

The study was geared to secondary school students in Korea in part because adolescence is a critical period during which future behavioral patterns are shaped, and in part because the learning process, including formal schooling, is most intensive and effective at this time. The survey was conducted with selected secondary school students, using a researcher designed questionnaire which measured their consumer knowledge.

The results show that the consumer knowledge level of secondary school students was somewhat low, scoring 21.32 on a scale of 40. On the average, students showed the most strength in financial management and the least strength in buying practices. Consumer knowledge in every content area increased with grade level, lending support to the importance of consumer education in the schools. Moreover, the increase in knowledge was most apparent in the content area currently covered in the textbooks used by the students under study. Consumer knowledge did not differ by sex, but did differ by residence, showing a higher level of consumer knowledge by students from urban areas.

In summary, the analysis of consumer knowledge of Korean adolescents leads to the following conclusion. Korean secondary students seem to lack sufficient knowledge required to function effectively as adolescent consumers or to grow as responsible and conscientious consumers. Further, the students under study were especially weak in terms of practical information needed to effectively guide their daily consumption behavior. To better prepare adolescents to assume their role as knowledgeable consumers able to make adequate consumer decisions, education programs should be instituted to strengthen consumer knowledge in all areas, especially in the area of buying practices. Thus, consumer education should adequately reflect the present need of adolescent consumers and should be instituted to a greater extent in Korean secondary schools.

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CONSUMER CREDIT IN A LESS DEVELOPED COUNTRY:  
WHAT WE DIDN'T LEARN IN NORTH AMERICA

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In this paper, a simple two equation model used to describe the North American consumer credit market is discussed in the context of the rural Tanzanian economy. The object is to emphasize the problems of cross-cultural comparisons using concepts commonly taught in North American colleges and universities. It is concluded that the problems should be viewed in the context of the importance of economic policies developed by Western authorities for application to Third World countries.

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Consumer economists armed with a range of perceptions of the functioning of the North American economy may be perplexed when they attempt to apply them in a developing country. When we in North American study consumer economics we too often assume that since the hard-learned lessons appear reasonable here, the lessons must be transferable to other cultures and economies. In this area of growing international trade and development aid, when communication between countries and cultures continues to increase, an understanding of aspects of consumer economics as they exist in other countries is essential.

The analysis of the functioning of credit markets in developing countries indicates that those cross-cultural assumptions cannot always be made. In the 1960s, development aid for agricultural credit worth \$915 million was given to Latin American countries by the Agency for International Development (AID), the Inter-American Development Bank (IDB), and the World Bank (IBRD). Developing countries have received over \$5 billion from foreign donors during the past several decades for the same purpose (Adams and Graham 1961). Despite the magnitude of these development grants, credit programs designed by the West frequently fail, often because conditions in the developing country are dissimilar to those in the donor country.

While further comparative studies on the topic of consumer credit would undoubtedly broaden the lessons to be learned, this paper will attempt to identify similarities and differences between credit markets in the East African country of Tanzania and the United States in order to demonstrate the challenges which occur when application of standard economic theory is applied to economies with differing cultural, political and/or institutional characteristics.

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The information used in this comparison comes from part of the baseline data collected at the inception of a development project in Mbeya Region, Tanzania. The project is jointly funded by the Government of Tanzania and the Canadian International Development Agency (CIDA).

CONSUMER CREDIT IN THE UNITED STATES AND  
TANZANIA

In the United States, consumer installment credit is defined as credit extended to individuals by commercial banks, finance companies, credit unions, retailers, and savings institutions to be repaid in two or more installments (Federal Reserve Bulletin 1988). It is considered to be a resource households utilize to improve their level of living. Credit can help to develop human capital or to purchase assets which lead not only to the household's increased consumption in the short run, but also to its enhanced production in the long run. Durkin (1974) states, "when consumers are able to invest in productive assets such as durable goods and human capital, the use of consumer credit services may enable them to achieve both high absolute levels of consumption and a preferred consumption time pattern."

In Tanzania, the relationship between household consumption and production is also readily observable but takes a somewhat different form than in North America since about 85 percent of the households in the country are agricultural producers.<sup>3</sup> Tanzanian production is characterized by a large family labor input and only partial integration with markets (Ellis 1988). The majority of household agricultural production is utilized for direct household consumption and only the output which exceeds household domestic requirements is marketed. Because the household unit is so closely linked to the consumption and production of agricultural output, the effects of credit utilization can be measured on both.

The general approach to the study of the consumer credit market in North America is to apply a simplified two equation model. An example is the model used by McGowan (1984) where the demand for a particular kind of loan is written as:

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<sup>3</sup>In the Mbeya region of Tanzania, one of the most productive in the country, households plant an average of 2.1 hectares (E. Weiler and J. Merryman (1982), *Input Marketing Study of the Mbeya Region*, Dar es Salaam: Government of Tanzania/FAO).

$$Q^d = f(i, Y, T, S, C)$$

where  $i$  = the interest rate or the price of the loan;  
 $Y$  = the borrower's disposable income;  
 $T$  = the social taste or acceptability of borrowing;  
 $S$  = the price of substitute sources of money;  
 $C$  = the loan's commissions, fees, and downpayment requirement;

and the supply of a particular kind of loan is written as:

$$Q^s = g(i, Pr, R, rr)$$

where  $i$  = the interest rate received by the lender;  
 $Pr$  = the probability or risk of default;  
 $R$  = the regulations and restrictions on the lender;  
 $rr$  = the rate of return on alternative financial investments.

The equilibrium rate of interest and quantity of a particular kind of loan (holding all other variables constant) occurs where the market clears:

$$Q^s = Q^d$$

We will compare and contrast conditions underlying the demand and supply curves in the markets for credit in the United States and Tanzania. The object will be not so much to expand the model as to expose the differences one must take into account when applying this model in either context. The two equation model outlined above is not meant to be definitive in any way. Indeed, many versions of the model exist, with differing emphasis on the variables included (for example wealth and taxation variables are often added to the independent variable list). What is of interest here is the market-based methodology. In what follows, the difficulty of applying the method will be discussed.

#### THE DEMAND FOR FUNDS

Underlying the demand curve is the consumer's attempts to maximize utility. Differences in the cultural and physical environments between Tanzania and the United States lead to divergent responses to the demand for funds. As indicated in the consumer loan model, the demand for loans is a function of interest rate or loan price; disposable income; social taste, price of substitute sources of money; and commissions, fees and downpayment requirements.

In the United States, low-risk borrowers have many sources of funds available to them and can make their borrowing decision based on the interest rate as well as the combination of services offered by the lender. Since the consumer credit market in the United States is highly functioning, the transaction costs

associated with receiving or offering a loan are relatively low. In Tanzania, while there is little interest rate variation because all rates are set by the government, consumers do experience varying costs associated with receiving a loan because of the very high transaction costs associated with a less well developed infrastructure and consumer credit market.

When consumers in rural areas borrow from the National Bank of Commerce or the Cooperative and Rural Development Bank, they must submit a loan application and develop a loan project plan at one of the lending institution offices, located either at the district or regional center. Each of these activities requires input from bank officers, and borrowers make several trips to the lending institution to complete the process. Extra trips are often necessary because of an absent bank official or a missing document.

The time and travel costs required to complete the process are considerable. Table 1 indicates the distances potential borrowers from the villages in our sample must travel to request a loan. Adding to the problem of distances between rural villages and the more urban towns is the condition of the roads and busses in Tanzania, making travel difficult much of the time and impossible some of the time. Some roads are literally closed during the four months of the rainy season, and the deteriorated condition of others leads to slow, uncomfortable, and dangerous travel. The busses, used by the majority of the people, often experience breakdowns or gasoline shortages which can leave travelers stranded for hours or days at a time.

TABLE 1. Distances of Sample Villages to District and Regional Centers

Village	Distance to district center (kms.)	Distance to Mbeya town (kms.)
1	44	56
2	76	100
3	83	107
4	77	123
5	55	101
6	30	102
7	73	145
8	98	170
9	76	121
10	101	76
11	86	86
12	56	56
13	118	118
14	36	36
15	75	75
16	41	41
17	4	139
18	31	169

The borrower's demand for a loan is a function of the borrower's disposable income. In Tanzania, as in the United States, when all types of consumer borrowing are taken into account, consumers who have middle levels of income borrow more than consumers with lower or higher incomes (see Table 2).

TABLE 2. Consumer Borrowing by Income Level.\*

Income Level	Borrower %	Non-Borrower %
Highest quintile	40	60
Fourth quintile	50	50
Third quintile	80	20
Second quintile	75	25
Lowest quintile	40	60

\* Data obtained in household-level survey in the Mbeya Region of Tanzania, October 1987.

Social taste toward borrowing is another variable in McGowan's model. Although indications are that there exists a high acceptability of consumer borrowing in Tanzania, at the present time no definitive study has been done to determine the attitude of individuals toward borrowing. Research must also be conducted in Tanzania to investigate the attitudes toward the utilization of various sources of borrowed resources.

