection through federal mandates is particularly complete.
- The topic of inflation and its impact on consumers is given special attention in this edition.
- Examples have been updated, and 1989 data are used throughout most of the text. References, with the exception of classics, have 1980 or more recent publication dates.
- Each chapter includes key concepts with the accompanying instructional objectives. They

allow the student and instructor to determine if the essence of the material offered is being understood.

- Each chapter lists the key terms, with definitions in the text. Additionally, these terms are alphabetized and defined at the end of the text.
- Each chapter includes a consumer quiz, most questions of which relate to the chapter. They lend excitement to the topic to be considered and introduce the topic with some practical inquiries.
- Each chapter has a quote that relates to the chapter; its intent is to introduce ethical considerations in marketplace issues.
- Each chapter concludes with a summary, questions for review, discussion questions, exploring personal values, projects, and references.
- This edition has an added chapter on conspicuous consumption and fashion.

The changes in this current edition reflect the changes in consumerism and changes recommended by those who have used previous editions and by others who are currently teaching consumer economics, consumer education, and personal finance classes at the college level.

Changing attitudes toward the free economy are investigated, especially the impact that inflation has had on the economy in general and the consumer in particular. There is hardly a facet of consumer activity that has not been touched by the huge federal deficit, the cutbacks in federal and state consumer programs, and the omnipresent problems of inflation and unemployment. These factors have changed the spending, investment, and savings plans of many persons; they have forced many prospective buyers of houses to question their ability to finance such a major purchase, and spiraling prices have changed both the clothing and food purchasing habits of millions of people. The impact of these factors, as they relate to such issues as consumer debt, insurance, and customs, is discussed throughout the text.

ACKNOWLEDGMENTS

The authors wish to thank the various individuals who have contributed to the initiation, development, and completion of this text.

Appreciation is offered to the approximately 100,000 faculty and students who have used previous editions of this text, and for the thousands of faculty and students who used the ninth edition. The comments we have received are most appreciated.

Appreciation is offered to Mr. Nils Anderson and the staff of Publishing Horizons in Columbus, Ohio—first, for giving us the opportunity to publish this text and, second, for their efforts with the manuscript and the marketing and distribution of the text to our college audience.

Dr. Zelenak expresses his appreciation to Dr. Edward Metzen, Chairman of the Department of Family Economics and Management at the University of Missouri-Columbia for his support and guidance. Special recognition is offered to Ms. Colleen Gannon and Ms. Jackie Coon for their efforts related to various facets of the text and very special appreciation to Ms. Helga Meyer for her professional expertise in the computer entry and proofreading of the text, development of the index, and other related assistance.

Dr. Zelenak thanks Dr. Lee for giving him the opportunity to be a part of the *Consumer Economics: The Consumer in Our Society* tradition, and for the total support Dr. Lee offered throughout this and previous editions.

Dr. Zelenak would like to thank his family, Helen Zelenak; Helen, Thomas, Robert and Janet Cracker; Arthur, A. J., Mark, Pam, and Pat Zelenak; and Charles and Ruth McKnight, for their support throughout this endeavor. This text is lovingly dedicated to Kathy and Ann Lee, Bonnie McKnight Zelenak, Melchior C. Zelenak, Lindsey Susan Zelenak, and to the memory of Menyhert Zelenak.

PART I
IS THE CONSUMER REALLY KING?

CONTENTS

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THE CONSUMER IN A FREE SOCIETY

The following concepts will be developed in this chapter:

1. A free economy is not a problem-free economy.
2. Consumerism—the effort by the consumer to influence the marketplace—must continue to make itself heard regardless of the pressures put upon it.
3. The soundness of our economy is based upon a healthy balance between production and consumption.
4. For a variety of reasons, the consumer does not exercise the sovereignty in the marketplace that classical economic theory espouses.

After having read this chapter, you should be able to successfully accomplish the following objectives:

1. List five adverse effects of inflation.
2. Explain the interrelationships among big business, big government, big labor, foreign governments, special-interest groups, and consumers; identify the contributions each of them makes to our economic problems.
3. Identify the attitudes of both business and the public toward consumerism.
4. List at least five indicators of problems within the consumer movement.
5. Explain the relationship between the individual as a producer of goods and services and the individual as a consumer of these same goods and services.
6. Cite several examples supporting the thesis that the consumer is not king in the marketplace.
7. Identify both the rights and the responsibilities of the consumer.