In the United States, the price of substitute sources of money is often high for high-risk borrowers. Interest rate ceilings have been established by the government as a way of protecting borrowers from unconscionable lenders. But because of the interest rate ceilings in the U.S., consumers rationed out of the official market for credit use other techniques to acquire productive assets, in the belief that their utility is improved by so doing. Techniques high-risk borrowers may employ to acquire resources in the present by paying for them in the future are the use of installment credit where there is a cash price and a time price; the use of "rent-to-own" schemes; the use of a pawn broker; and the use of a loan shark, even though illegal.<sup>4</sup> In each case the borrower, while achieving the consumption goal, pays a higher economic cost as well as potential psychic or physical costs than would have been accrued through access to funds in the official credit market.

The human dimension of credit rationing in North America is illustrated by Caplovitz (1974). In his book he describes the misfortune which occurs to consumers who default on loans: individuals who were younger, had lower incomes, a higher rate of unemployment, and less

<sup>4</sup>A minority of borrowers rationed out of the official market for credit may have available to them low cost alternatives such as government-insured student loans, family loans or life insurance policy loans.

education than the general population, and who were most often minorities. Caplovitz maintains that consumers with these demographic characteristics would be high-risk borrowers and rationed out of the official market for credit. As a result, they are likely to fall prey to exploitative salesmen and creditors willing to sue their customers much more quickly than other consumers would be sued by their creditors.

In Tanzania, the price of substitute sources of money is not as much of an issue as is the availability of alternate funds. The quantity of consumer loans from institutional sources is extremely limited since the government is the main supplier of credit and uses its seriously constrained resources for other development programs within the country. When the potential borrower is not granted a loan by one of the two lending institutions, the borrower has the option of attempting to borrow funds through a cooperative of which the borrower is a member, wait for a change in government policy, or continue without the benefit of the loan. The supply of credit for retailers is constrained by the quantity of retailers in the rural sector. There is often only one retailer in a village and if the potential borrower is refused credit, the individual must attempt to obtain it from another sector, regardless of the price. Borrowers attempting to acquire funds from non-institutional sources have a better opportunity to obtain substitute sources. The variation in the price of the loan is based on the lenders position in society as well as the relationship of the borrower to the lender.

In Tanzania, the downpayment on the loan from government institutions is regulated by the government. For most loans extended by the National Bank of Commerce of the Cooperative and Rural Development Bank, the borrower is required to provide 25 percent of the cost of the project. The NBC publication (National Bank of Commerce 1984) states that a maximum of 75 percent of the borrower's working capital will be loaned but discussions with a CRDB official (March 1988) indicate that the calculations of working capital can take into consideration non-cash assets the potential borrower may possess. He explained that a farmer requesting a loan for a pair of oxen and a plow could consider the pair of oxen he already has as part of the necessary working capital. If they were valued at 25 percent of the project, the bank would provide a loan of the other 75 percent. Potential borrowers in Tanzania are required to pay an application fee to either the NBC or CRDB when requesting a loan. As with the interest rate, the fees are subsidized and do not represent the bank's costs in evaluating the loan request. The lowest fee charged is Tshs.<sup>5</sup> 20 for loans from Tshs. 1 to 20,000 and the highest fee is Tshs. 500 for a loan over Tshs. 500,000.

<sup>5</sup>100 Tshs. = \$2.00 (May 1987)

## THE SUPPLY OF CREDIT

In Tanzania, consumer credit is offered through institutional channels by the government<sup>6</sup> and by retailers. The objectives of the government influence the supply and distribution of all funds offered by the lending institutions to all sectors of the economy.<sup>7</sup> One of the major goals of the country is the development of the agricultural sector and it is recognized that, "productivity can be raised only by optimum utilization of natural and human resources and by the adoption of improved methods of production... (which) call for capital investment which cannot be met by the poor and indigent farmers from their own resources or savings. Credit is an important tool for bringing about this transformation and ensuring the economic development of the rural masses" (Ramamurthy and Kisarika 1982).

Credit is also sometimes available to consumers when they purchase goods from retail outlets. In most areas of Tanzania two crops are harvested each year, and most are used primarily for household consumption with minor amounts sold for cash. During the planting and growing time farmers require agricultural inputs but lack the funds to purchase them. Retailers provide the inputs to borrowers free of charge until the harvest when the borrowers sell their

<sup>6</sup>Three government institutions in Tanzania provide credit to the rural sector. The Bank of Tanzania manages the currency, sets interest rates and handles the country's foreign exchange reserves. In addition, it controls the Rural Finance Fund which is designed to provide subsidies of capital or interest to loans extended under special development schemes. The Bank also extends refinance facilities to other credit institutions involved in rural development projects. The National Bank of Commerce provides loans to the agricultural sector for crop purchases, and to cooperatives, ujamaa villages and individuals for production. The Cooperative and Rural Development Bank provides loans to the agricultural sector for seasonal inputs, rural transportation, farm machinery, and crop establishment.

<sup>7</sup>Agricultural sector (cooperative societies, cooperative unions, crop marketing boards, sisal industry), parastatal industries, private industries, trade sector, building and construction sector, transport sector, and the tourist industry ("Annexure A: Schedule of Interest Rates on Deposits for all Banks and Financial Institutions," Memo from the Bank of Tanzania: Dar es Salaam (June 1987).

crops and repay the loan<sup>8</sup>. The retailers of farm inputs provide this form of credit in response to indirect pressure from the government which has a policy to enhance the development of the rural areas.

While in many developing countries private money lending provides a major source of rural credit (Hayami and Ruttan 1985), there appears to be little evidence of it in Tanzania. In their study of the Mbeya Region in Tanzania, Ramamurthy and Kisarika conclude that "the influence of private moneylending does not appear to be felt in the rural areas" (1982). In a recent survey by Hyuha (1987) in that same area, women stated that they borrow money, at zero interest rate, from friends, relatives and neighbors for very small financial requirements such as salt and matches. An official at CRDB, in a personal interview with one of the authors (April 1988), stated that informal (non-bank) loans were frequently extended by members of the Indian business community to traders selling "Black Market" goods during the economic crisis in 1983 but to his knowledge the informal credit market did not extend to consumers.

The final source of credit is from non-market or reciprocal transactions between individuals or households in the rural environment. Ellis (1988) describes reciprocity as, "exchanges which are culturally defined, non-replicable between one event and the next, and involve unlike goods and services." When individuals provide goods and services for other members in their community they assume "investment in maintaining their position in kinship, community, or religious networks may pay off in the long run by expanding their potential claims on assets and, therefore, their risk-bearing capacity" (Hyden 1980).

If individuals living in rural areas provide labor for one of their neighbors during the weeding season and do not receive money for their work, they possess the assurance that at some time in the future the neighbor will reciprocate and provide either goods or services to assist them. The custom of reciprocal exchange has other economic advantages at a time when the interest rate on saving accounts is 24 percent (Bank of Tanzania, 1987) and the rate of inflation is 32 percent (see Table 3). Investors with money in savings accounts lost 8 percent of the real value of their principal in 1987. Individuals with savings can obtain,

<sup>8</sup>This availability of farm inputs through retailers is a fairly recent development. In 1982 the Tanganyika Farmers' Association (TFA) was the only retail supplier of farm inputs (fertilizer, chemicals, seeds, hand tools, ox-drawn equipment and etc.) in Tanzania. Supplies from TFA were available to all consumers but a year-end rebate and interest-free credit were available to members of the association. Membership was gained through application and the payment of a relatively small initiation fee.

potentially, a higher rate of return on their investment by providing goods or cash to their neighbors and relatives than by having had their assets in a bank. Such loans have also the added advantage of reduced risk since they are provided to associates. In every case the non-market agreement, while implicit, is nevertheless culturally enforced.

Differences in the real rate of interest for consumer loans are dramatic when comparisons between the United States and Tanzania are made. In the United States, the interest rate on an unsecured consumer loan averaged 14.8 percent in 1986, at a time when the inflation rate was 3.8 percent (see Table 3). At the same time, the interest rate on consumer loans in Tanzania was 29.7 percent and the rate of inflation 32 percent. The government sets the interest rates for all categories of loans and as part of the program of economic assistance in the development of the country, rates are set below the rate of inflation. This policy provides an income transfer from the lending institutions to borrowers fortunate enough to acquire loans. In 1987, the interest rates set by the government ranged from a low of 20 percent for loans to primary cooperatives to a high of 29.7 for consumer credit, an indication of the relative value the government placed on each sector (see Table 3.)

TABLE 3. The Inflation Rate and Interest Rates on Consumer Loans and Savings Accounts in Tanzania and the United States

	Tanzania %	United States %
Inflation Rate <sup>a</sup>	32.0	3.8
Fixed Deposit <sup>b, c</sup>	20.0	7.1
Consumer Loan (unsecured)	29.7	14.8
Primary Coop. Loan	20.0	n.a

<sup>a</sup>Tanzania inflation rate for financial year 1986/87 (Bank of Tanzania, November 1987); U.S. inflation rate for 1986-87 (Bureau of Labor Statistics (1987) NEWS, U.S. Department of Labor, Chicago, IL).

<sup>b</sup>Tanzania Fixed deposit (9-12 month) and loan rates effective July 1, 1987 from "Annexure A: Schedule of Interest Rates on Deposits for all Banks and Financial Institutions." Memo from the Bank of Tanzania: Dar es Salaam (June 1987).

<sup>c</sup>U.S. fixed deposit (6 month) for 1987 and personal loans, (24-month) for 1988 (Board of Governors of the Federal Reserve System (1988), Federal Reserve Bulletin, Vol, 74, no. 1. Washington, D.C.)

In McGowan's model the supply of credit is potentially influenced by the probability of default. In the U.S. leading institutions differentiate borrowers according to this probability. Credit rationing occurs when sociodemographic characteristics associated with risk cause borrowers to be rationed out of the official market for credit because of the unwillingness of stockholders of lending institutions to extend high risk loans, and because higher costs are associated with

evaluating higher-risk loans (Avio 1973). At the present time, creditors are actively marketing home equity loans because the probability of loss from default is low since the borrower's home is used to secure outstanding loan balances (Canner, Fergus and Luckett 1987).

The Tanzanian government also appears to be sensitive to the risk characteristics of borrowers. The National Bank of Commerce and the Cooperative and Rural Development Bank follow similar loan application procedures designed to identify low-risk borrowers. Approval is based on the borrower's ability to meet minimum loan conditions<sup>9</sup>. As well, the borrower must have a proposal for a profitable project for which the borrowed money will be utilized. When the loan is approved, the money is given to the supplier of the inputs required for the project as another way of reducing the probability of default. If a consumer applies for a loan to purchase a farm implement, the Cooperative and Rural Development Bank purchases the implement and the consumer receives the implement rather than cash.

It is the belief of the CRDB that projects fail (and therefore borrowers default) because of lack of skills and experience in planning and management. In order to reduce the possibility of default, borrowers are assisted through the application process and during the loan period by technical assistants. In addition, a grace period on both principle and interest is allowed, for longer term loans, until the project starts to produce.

Despite the apparent rigor applied to the granting of loans, there is a discretionary aspect which, in the past, has led to a high rate of loan default. Loans are often granted by the lending institutions to achieve the government's national development objectives rather than to meet short-term profitability requirements. Following independence the government advocated the increased use of tractors in agriculture and even when they proved to be unproductive, "the credit system continued to give priority to tractors..." (Wangwe 1987).

The recovery of loans has been a major problem of credit institutions in Tanzania. In 1971 the National Development Credit Agency was replaced by Tanzania Rural Development Bank (TRDB) (which was replaced by Cooperative and Rural Development Bank in 1984) after the default of in excess of 40 percent of its loans. After ten years of operation TRDB was found to have around 30 percent of its loans overdue and probably uncollectable (Ramamurthy and Kisarika 1982).

<sup>9</sup>Conditions of the loan stipulate the applicant must have funds to cover 25% of the project, with the remaining 75% coming from the lending institution. In addition, the borrower must provide security for the loan in the form of property or a title to land.

Other sources indicate that 65 percent of all TRDB loans were in default in 1980. Producers of cotton had the highest default level (90%), followed by smallholder tea producers (78%). Of all transport loans, 90 percent were in default, as were 78 percent of all farm machinery loans extended by TRDB (World Bank 1982). Several reasons are given for the high incidence of loan default, including political intervention, frequent institutional changes, and the problems occurring when the necessary supervision of borrowers living in rural areas far removed from the bank is not possible (World Bank 1982). In Tanzania, therefore, even when the probability of loan default is high, loans must be extended to meet government goals.

Although the United States has a market economy, the government also has a policy of overriding economic forces and supporting loans where the default rate could be high. Guarantees in support of education or low income housing loans are made by the government to private banks as part of program of social investments. This assistance provides borrowers with funds at rates of interest they would not qualify for on the open loan market.

Regulations and restrictions on the lender are made in both the United States and Tanzania. The effect of government regulation of the credit market in the United States is that the loan market is segmented and portions of low income consumers are rationed out of the market. In an environment where usury laws establish ceilings for interest rates charged to borrowers, the necessary economic incentives for extending loans to high-risk groups are removed and lenders are unable to cover their higher costs.

Arguments in support of interest rate ceilings tend to center on the need to protect high-risk borrowers who have lower incomes. Although there is high competition among lenders in low-risk segments of the market, monopoly elements exist in the high-risk segments of the market and proponents of interest rate ceilings support laws which protect would-be borrowers from exploitation. In addition, the absence of interest rate ceilings is theorized to cause income redistribution from borrowers to lenders, which leads to another cost to the poor (Avio 1973; Jadlow 1975). Opponents of interest rate ceilings argue that since consumers use credit to purchase productive assets, the borrower is economically rational to borrow at apparently high rates, as long as the marginal productivity of the asset is equal to the interest rate (Durkin 1974).

In Tanzania, while the predominant catalyst in the loan market is the government, the National Bank of Commerce and the Cooperative and Rural Development Bank function as individual entities with their own institutional goals. But each is affected by restrictions established by the government. The National Bank of Commerce was formed at independence in 1967 when foreign-owned banks were nationalized. Following

independence, NBC's lending policy was altered since former standards "ignored the vast differences in the levels of development." Security requirements were also changed as "former requirements were sufficient to exclude the flow of credit from these banks to the domestic and undeveloped-developed sectors of the economy" (National Bank of Commerce 1984).

The Cooperative and Rural Development Bank and its predecessors have been greatly affected by changing government philosophy. Many of the loans made by the initial Agricultural Credit Agency were considered by farmers to be grants from the government and became uncollectable. During the time the National Development Credit Agency was functioning, the government, in its effort to develop collective production, instructed the agency to extend loans to cooperatives which then provided loans to smallholders. Problems arose when the agency could not collect from "the ultimate borrower" (World Bank 1982). The Tanzania Rural Development Bank was charged with the task of distributing agricultural inputs to the rural sector. Since it lacked the infrastructure or the staff to fulfill this goal, major problems arose and it was later replaced by the CRDB. In each case, the government determined the leading policies, capitalization at inception and the number of defaulted loans which would remain on its books following restructuring.

In North America the loans are supplied in relation to their economic productivity, and the rate of return on alternative financial investments is of concern. As mentioned earlier, government philosophy in Tanzania overrides productivity or consumer preference. The following table indicates how the loan allocations by the government, through the Cooperative and Rural Development Bank, to various parts of the agriculture sector of the economy, change from year to year.

TABLE 4. Loans Allocated by the Cooperative and Rural Development Bank to Various Parts of the Agricultural Sectors involved in Agricultural Production in Tanzania.<sup>a, b</sup>

Sector	Year					
	1978-9	1979-80	1980-1	1981-2	1982-3	1983-4
Ag. Inputs	125.8	133.2	74.0	92.3	136.1	87.5
Farm Mach.	7.3	1.5	13.0	10.9	20.3	15.2
Rural Transp.	6.5	10.0	1.1	88.3	20.8	13.7
Small Ind.	11.3	12.0	10.8	17.0	15.0	23.5
Livestock	15.5	16.6	1.2	46.6	6.3	5.4
Fisheries	13.5	1.4	0.6	3.6	1.6	1.6
Storage	2.3	2.8	0.4	3.9	6.0	0.3
Crop Est.	4.6	30.4	0.1	0.7	0.7	0.2

Source: Cooperative and Rural Development "Annual Report and Accounts: 1 July 1984 - 30 June 1985." Dar es Salaam, Tanzania.

<sup>a</sup>Data in million Tanzania Shillings

<sup>b</sup>Comparisons of loans distribution within years are more meaningful than comparisons between years since amounts are stated in nominal terms.

## CONCLUSIONS

The object of this paper was to illustrate what can occur when the kind of model we have come to accept as a description of the workings of the economy is applied in a cultural context widely



different to that of North American. In this case a simple two equation model of the credit market was the vehicle from which to extrapolate to the United States and rural Tanzania. Even from this simplified basis we are able to show key differences in the variables which constitute the demand and supply of loans in the consumer credit market. For example, interest rate differences affect the price of consumer loans in North America while transaction costs are related to loan price in Tanzania.

It is clear from this study that a person trained in consumer economics in North America would find it difficult, if not impossible, to gain much insight into the Tanzanian situation without extensive additional institutional, cultural and political knowledge. While this point is not difficult to establish, its consequences are far-reaching. Decisions about the use of credit in the Third World are continually being made by economists operating out of developed countries who, in the absence of detailed field knowledge, most inevitably fall back on the concepts they learned in their academic studies.

The market-based approach to the credit market is not at fault per se. The problem, as we see it, is to point out to an audience raised on the notion that economics is "value free" and models are "scientific", that the models may be inappropriate or insufficiently specified when applied across countries. Models should not be simply transferred to new contexts. A period of study of the contexts is an essential forerunner to model specification.

The information contained in this paper was obtained through an international project sponsored jointly by the Tanzanian government and the Canadian International Development Agency. Only through the sharing of information between countries, and through conferences such as this one, Wingspread and the forthcoming Sunbird conference can we hope to learn more of the cross-cultural ramifications of the models we study in our undergraduate and graduate courses. We sincerely endorse the efforts to extend the national outreach endeavors of the ACCI.

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## CONSUMER PROTECTION IN KOREA: SHOULD CONSUMER EDUCATION BE MANDATORY IN KOREA?

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### HISTORICAL BACKGROUND

Consumer problems and the protection issue in Korea are discussed. Historical background including a recent development is examined, and the causes of these problems are explored. Related research issues in the literature are discussed. Policies are proposed as solutions to consumer protection problems in Korea.

When Korea was a preindustrial society, consumption was confined to a limited number of domestic goods. There was little variety in the types of products, and often consumers were producers of their own goods. Products were primarily agricultural products sold in an open outdoor market on the street or in an open land area; therefore, consumers were able to see, feel, and evaluate the quality of products at point of purchase.