Key Terms:

collective consumption
consumer sovereignty
consumerism
discretionary income
disposable personal income
gross national product (GNP)
inflation
monopolistic competition
monopoly
national income
natural monopoly
net national product
oligopoly
per capita disposable income
personal income
principle of diminishing utility
product differentiation

Consumer Quiz

1. It is often noted that Japan has a lot of trade barriers. However, U.S.-manufactured goods are highly protected and the U.S. situation appears to be getting worse. True or False?
2. What is the biggest consumer rip-off?
3. Because of new FDA regulations, tanning booths are now considered safe. True or False?
4. When a food product is labeled, "low calorie," "reduced calories," "lean," or "extra lean," what specifically do these terms mean?
5. You have purchased an item from a store which advertises, "Satisfaction guaranteed, or your money back." You are not satisfied with the product but the store refuses to refund your money. What can you do?

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1. True. U.S. trade protectionism is bad and appears to be growing worse. According to a

1988 CNN Report, 35 percent of all U.S.-manufactured goods today are protected by trade barriers, up from only 8 percent a decade earlier.

2. The biggest consumer rip-off is economic or industry concentration. We pay higher prices for a wide range of products because there is virtually no competition in various U.S. industries.
3. False. Tanning booths are not necessarily made safer by FDA regulations. "FDA"-approved simply means that the tanning booth has provided tanners with goggles, and so on. The American Medical Association (AMA) takes the position that since both UV-A and UV-B rays are harmful, there is premature aging and a higher risk of cancer for people using tanning booths.
4. "Low calorie" means that the product contains 40 calories or less, or 0.4 calories per gram; however, foods that are by nature low in calories—such as mushrooms—cannot be so described. Foods labeled "reduced calories" must be one-third lower in calories than nonmodified foods and comparisons must be noted. "Lean" means that the food contains no more than 10 percent fat; "extra lean" means no more than 5 percent fat.
5. If the store does not honor its advertised claim of refunding your money when you are not satisfied with the merchandise, you should contact your State Attorney General's Office and/or the Federal Trade Commission and file a complaint against the store. Failure to comply with advertised claims or policies is a violation of most state and federal laws.

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THE CONSUMER IN A FREE SOCIETY

Today the consumer movement is no longer a fringe movement but a universally accepted social necessity, a public responsibility. And because of this, it is no longer business as usual, no longer advertising as usual.

Anwar Fazal, past president, International Organization of Consumers Unions

THE CONSUMER IN A FREE ECONOMY

CAN CONSUMERS COPE WITH A FLUCTUATING ECONOMY?

Inflation is a rise in the general level of prices.

INFLATION is a major problem for consumers. Inflation represents the high cost of living. When an increase in the volume of money and credit exceeds the goods and services in the market, the general level of prices rises. As the general level of prices goes up, the purchasing power of the dollar goes down. For example, if $1.00 was worth $1.00 in the base year of 1967, it would have been worth $3.30 in 1913, and less than a quarter in the 1990s. Notice the qualifying adjective in the phrase "general level of prices." This means that, while the prices of most goods and services go up during inflation, some prices may be stable, and some may actually decline. Inflation seems to be a cyclical and recurring problem in our economy.

SOME INSIDIOUS EFFECTS OF INFLATION

1. Inflation is a hidden tax. It takes away purchasing power without giving the consumer anything in return. Unless one's income increases, the inflation tax is roughly equal to the rate of inflation. For a few years in the late '70s and

early '80s, double-digit inflation eroded income to the extent that the value of a dollar was reduced by nearly 50 percent in just five years.

2. Inflation encourages deterioration of quality. Instead of or in addition to increasing prices, producers may reduce quality. Some suggest that this occurred in the domestic automobile industry. When quality is reduced and prices are increased at the same time, the hidden effect is doubly bad.

3. Inflation encourages short measuring. Everything that is bought and sold has to be measured. In periods of increasing costs, producers can maintain prices by reducing quantity. This is usually legal if the smaller amount is declared on the label. An example is the change in the 1980s from one- and three-pound cans of coffee to 13- and 39-ounce cans, respectively, but careless consumers who do not read labels will be unaware of this.

4. Inflation upsets consumers' financial planning. In the 1990s, a typical urban family of four needs an income of over $30,000 annually to maintain a moderate level of living. In the 1970s, a comparable family needed about one-half of that income to maintain a similar level of living.