Consumer problems, related to rapid industrialization, are prevalent in most modern societies. These problems are directly related to the well-being of consumers. In theory, consumers in a mixed-enterprise, capitalistic economy such as Korea can exert a tremendous amount of power on performance of the economy. In practice, however, they often are victims of producer- or seller-controlled unfair market mechanisms. Consumers cannot function efficiently and effectively in the face of imperfect knowledge and without understanding the role of consumer information and consumer protection in their economy.

Although consumer problems are similar in industrialized nations, they may differ in type and degree by consumers' amount of knowledge and understanding of their rights and responsibilities in their particular economy. Therefore, consumer problems need to be investigated at the national level in Korea.

Remarkable economic growth has taken place since 1960, and Korea has become an industrial society. The number and variety of consumer goods have multiplied accordingly. Consumer values and the way consumers interact in the marketplace have changed. Consumer problems, too, have accompanied industrialization. In fact, consumer protection problems have become one of the most important issues in Korea (Jang, 1980, 1982; Jung, 1989). The major purpose of this study is to examine current consumer problems in Korea and provide policy suggestions for effective consumer protection. Consumer education is examined as a key solution.

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In 1968, the Korean government established the Korean Women's Association as an agency of the governmental Department of Health. The major function of the Association is to publish the Monthly Consumer Protection Bulletin which provides various types of information on manufactured products. On December 1, 1979, the Consumer Protection Act was passed by the Korean congress, and it became effective on January 4, 1980 (Im 1980). The legislation defines and regulates unfair retail trade practices and the rights of consumers. The law also established the Fair Trade Commission to supervise fair trade practices.

In the 1970's, independent private consumer organizations were formed: the "Consumer Union of Korea" in 1970 and the "National Council of Consumer Protection Organizations" as a unified form in 1978. To inform and promote interest in consumer issues, the former published Consumer Education Bulletin and the latter published Monthly Consumer. Both publications provide various types of information for consumers.

The Korean consumer protection movement has an history of about 20 years but mainly it was sponsored by women's and other private organizations (Chung, 1987). Such organizations include the YWCA, Women's Group Council, Research Institute of Women Affairs, Consumer Education Group, Institute of Korean Women, Korean Mother's Association, and Korean Women's Association. The role of these women's organizations are to publish materials related to consumer affairs and protection.

### SOCIO-ECONOMIC CHARACTERISTICS

Korea's population was 42,082,000 persons in 1987; 28.3% of the total population were under 14 years, 67.2% were ages 15-64 years, and 4.5% were 65 years or over (Korea Economic Planning Board, 1988, pp. 6-7).

Since 1976, due to the Government population control policy, population growth has remained at a 1.5% level and is forecasted to decline to 1.3% in the 1990s. The average life expectancy was 66 years in 1980 but will increase to 72 years by the year 2000 (A Guide on Korea, 1986 pp. 9-12).

Education has always been regarded as one of the most important human resources in the Korean society. Colleges and universities in Korea operate with strict enrollment limitations because of the gap between college admission limits and the number of aspirants. The literacy rate is 90% in Korea, one of the highest in the world (Yonhap News Agency, 1985).

Per capita Gross National Product (GNP) increased from \$1,262 in 1980 to \$2,199 in 1987. The consumption of public and private goods and services for personal and household use was the largest part of the GNP, i.e., 63.3% of the GNP in 1987 (Korea Economic Planning Board, 1988, pp. 16-17). In 1984, the average monthly income of urban and rural workers was \$729 and \$578, respectively. Compared with rural households, urban households had a higher average monthly expenditure i.e., \$317 versus \$302 (Yonhap News Agency, 1985).

#### CONSUMER PROBLEMS: CAUSES AND SOLUTIONS

As consumer problems emerged as a major social issue, the consumer protection movement gained widespread attention of the public. Consumer problems grew from individual ones to those of the public as a whole (Choi 1981). However, the consumer protection movement today has become an ineffective one, and consumers in practice have little protection against unfair trade.

##### Causes

Two shortcomings of consumer protection measures in Korea can be cited. First, if a consumer buys goods at a large department store, he/she may be able to get a refund or an exchange of goods. However, if the consumer buys goods at a small store, there is no formal warranty period for the goods sold. Unless the merchandise is manufactured by a large corporation which provides a warranty, a refund or exchange is practically impossible. Consumers usually pay in cash, and small stores usually do not issue sales receipts to consumers. Although goods are sold at a list price at large department stores, consumers do not purchase at a list price in many small stores and in the open street market. The initial price asked by the salesman or saleswoman at many small stores and in the open street market is only a first asked price on which a consumer starts to bargain. Consumers are often cheated about the quality of the goods they buy and in the end pay higher prices than a fair market price would be.

In the present situation, there appears to be no way for consumers to protect themselves against this kind of deceptive trade practice. Consumer agencies are not concerned with the level of prices consumers pay. If the consumer has a complaint against a seller about the high price of a good, once he/she has paid for it, no agency has legal authority to intervene. The situation is even worse in rural areas, because there is no organization similar to the consumer agency or association to provide information.

The second shortcoming of consumer protection revolves around advertising. In a mass production society where producers and consumers are separated widely, a communication system is essential to inform the consumer about producers and their products. In such a society, advertising is essential for marketing and purchasing. Advertising is an integral part

of the marketing system and is an important part of the market economy. Major functions of advertising in Korea are to inform consumers about existence of new products, their functions, prices, and advantages. Thus, advertising provides valuable consumer benefits, some of which are educational and others economic in nature.

However, the incidence of false advertising is rapidly increasing, and there is no government control on false advertisement in Korea. Shin (1981) found that about three-fifths of the consumers living in Seoul (Capital City) and other cities complained about deceptive advertising (p. 18). These data are presented in Table 1. Consumer complaints were on various food items, electric appliances, clothing, and shoes. All of these products are the necessities of life.

Table 1. Korean consumer complaints about deceptive advertising

Responses	Capital city	Other cities	Total
Complained	60.6%	63.2%	61.8%
Did not complain	39.4%	36.8%	38.2%
Total	100.0%	100.0%	100.0%

Source: Shin (1981).

Deceptive advertising takes various forms. The so-called "bait-and-switch" is that a seller attracts consumers by advertising certain goods at low prices, but no mention is made about the small number of units for sale at that price. Consequently, when consumers go to the store to purchase the advertised good, they are told that the item is already sold out. Then they are encouraged to purchase an item of higher price.

Another form of deceptive advertising is the false description of products. Consumers purchase certain products believing the advertisement and later they find that the quality of these products is quite different from what the firm advertised (Shin 1981). Consumers need to be aware that the purpose of advertising is not only to inform consumers about various products but also to sell such products by stimulating and influencing consumers. It is important that consumers should understand motives, methods, and practices of advertising. They should know how to use advertising wisely and how to analyze it.

##### Solutions

Based on the above two shortcomings of consumer protection, the following suggestions are in order for improved consumer protection. First, effective consumer agencies should be organized and sponsored by the government, women's organizations, consumer groups, and respectable business organizations. Consumer agencies should have two distinct functions. The first

function should be to provide educational activities. That is, consumers should be educated with regard to shopping practices, quality of products, and channels of complaints. Consumer education should include understanding of consumer buying behavior, because frequently consumers make an error in selecting products and many consumers try to discount prices rather than selecting good quality products.

Second, consumers should be taught to obtain objective information on products. Consumers generally do not have sufficient and adequate information about products because they do not know where to get it. Furthermore, there are few sources of information available in Korea. Most consumers are unable to get information on the essential features of a product such as specifications, standards, and performance. Third, consumers should be encouraged to report defective products or poor quality. This leads to the need for the second function of consumer agencies. The second function of consumer agencies should be the settlement of consumer complaints. Consumers are reluctant to report defective items for various reasons. According to a study by Jang (1980), less than 1% of all consumers who bought defective items complained (p. 139). The major reason is that consumers can complain only to the seller, and such complaints are useless if the store rejects the consumer's complaint. The current women's organizations and private consumer associations cannot handle such complaints because they have no influential power due to the lack of organization and powerful leaders, the lack of government and business support, and lack of funds (Jang, 1980; Choi 1981; Shin, 1981).

#### RELATED RESEARCH ISSUES

Because there are many consumer problems, research covers a wide range. The areas of research in consumer problems include legislation and organization of more effective consumer protection, consumer education on quality and safety of products, wholesale and retail marketing systems, antimonopoly and fair trade practices, producer education on quality and safety of products, and consumer awareness and response to the consumer protection movement. Unlike the consumer information, the subject of consumer education has received little attention in the literature of marketing and consumer behavior.

Jang (1980) surveyed 1,000 consumers to find consumer awareness and response about the consumer protection movement. As indicated in Table 2, Jang found that nearly all of the consumers were aware of the consumer protection movement, but the vast majority (88.2%) of consumers felt negative about the movement. The findings imply that the consumer protection movement is not working effectively. Therefore, a more effective consumer protection movement is needed.

Thus far, discussion of consumer problems has been concerned with those of adult consumers. Children have relatively little money to spend, and thus the problems of young consumers often have been ignored. In addition, children have little or no understanding of a free enterprise system. Yet, consumption behavior of youngsters

Table 2. Consumer awareness about and responses toward the Korean consumer protection movement

Consumer awareness about consumer protection movement		
Responses <sup>1</sup>	Number of respondents	%
Yes	983	98.3
No	14	1.4
None	3	0.3
Total	1,000	100.0

  

Consumer responses on current consumer protection movement		
Responses <sup>2</sup>	Number of respondents	%
Positive	108	10.8
Negative	882	88.2
None	10	1.0
Total	1,000	100.0

Source: Jang (1980)

<sup>1</sup>Have you heard about the consumer protection movement?

<sup>2</sup>Do you think consumer protection movement is working effectively?

is particularly important because not only does it shape much of their consumption patterns for their life-time, but it also affects their present and future well-being. Accordingly, some research attention has been directed to the problems of young consumers.

Jung (1985) surveyed secondary school students and found that their level of consumer knowledge was very low. The average score of consumer knowledge was 21.32 on a scale of 40. For the knowledge scores of money management and buying practice, the means were 5.87 (highest) and 4.93 (lowest), respectively, on a scale of 10 (Table 3). Consumer knowledge appeared to have a positive but not significant effect on consumer behavior.

Findings indicate that young people do not put what knowledge they have to practical use, and they very often behave irrationally as consumers (Jung 1985). Students are especially weak in terms of practical information. This may indicate that younger consumers have difficulty applying what they learned. Therefore, young

people should be educated to want to utilize their knowledge and abilities more practically in consumer behavior. They need to develop knowledge about consumer rights and roles. Jung (1989) pointed out that:

"Consumer education should adequately reflect the present need of young consumers and should be reinforced in secondary schools to improve the student's consumer knowledge (p. 12)."

Table 3. Consumer knowledge scores for Korean secondary school students

Variables	Mean score	Standard deviation	Number of respondents
Principles of economy	5.26	2.07	709
Money management	5.87	1.97	708
Consumerism	5.25	2.12	709
Buying practice	4.93	1.90	709

Source: Jung (1985)

Socio-economic factors have been recognized as important determinants of consumer behavior in several studies (Chae, 1985; Kim, 1986). Taking region of residence, level of income, age, and educational level into account, Chae (1985) analyzed the recent tendencies of women's consumer behavior, using survey data obtained from 389 randomly-selected housewives living in Taegu, Korea. She found that most of the housewives had strong feelings about safety of products, consumer protection problems, health care, and economy in managing family budget, but they did not seem to care about high quality goods.

There were significant differences between urban and rural housewives, i.e., urban housewives had higher tendencies than rural housewives in inclination to consumer protection problems. Age of housewives was an important factor in its impact upon consumer protection problems. That is, the younger age group was significantly more concerned about consumer protection problems than the older age group. The relationship between income level and consumer protection problem was curvilinear, i.e., the mean score was the highest for middle income group than for the low and high income groups, respectively. Education of housewives was a significant factor which was positively associated with awareness of consumer protection problems.

Kim (1986) investigated level of consumer skill and market risk taking family income into account. She used survey data obtained from a random sample of 525 home managers in Seoul, Korea. The low income group was from households with annual income between 1,320,000 won (\$1,650) and 3,240,000 won (\$4,050); the middle income group had a household income between

3,360,000 won (\$4,200) and 9,600,000 won (\$12,000). In the high income group, a household income was above 9,720,000 won (\$12,150). Kim found that the relationship between income and consumer skill was curvilinear, that is, consumer skill increases rapidly, then flattens out, and ultimately falls, as income increases.

One of the interesting findings was that low-income and high-income groups had more consumer problems, i.e., lower consumer skill and higher market risk, than the middle-income group. Low-income consumers had relatively more problems in quality of products and door-to-door sales than middle-income consumers (23.11% versus 18.93%), and high-income consumers had relatively more difficulty in false and misleading advertising (12.32% versus 10.29%), overcharges, and unfair bargain problems (25.42% versus 23.55%) than low-income consumers (Table 4).

Table 4. Level of income and various consumer problems

Consumer problems	Consumer income groups				F-values
	Total <sup>1</sup> %	Low %	Middle %	High %	
False and misleading advertising	11.69	10.29	11.98	12.32	8.78***
Overcharges	5.60	5.11	5.70	5.92	2.25*
Unfair bargain	24.63	23.55	24.67	25.42	2.59*
Warranty, repair, and exchange	19.18	18.27	19.28	19.19	2.26*
Defective products	19.11	19.68	19.44	18.51	1.52
Door-to-door sales	19.79	23.11	18.93	17.92	20.62***
Total <sup>2</sup>	100.00	100.01	100.01	100.00	

Source: Kim (1986)

<sup>1</sup>Total number of cases = 525

<sup>2</sup>May be different from column sum because of rounding error.

\*p<.05 \*\*\*p<.001

Based on this review of major recent studies on consumer behavior, consumer education requires sustained research. Topics to be covered include necessary marketplace skills and knowledge and consumer characteristics which provide insight into lifestyle differences.

## A RECENT DEVELOPMENT

In July 1987, with the expense of 4,000,000,000 won (\$5,700,000), the government set up an action oriented organization called "Consumer Protection Agency" (Zi, 1987 p. 26). Consumers can go to the agency directly to file any complaints on defective goods and services or on any unfair practices by the sellers and manufacturers. Then, the agency investigates consumer complaints and exerts authority to settle the dispute.

The establishment of the government consumer protection agency has advantages. The major advantage is that consumers have a place to go to file a complaint without hiring a lawyer. Second, the agency is a governmental organization, so it has more influential authority than a mere private consumer protection association, and so business firms may be more willing to comply with the agency mediation and suggestions. Third, the agency publishes Consumer Period which provides various types of information, such as quality of product, grades of products, and case studies for consumer problem solving which are very useful for consumer education purposes.

The disadvantage, on the other hand, is that under the regulation, private consumer organizations can not engage in activities to settle disputes between consumers and merchants if sellers do not agree with consumers. Also, some activities of private consumer protection organizations are limited (Zi, 1987). Consumers may be reluctant to file formal complaints with the government, unless the case involved very expensive items, and consumers are really confident about their cause of complaints. In such cases, many small consumers may suffer, and the number of small consumer complaints may fall.

To avoid such problems, limiting some activities of private consumer protection organizations need to be eliminated, and both the public and the private consumer protection agencies should be allowed to coexist actively. It should be noted that many consumer organizations are organized by consumers themselves with networks in the country. Therefore, such organizations should be useful to both the government and consumers in helping to find out what are important issues in consumer protection.

## CONCLUDING REMARKS AND POLICY SUGGESTIONS

The consumer has the right and responsibility to be able to purchase at the best competitive prices, to be informed against misleading practices, to have assurance of being given the facts necessary for the best choice of goods and services, and to safety against market goods that are dangerous and hazardous to life or health (Chung, 1980). Consumers cannot exercise such rights if they have no information and if they have no way to submit and settle complaints when they have them. Consumers are apt to give

up their own rights in high-pressure markets. They can protect their interests only when their efforts are concentrated on upholding their rights.

Problems cannot be solved unless consumers have self-awareness of their rights. Often they have little incentive to actively seek new product information, and much of the information is originally acquired passively by consumers, mostly from seller-generated sources which are easily obtained and inherently biased. Consumers need information produced by third party sources such as Consumer Period, Monthly Consumer, Consumer Education Bulletin, or Consumer Report on the existence of various products and their alternatives, the advantages and disadvantages of products, quality and price of products, and understanding the importance of consumer behavior for the economy as a whole. Also, they need protection and education.

Therefore, the following policies are suggested as the way to provide maximum protection for consumers in Korea:

First, implement strong legislation of antimonopoly and fair trade practices.

Second, initiate strong legislation against deceptive advertising, incomplete labeling, and bad selling practices.

Third, make consumer education mandatory for students from elementary school through college with adult education programs instituted for those who have completed formal education. The introduction of consumer education courses and units into the school curriculum should be paralleled with consumer education programs outside the formal education system. Such consumer education programs should be sponsored by a variety of public and private institutions.

A few comments are in order on the type of education consumers should have and where they should be able to obtain necessary consumer information. Consumer education should include information and should develop knowledge on grades of products, quality characteristics, cost comparison techniques, advertising, and consumption behavior. However, information about consumer products is often difficult for an individual to obtain, because securing the needed information requires investigation and tests that individual consumers usually cannot do. Therefore, consumer agencies and organizations should distribute product information to consumers in an understandable format.

Consumers should be taught about the importance of their purchasing behavior, what information is available, how to appraise information, how to utilize such information, and how to choose the goods and services they want. Consumers need to understand the kind of techniques and appeals used in advertisements in order to help them use the choice-making process to maximize their economic well-being.

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# CROSS-CULTURAL EVALUATIONS OF CONSUMER EDUCATION: A DISCUSSION<sup>1</sup>

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## COMMENTS ON THE PAPER BY JUNG

This study attempts to demonstrate the need for consumer education for adolescents in Korea from students' scores on a test of consumer knowledge. The students had low scores in all four content areas. The study is descriptive and was well implemented. My comments focus on 1) the background provided to justify the study and the test content; 2) the interpretations; and 3) the validity and reliability of the test instrument.