5. Inflation makes borrowing money cost more because interest rates are forced up. When inflation increases rapidly, the Federal Reserve often slows the flow of money into the banking system. This has the effect of forcing interest rates up as the available amount of loanable funds is reduced. This is well illustrated in the housing industry. When the interest rate for mortgage money rises beyond customary rates, potential buyers and builders stop borrowing. The construction industry bears the brunt of this anti-inflationary measure, and building drops to a minimal level. As a result of decreased supply, the market value of existing buildings often rises.

6. Inflation diminishes the value of insurance coverage. Typically, a house that cost $40,000 in the 1970s is worth over $125,000 today. As a result, the insurance coverage now ought to be more than three times what it was two decades earlier. Inflation creates similar problems with reference to other kinds of insurance, especially life insurance.

7. Inflation decreases the value of savings and investments. One of the requirements of a good monetary system is that money serve as a storehouse of value. If $1.00 were always worth 100 cents, a saver could be sure that the $1.00 saved in the 1970s would be worth 100 cents in the 1990s. Instead, because of inflation, a $1.00 worth $1.00 in 1970 is worth a small fraction of that amount today.

In an effort to avoid such erosion (loss), some savers put their dollars into other forms of wealth—such as land and common stocks—whose value tends to rise as the general level of prices goes up. But many small savers were devastated by the stock market crash in the late 1980s, and lost confidence in that means of saving. Further, real estate prices plummeted in various parts of our country in the 1980s. As a result, many small savers are keeping their dollars in commercial banks or savings-and-loan banks. The interest payable on such savings is approximately 6 percent. So if inflation amounts to 8 percent, the small saver loses all interest on his or her savings and approximately 2 percent of principal (that is, the amount invested).

DOUBLE TROUBLE—INFLATION AND UNEMPLOYMENT TOGETHER

Historically, inflation has been concurrent with prosperity and full employment. In such a situation, the evils of inflation are partially offset. But when nearly 10 percent of the labor force was out of work and without earned income, as in the early 1980s, the evils of inflation and unemployment are compounded.

The economic cost of unemployment can be substantial. The volume of goods and services lost in the early 1980s because of idle workers amounted to more than $100 billion. Add to that the transfer of money in unemployment compensation, welfare payments, and relief, and the total gross loss was approximately $200 billion.

The noneconomic costs of unemployment—mental anguish, anxiety, disintegration of personality, loss of self-respect, and feelings of inadequacy, helplessness, hopelessness, and powerlessness—cannot be measured; but they are very real. And the longer a person is idle and without income, the greater the physical and psychological cost.

WHO IS TO BLAME FOR AMERICA'S ECONOMIC PROBLEMS?

Among those often cited as being responsible for America's economic woes are "big" business, "big" government, "big" labor, the policies of foreign governments, special-interest groups, and consumers themselves.

BIG BUSINESS?

A coalition of various citizen groups has held various "Big Business Days." The theme is to highlight the idea that giant corporations exercise an inordinate amount of economic and political power over consumers. The coalition contended that American consumers must depend on a relatively few corporations for survival. For example, only 100 of the approximately 1.5 million corporations in America receive more than one-half of all profits in manufacturing and the largest 200 corporations receive about 75 percent of the profits. The result of this heavy concentration of business is that the competitive marketplace cannot be truly effective since one of the key elements (price competition) is not functioning as it should.

BIG GOVERNMENT?

Other citizens note that government regulation and the customary deficit spending have created our economic plight. This group cites petty regulations such as the fire extinguisher requirements of the Occupational Safety and Health Administration (OSHA), which decrees the exact height that the casing on the extinguisher must be placed on the wall. A deviation of a few inches caused warnings and penalties assessed by OSHA regulations. Further, many economists have repeatedly cautioned that deficit spending and inconsistent fiscal and monetary policies by our policymakers have created uncertain economic conditions. The huge federal deficit that we have had in the 1990s has created economic chaos in money markets both at home and abroad.

BIG LABOR?

Still other citizens cite the high wages and the decline in productivity of the American worker over the past few decades as the cause of economic woes. This group notes that in some industries, blue collar and white collar workers command salaries up to twice as much as their foreign counterparts. Yet the American worker's output often does not approach that of the foreign employee. The result is that foreign companies are better able to compete because they can produce their products at a much lower cost.