### Background

The author provided a general review of consumer problems and the content of tests used to measure knowledge of consumer issues in the U.S. A brief description of Korean consumers' problems, especially those of teenagers, would have improved the justification for the study and the types of questions included on the test, however. The reader is provided a clue about the magnitude of Korean consumers' problems only in the conclusion, where Jung states that "consumer problems are mushrooming in Korea." If little or no pertinent Korean literature had been available a review of literature regarding countries at similar stages of development might have justified the study and content better than the U.S. literature which was reviewed. Since this was not the case, it would have been well for the author to note why she used only U.S. literature and to have described the similarities and differences in Korean and American adolescents' consumer problems.

In addition, the importance and implications of the study were obscured because of the lack of descriptions of the subjects, participating schools and school systems with regard to whether the subjects had previously taken consumer education, availability of consumer education, and the method with which curricula are established for these schools. Such information also would have provided a context within which to interpret the results more meaningfully.

### Interpretations

The interpretations of others' and the author's work were often too broad. Part of

<sup>1</sup> This discussion is based on the original, unrevised manuscripts and thus some of the comments may have been addressed by the authors in subsequent versions.

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the problem may have been the difference in language. However, the paper was otherwise well written and easy to follow. It is usually, if not always, erroneous to interpret test scores as attributes of the test takers. This is because the range of knowledge tested is usually lean and because content validity cannot be determined with surety. Jung, in one case for example, reports that the scores show that "students have insufficient knowledge" of consumer education. Considering that Jung had provided no standards of knowledge or evidence that the test was developed to measure consumers' efficacy in the marketplace (albeit the hope that knowledge improves performance), the results may not be interpreted in relation to a standard. Instead, the results show that the students scored low on the test. The more specific example about scores on conceptual versus practical problems was accurately interpreted and more informative.

The most egregious interpretations were those attributed to results from Moschis' (1976) study and this study comparing scores of adolescents from rural and urban areas. In the Moschis (1976) study the result of men scoring higher than women on a given test were interpreted by Jung to mean that men are intellectually superior to women. Likewise students from rural areas who had scored lower than their urban counterparts on Jung's test were described as inferior. Those are large leaps. Although these undoubtedly do not reflect personal beliefs, it would be well in the future to interpret literally or to ask colleagues of opposing biases to review interpretations.

### Validity and Reliability of the Test Instrument

Solid attempts were made to ensure the content validity of the questions. Questions were adapted from those used by other scholars of consumer education, although I was surprised to see the omission of Garman's (e.g. Garman, 1979) work. Jung suggests that "extensive efforts" were made to adapt these questions (originally developed for Americans, including older people) to Korean adolescents. Elaboration on this task would be helpful to others developing test instruments cross-culturally.

No mention of testing for internal consistency was made. Sample size was more than adequate to perform this simple test.



#### COMMENTS ON THE PAPER BY CHUNG AND HAFSTROM

This paper discusses changes in the Korean economy, consequent consumer problems, and suggests methods to resolve them. The authors are to be congratulated in taking such a wide view of consumer problems while focusing on specific issues. The Korean consumer movement appears to have great potential for improved efficacy, especially with the encouragement and direction provided by Chung, Hafstrom and others.

The authors would more likely succeed in stimulating policy change if the paper had used more specificity and documentation, as well as a more appealing approach. These would strengthen both major components of the paper -- the case for consumer problems needing redress and the forms of redress to employ.

#### Consumer Problems

As written, the arguments for the needs of consumers are vague and lack empirical foundation. If the empirical work about Koreans is unavailable, a review of the scholarly literature from other countries at similar levels of development with similar problems would better convince policy makers and others of consumers' needs. Additionally, if Korean and U.S. politicians are similar, they need to be inspired as well as informed. In the U.S., consumer legislation tends to be enacted only when consumers and politicians are riled and the offending businesses thus suffer losses and join in the effort to curb their own problems via governmental action. This need not be the case if consumer advocates could provide evidence sufficiently convincing to marshal political energy. Information presented in popular articles could augment the descriptions provided in the scholarly literature from Korea and other countries. Likewise, interesting case studies which typify particular consumer problems would capture not only the minds, but also the imaginations of politicians and voters (consumers), ala Upton Sinclair, Ida Tarbell and Ralph Nader in the U.S. experience.

#### Policy Implications

The paper also would be strengthened if a conceptual framework such as the Uhl (1971) model were used to suggest the policy implications. Benefit/cost analyses, as employed in the Uhl model, would lead to more concise, effective suggestions than those presented herein. Such a model would also indicate alternatives to government protection (emphasized in this paper) and thus provide a

greater chance of long-term success to the Korean consumer movement. Furthermore, a review of efficacious policies established elsewhere, reformulated to pertain to consumer problems in the Korean context, is recommended.

Both the Chung and Hafstrom and Jung papers have posed an important information problem -- the assembling of literature written in many different languages, as well as "fugitive" literature. As each country's consumers face the need for information relevant to their problems it would be wasteful, if not impossible, to study consumers in every country regarding every issue in as timely a manner as needed. An inexpensive data base containing information which those in countries at similar levels of development with similar problems may adapt to their particular needs would be tremendously helpful. One example of this effort is the initiation of a data base on consumer education literature by the Consumer Education Committee of the American Council on Consumer Interests.

#### COMMENTS ON THE PAPER BY HARDER AND WIDDOWS

These authors compare factors which determine the quantity of credit demanded and supplied for consumers in the U.S. with producers and consumers in Tanzania. My comments pertain primarily to the source of the information about Tanzania and the premise of the analysis.

The data source and description of data collection methods would have been helpful. The major problem of the study, however, was the premise, yet it generated much stimulating thought. The authors compared factors influencing the quantities demanded and supplied of consumer credit in the U.S. with producer and consumer credit in Tanzania. The focus was on factors influencing the demand and supply of credit for producers, however. The problem was that the authors claimed that producer (farm) credit in Tanzania is actually consumer credit. This led to an often incorrect and confusing discussion. Both producer and consumer credit in Tanzania was confusion. The paper would be strengthened by employing standard definitions of consumers and producers and clarifying the focus.

Because the factors influencing the demand and availability of credit, especially the latter, may differ for producers and consumers it would have been preferable for the authors to have simply stated what they were doing -- namely comparing the factors influencing the supply and demand for consumer and farm credit across cultures.

Alternatively, the analysis might have been limited to cases in which producer and consumer credit were similar. For example, some formal credit programs targeted to aid small very poor farmers in some developing countries support consumption. These are not tied to investments, as would be more typical in farm lending. For farmers who farm without purchased inputs these "loans" are made to enhance the labor input. Thus, most of the farmers buy food with the money.

Another case in which the equivalence of consumer and producer might be argued is when most of the farm output is consumed by the household. The authors used this point implicitly by considering farming to be household production but supplied no evidence to support it.

More generally, however, in both less and more developed countries, there are differences in the ways credit worthiness is determined. This is because, in contrast with consumer loans, decisions to make producer loans employ investment analyses calculating the expected return on the investment. Loans to smallholder farmers often require information about the intended use of the money, farming experience, type of crop, size of farm, yield, etc. which would not be the case with most consumer loans.

Questions generated by the analyses resulting from defining consumers as producers include the following: 1) While farmers may have positive attitudes toward credit for farming do they also have positive attitudes toward credit for consumer goods? 2) What constitutes a high-risk borrower of consumer credit, versus farm credit? 3) How do default rates of farmers and consumers differ?

Furthermore, the title of the paper leads us to believe the authors will discuss what we haven't learned about consumer credit in the U.S. that would apply to or differ from that in Tanzania. They did not discuss this but have provided an interesting line of approach for future research. For example, we have not learned that the poor can be credit worthy. In the small amount of research done on the subject, it is apparent that banks with high default rates such as those in Tanzania, would do well to change practices to enable the poor to succeed. Techniques used by such groups as Women's World Banking and the Foundation for International Cooperative Assistance would demonstrate effective strategies as well.

In conclusion, the idea presented by Harder and Widdows has merit but needs to be implemented in a more straightforward manner. In particular, it would be preferable to study

consumer credit in less developed countries. Much less is known of consumer than producer credit in these areas. Research needs regarding consumer credit in developing countries include purely descriptive work as well as answers to questions about costs of credit, stability of supply and the influence of consumers' characteristics such as gender and socio-economic status on perceived credit worthiness.

#### CONCLUSION

These authors have presented all of us with an opportunity to begin to analyze consumer problems and their resolutions more generically and globally. After pulling together these common problems and experiences, particular forms, implications and solutions may be identified for smaller more homogeneous groups and yet these would likely span many borders.

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## STATEMENT ON AUTOMOBILE INSURANCE

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Consumers and insurers stand at a crossroads. Where we go from here depends in large part on us and the people we represent.

### I. PRIVATE INSURANCE IN OUR SOCIETY

The seventeenth and eighteenth century Enlightenment gave life to concepts such as freedom of speech, freedom of worship, and the inalienable rights of life, liberty and the pursuit of happiness, as embodied in the Declaration of Independence, the United States Constitution and as reflected in such thinkers as Locke, Burke, Jefferson, and Mason. It also refined another fundamental concept: private insurance. Widely established in England in places such as Lloyd's Coffee House in London, the concept of people voluntarily joining together to provide security by spreading the risk of loss took root in America from the earliest days of the settlement of the continent. In 1752, Benjamin Franklin helped establish one of the oldest insurance companies in America.

The Enlightenment stressed individual rights and responsibilities; insurance helps make their full enjoyment possible. Insurance was nurtured in the same environment that brought the concept of fundamental human rights which are the beginning and end of America's political system. Insurance makes the exercise of those rights possible for many people who otherwise could not engage in new and risky enterprises or venture so far, without the economic security provided by insurance.

America's 3,555 property and casualty insurers paid \$136 billion in claims and related expenses to millions of victims in 1986, alone. Last year, for example, automobile insurers paid \$55 billion in benefits and related expenses to millions of accident claimants. 1.9 million Americans earned their livelihood from private insurance. (Women represent 49% of all professional employees in insurance.) Insurers paid \$5.5 billion in premium taxes and maintained a self-contained system, without taxpayer subsidy, to assure claimants will have payment of their claims if their company becomes insolvent.

The insurance industry also funds some of the best safety research and communications through the Insurance Institute for Highway Safety. The industry actively fights fraud through the

National Automobile Theft Bureau, index bureaus which are used to cross check frequent claimants, company special investigation units and frequent cooperation with law enforcement. We also engage in massive public information and education programs on safe driving, fire prevention, and risk management.

On a daily basis the insurance industry lobbies before the Congress and every state legislature for enactment of important safety and loss reduction measures.

For example, five times in the last session alone, we testified before Congressional Committees on automobile insurance and each and every time, focused on highway safety. We worked on highway safety measures and loss control measures in several states, and helped see a seatbelt law enacted in Pennsylvania, after more than three years of effort. We lobbied along with the American Automobile Association and the American Trucking Associations, to get legislation in the recently enacted Drug Bill on drunk driving and commercial motor vehicle safety. AIA's Automobile Insurance legislative policy committee demands to know what progress we have made on highway safety measures at each meeting. Although this may not fit into what you have heard from some sources, the insurance industry cares about safety and backs that concern up with economic and human resources.

This industry is also private enterprise, which means in addition to service and loss prevention, it also has a profit motive. But what have those profits really been?

From 1981-1986, including all property and casualty lines, the industry had an underwriting loss of 13.8% and after adjustment for investment income and taxes sustained a .4% loss. In 1987, in California, the overall results were not much different for 1981-1986, where the net loss was 1.2%. This clearly does not conform with the public perception that the insurance industry is making 20% or 30% on every policy it sells. But, these numbers are not insurance industry numbers; they are compiled by the nation's Insurance Commissioners.

From 1980-1987, the insurance industry average return on net worth was 9.3% versus 12.8% for utilities, 11% for transportation industries, 12.8% for commercial banking, 11.7% for diversified financial industries, and 12.2% for the Fortune 500 Industries. Thus, in absolute numbers or in comparison with other industries, insurance industry "profits" are any thing but "obscene", "a rip-off", or "excessive."

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The story for automobile insurance as a line of insurance is no different. The latest numbers show that auto insurers pay out more than \$1.07 in expenses and losses for every dollar they take in in premium. For 1987, auto insurers made a miniscule 2/10s of 1% profit on auto insurance.

## II. AUTOMOBILE INSURANCE

The price of any product in our system should at least be equal to the expenses and the raw material costs that go into that product while allowing a reasonable profit. For automobile insurance, the raw materials in the first instance are highway accidents, deaths, and injuries auto thefts, and property damage. The costs of these accidents are determined by lawsuit, medical care, and automobile repair expenses. Most of these costs have been inflating rapidly and have an inflationary effect on automobile insurance premiums.

### Losses

Car insurance is a major public issue in high loss states where rates have traditionally been high and in states where losses have dramatically increased, resulting in similar increases in rates. Because motor vehicle accident losses are the raw materials of auto insurance rates, the surest route to lower rates is highway safety.

Private passenger auto insurance losses and related expenses rose from \$30.2 Billion in 1982 to \$52.3 Billion in 1987, a 75.1% increase. To cover the losses, insurance premiums rose slightly less than 75% during those 6 years. The staggering increase in losses was led by a 90% increase in bodily injury liability losses and related expenses, reflecting sky-rocketing health care and lawsuit related costs. Over a longer period, bodily injury claims costs are up 140% from 1976-1987, as compared to the C.P.I. increase of 85%. The average bodily injury claim went from \$3,376 in 1977 to \$8,074 in 1987.

The losses and resulting rates, however, have not been evenly distributed across the country. The states with the highest average cost per injury claim, and the highest rates, are New Jersey, California, Maryland, Pennsylvania, Delaware, Arizona, Massachusetts, Nevada, D.C., Louisiana.

52% of the 1987 injuries are from large cities; 29% from medium sized cities and 19% from small towns and rural areas, compared to 31% in 1977. Major cities often generate far higher claims costs than do the states in which they are located.

First party medical claims have also increased dramatically. During 1983-1988, the average cost of such claims increased 57.1%, while the average cost of a bodily injury claim increased 71.3%. In both cases, the increases have been caused more by the increased severity of each claim (+48% for bodily injury liability and +42.5% for medical) than by the frequency of

claims (+15.7% for bodily injury liability and 10.2% for medical).

While the rise in auto insurance losses is driven most by the claims for deaths and injuries, auto repair claims costs have increased substantially as well. The over-all 47.8% increase in collision losses from 1983 to 1988 is totally the result of the 48% increase in the severity of the claims while the frequency has even decreased slightly.

Over-all car insurance claims and related expenses have increased 75.1% and premiums have increased 74.8% from 1982 to 1987. There have been few, if any profits in auto insurance during this period. The National Association of Insurance Commissioners found a 7.5% operating loss, which after investment income and taxes netted out as a 2/10s of 1% profit from private passenger auto insurance in 1987. Standard and Poor's found that auto insurance does not compare favorably with many other industries and that: "Based on S & P's financial analysis, on a national basis the insurance industry is clearly not reaping windfall profits nor is it sustaining huge losses in personal automobile coverage." 83% of the premium dollar is paid out in losses, so the real culprit behind rising auto insurance rates are the losses. Insurer's 21% expenses compares favorably with the banks' 27%.

To reduce those losses, there are only three alternatives: prevent the losses in the first place, reduce the costs of these losses after they occur, or both. By preventing significant amounts of accidents, health, injury and damage claims, we can reduce overall losses, never mind inflation in health care, litigation and auto repair costs. On the other hand, no-fault, health care cost and car repair cost containment measures could also reduce the cost of the accidents.

### Highway Safety

The day that this meeting is being held, 126 Americans will be killed and 5100 will be injured in highway accidents.

The subject of the costs of auto insurance begins and ends with highway safety. The deepest root cause of auto insurance problems is the level and increase of accidents, deaths and injuries on our highways. After a downturn earlier in the 1980s in the number of fatalities, 1987 showed 46,386 killed (5% more than the prior 5 year average) with more than 1.8 million disabling injuries. There were 9 million more accidents in 1986 than there were in 1980, caused in part by 20 million more registered vehicles.

While more people are wearing seat belts and air bags are available on more cars, driving speeds have increased in many parts of the country, resulting in an average 19% increase in fatalities on rural interstate highways. Although some designs may be safer, cars are much more expensive to repair. Drunk driving

remains a major contributor to highway accidents, deaths and injuries. Big truck accidents continue to block main arteries for hours and grab headlines in many parts of the country. In other words, highway safety is a very mixed bag, with some slight gains, neutralized by losses in other areas.

Even while we emphasize the economic aspects of this dismal record, we should never forget the human suffering that we must prevent.

#### Lawsuit Costs

The costs of each injury have skyrocketed, as a result of lawsuit and health care related costs. Earlier this month, the All Industry Research Advisory Council (AIRAC) issued a new report, "Compensation for Automobile Injuries in the United States" which demonstrates the extent to which the legal system contributes to automobile insurance losses and premiums. According to the AIRAC report, "the cost of injuries caused by automobile accidents rose more than 140% between 1977 and 1987, far exceeding the 85% increase in the cost of living as measured by the Consumer Price Index." The average bodily injury liability claim skyrocketed from \$3,376 to \$8,074.

Attorney representation in bodily injury claims increased from 31% in 1977 to 45% in 1987, resulting in higher numbers of soft tissue injury claims, and higher awards, although very little of this additional money ends up in claimants' hands. Claimants with attorneys receive gross settlements about 7% higher than those obtained by claimants without attorneys, but an average of 31% is gobbled up by attorney fees and other legal expenses. For backsprains or strains, gross settlements are \$5,336 higher when the claimant is represented by an attorney, but the claimant nets only \$612 more. Likewise, attorney involvement resulted in much longer settlement times.

#### Health Care Costs

The effect of health care cost inflation has been no less significant than lawsuit related costs. Medical expenses are 70% of the economic losses for claims other than fatality and permanent total disability claims. Health care costs have been inflating at more than 10% per year, far above the Consumer Price Index. The inflation has been most severe, however, in hospital costs which are often a part of treating automobile accident injuries. Health care cost inflation forces up medical payments coverage costs, but also inflates bodily injury liability costs, because liability cases are often settled as a multiplier of health care expenses. So, a \$100 increase in medical care yields a \$211 increase in the liability claim values.