FOREIGN GOVERNMENTS?

Some citizens think that the trade policies of foreign governments are the cause. Examples often enumerated are the policies of some governments (notably Japan) that protect their industries through tariffs, quota restrictions, or special tax subsidies.

SPECIAL-INTEREST GROUPS?

Others suggest that special-interest groups, through lobbying efforts, have become a significant force in the development of legislation, much of which adversely affects consumers and the economy. The number of Political Action Committees (PACs) has increased dramatically. Perhaps more significant is the rise in the number of corporate PACs, from less than 100 in the mid-seventies to more than 1,000 today, with no apparent slowdown in the future.

CONSUMERS?

Other citizens blame U.S. economic problems on consumers. The opinion is that many economic and political problems would not occur if the American consumer were informed and took an active interest in exercising rights and responsibilities in society and the marketplace. Further, many think that Americans have become accustomed to the "good life" and that they are unwilling to accept the fact that resources are limited, and that we cannot, as a society, continue our "wasteful existence."

It is likely that big business, big government, big labor, consumers, and many others share, to varying degrees, the blame for America's economic problems. Perhaps the solution is to develop an overall national-interest approach that will require consistency by various special-interest groups. Common Cause, a significant citizens' lobbying organization, perhaps best identifies the problem and the solution with the following statement:

> The Special Interest State is a system in which interest groups dominate the making of government policy. These interests legitimately concentrate on pursuing their own immediate—usually economic—agendas, but in doing so they pay little attention to the impact of their agendas on the nation as a whole. Looking at the broad picture is the responsibility of policymakers, but in recent years they have capitulated more and more to the pressures and political clout of narrow interest groups. That capitulation has been particularly flagrant when policymakers have tried to deal with the economic and energy dilemmas facing our country. The result has been a fragmented, short-sighted set of policies which serve the immediate interests of those with the most access and greatest influence over government decision makers. The special interests which seek benefits from the government are not sinister forces. They are all of us. There are economic, occupational, and regional interests, and local and state government interests. They include public-interest groups as well as business, professional, and labor groups. But the intensity

of the competing and conflicting demands of legitimate-interest groups, both public and private, has led to government by interest group, a system which ignores the overall national interest.[1]

CONSUMERISM—A PEOPLE'S MOVEMENT

CONSUMERISM DEFINED

Not very many years ago a person looking in a dictionary for a definition of the word **CONSUMERISM** would not have found it. *Consumerism* is a relatively new word, apparently coined in the business community in the mid-1960s as a term of derision describing the activities of the growing number of consumer advocates, both inside and outside the government, who questioned the inadequacies of the marketplace and the reluctance of business to deal with consumer needs and demands. It was not long, however, before the word assumed respectability.

Consumerism is an attempt by individuals and/or groups to place the needs of the consumer in an equal or superior position to the needs of the producer.

A special assistant to the president for consumer affairs defined consumerism as nothing more and nothing less than a challenge to business to live up to its full potential—to give consumers what is promised, to be honest, to give people a product that will work and that is reasonably safe, to respond effectively to legitimate complaints, to provide information concerning the relevant quality characteristics of a product, to take into consideration the ecological and environmental ramifications of a company decision, and to return to the basic principle upon which so much of our nation's business was structured—satisfaction guaranteed or your money back.

ATTITUDES OF THE BUSINESS COMMUNITY AND CONSUMERS TOWARD CONSUMERISM

A retired chairman of General Motors said that the ultimate aim of consumer advocates who criticize business is to alienate the American consumer from business and to tear down long-established relationships that have served both business and consumers so well.

Consumerism has also been attacked by business as an effort to cripple the free-enterprise system. On the other hand, some business managers look on consumerism favorably as an attempt to make business do what it should be doing, thereby making the free-enterprise system work as it is supposed to work, rewarding those businesses that serve consumers well and penalizing those that do not.

When the words *consumerism, consumer movement,* and *consumer advocate* are mentioned, often the name of Ralph Nader is mentioned. Ever since the publication of his book *Unsafe at Any Speed* in 1965, Nader has been in the forefront of the consumer movement, challenging American business when he believes it is not doing right by the consumer.

IS CONSUMERISM HERE TO STAY?

With the elections of Presidents Reagan and Bush, the ineffectiveness of the Carter Administration, and the conservative mood that has developed in the