#### Auto Theft and Fraud

Auto theft continues to be a growth industry, with 1.3 million motor vehicles stolen last year, an increase of 5.3% nationally. Auto

theft costs an average of \$19 for every insured car in the United States.

#### Auto Repair

Auto repair costs have been increasing. The average cost of a new car has doubled since 1976 and today's automobiles are more expensive to repair, as a result of unibody construction, plastics, and more complex electronics. Hourly repair rates in some areas exceed \$50. Meanwhile, the auto manufacturers are attempting to restrict the use of competitive repair parts through a massive, national advertising and legislative campaign.

#### Uneven Geographic Distribution of Auto Insurance Losses

The level and rise in the cost of automobile insurance, however, have not been evenly distributed across the country. The AIRAC study documents the highest auto injury costs per insured car were in New Jersey, California, Maryland, Pennsylvania, Delaware, Arizona, Massachusetts, Nevada, District of Columbia, Louisiana and Connecticut. With few exceptions, these states line the East and West Coasts, with the lowest being generally interior states such as Nebraska, Wyoming, Kansas, Idaho, South Dakota, Iowa, Maine, North Dakota, Arkansas and Alabama.

There is a pattern of high attorney involvement, and high losses, combined with high levels of health care costs and crime and fraud on both coasts. This has been particularly shocking to West Coast motorists, many of whom I believe think of themselves as free spirited drivers on wide open stretches of freeway. In fact, insured losses and traffic congestion make the West Coast more like the East Coast than any earlier "frontier".

The February 18, 1989 issue of the *Economist* carried some startling revelations in a story headlined "The City, The Commuter and The Car." In 1975, 40% of rush hour traffic on American urban interstates was "congested"; today, it is 65%. Suburbanites average 24 miles per hour, not much faster than the Urbanites' 21 miles per hour. In Santa Clara County, California, 250,000 new jobs have been zoned, but only 70,000 new homes. Suburbanites also drive 12 miles to work, rather than 9, so they spend more time behind the wheel. There has been a 30% increase in the volume of car travel from 1976 to 1986. The factors leading to such increases include development, land use decisions which separate homes from business, lack of mass transit and habits.

The AIRAC study found that injury producing auto accidents are predominantly an urban phenomena, with about 52% of the injuries occurring in central cities and suburbs and 29% in medium sized cities. Only 19% of injuries arose from accidents in small towns and rural areas, down from 31% ten years earlier.

A recent ISO study documented the steeply higher losses in some urban areas when compared to the states in which they are located. For bodily injury liability, Baltimore, Boston, Milwaukee, Cleveland, Chicago, Los Angeles, Miami, Newark, New York City, and Philadelphia had average claim frequencies more than 50% higher than the respective statewide figure. For property damage liability, Baltimore, Boston, Detroit, Los Angeles, Newark and Seattle had average claim frequencies more than 25% higher than the respective statewide frequency. For comprehensive coverage, eight cities (Boston, Chicago, Cleveland, Detroit, Miami, Newark, New York City and Philadelphia) had average claim frequencies more than 25% higher than the respective statewide averages. They average 646 motor vehicle thefts for every 100,000 persons in the most populated areas vs. 203 for areas outside urban areas and 110 thefts in rural communities.

In sum, as a result of lack of government planning, land use patterns, and other factors relating to economic growth, automobile insurance losses tend to be clustering in the most populous areas, which are the East Coast and the West Coast. Further, there is an even greater concentration of traffic and losses in and around urban areas than in other parts of these states. Where the two phenomena intersect, an explosive loss situation, such as in L.A. County, is virtually guaranteed.

### III. REGULATION

According to some insurance industry critics, automobile insurance rates are at the level they are because of insurer "inefficiency". They allege that large portions of every premium dollar are wasted "overhead".

#### Efficiency

The reality is that insurers' operating expenses are 21% of the premium dollar, not the 30 cents that are often projected, one half of those expenses being agent commissions. The remainder are what some erroneously call "non-essentials" such as telephones, computers, drive-in claims offices, postage and printing. In fact, the insurance industry stacks up well against other major industries, with 21% expenses versus 27% for banks, and 35% for department stores.

There is also a wide diversity in the amount of overhead, depending on the efficiency of a particular insurer and the kind of delivery mechanism that it uses. In fact, insurers are no different than many other competitive industries. When you buy clothes, for example, you can buy from a specialty store with highly individualized service on a first name basis, from department stores or from warehouse-type discounters with no individualized attention. The prices are different, so is the level of service and the fit of the final product.

### Affordability of Auto Insurance

Automobile insurance, through voluntary and residual markets is available to all eligible motorists in every state. Affordability, however, is an issue for some people in high loss states or in high loss areas of some states. Auto insurance prices generally reflect the differences in loss costs from area to area. Some low income people who live in urban areas may be confronted with the highest auto rates because of the highest exposure to risk based on loss costs, but have the least ability to pay.

### The Effect of Wasteful Regulation

Wasteful regulation, or a state takeover of free enterprise insurance, has never produced long term benefits for the public. In each and every case, huge deficits have been created, because government responds to political pressures and lacks the economic will to do what insurance companies must do: reserve adequately for future losses. In places where the state performs insurance functions, such as the Ohio Workers' Compensation monopoly, the New Jersey JUA or the setting of automobile insurance rates by Massachusetts, the results have often been deficits, increasing prices, and unhappy consumers. Subject to reasonable and cost effective regulation, private insurers are quite capable of providing auto insurance to millions of Americans promptly and efficiently, while maintaining solvency in the system, and avoiding a taxpayer bail out.

### Regulation Does Not Assure Lower Prices

Professor O'Connor studied the comparative performance of prior approval vis-a-vis competitive rating states. He found little difference in the amounts one system returned to consumers versus the other. In Massachusetts the rates are fixed by the government and in New Jersey there is a consumer counsel and heavy regulation, yet those two states have the highest auto insurance rates in the country.

### Proposition 103 Is Not A Solution

Political issues are best resolved on a win/win, rather than a win/lose basis. Edmond Burke, the English Parliament's leading supporter of the American cause during our revolution and an opponent of the excesses of the French Revolution, said this about the way representative government should work:

"[opposing interests] render deliberation a matter not of choice, but of necessity; they make all change a subject of compromise, which naturally begets moderation; they produce temperaments, preventing the evil of harsh, crude, unqualified reformation; and rendering all the headlong exertions of arbitrary power, in the few or in the many, for ever impracticable."

We respectfully submit that Proposition 103 is inconsistent with these values. It should not be our model for future insurance regulation.

The New York Times characterized Proposition 103 as a "recipe for chaos". In that editorial, as well, The New York Times pointed to the need to reduce losses, by among other things, enactment of a no-fault system. The Wall Street Journal referred to Prop 103 as the "California Smash-up."

Proposition 103 fails to do anything about highway safety, health care costs, lawsuit costs and the other losses that have accounted for automobile insurance premiums increases in California. For example, bodily injury claims costs in California rose far more than the costs for other states with similar tort systems, from 1977 to 1987. The California average bodily injury loss cost per insured vehicle increased 211% in the ten years ending in 1987, compared to 128% for other states with similar systems. The average total economic loss for claimants in California was 57% higher than for claimants with other similar legal systems.

Proposition 103 won by an extremely narrow margin, despite its promise of a gift of as much as 50% off auto insurance premiums, with no corresponding reduction in costs and losses. In fact, Proposition 103 was rejected by most of California, winning in only the Los Angeles and San Francisco areas. We believe the reason why those Californians rejected Proposition 103, is because they recognized that the responsible solution must include loss reduction to bring them lower prices and must preserve the security of the automobile insurance system that they rely upon.

Auto insurance stability and lower prices, are in everyone's interest. Consumers have two major interests relating to insurance: a reasonable price and the security of knowing that their insurance companies will be there when they need them. Tragically Proposition 103 slashes prices but jeopardizes the financial security of millions Californians, and millions of Americans.

The effect of Proposition 103 may be felt not only in California but around the country. Proposition 103's four billion dollar price tag will cost the rest of country a reduction by up to eight billion dollars in the ability of insurers to insure them. This is equivalent to a reduction in the ability of insurers to write as many as eight million automobile insurance policies in the rest of the country, because a reduction in surplus results in a reduction in the ability to write insurance, under widely accepted regulatory standards.

Not only is Proposition 103 economically irresponsible and anti-consumer (in jeopardizing the security that millions rely upon), Proposition 103 is unconstitutional. It embodies the proposition that a state can move in and effectively control any industry, when

one vote more than 50% of the population decides that it doesn't like the prices that must be charged. Will farmers, clothing makers or computer manufacturers be next?

Under Proposition 103, insurers would be forced to do business in the state and would be forced to do this business at a huge loss. Proposition 103 then loads up the regulatory apparatus with so much baggage that it would no doubt take years for completely warranted rate increases to be approved in the future.

#### Regulation Disguised as Competition

Many of the so called "consumer advocates" offer the public what they claim to be an alternatives of "regulation" or "competition". On the regulatory side, they offer increased government regulation, while they really offer the same on the "competition" alternative. Under both, they advocate repeal of anti-group and anti-rebate laws, repeal of McCarran-Ferguson, and repeal of prohibitions on banks underwriting insurance.

Any and all of these actions will likely have little or no impact on auto insurance prices and less competition, rather than more, could also result. Most tragically, these programs miss the main point entirely, by focusing on non-issues, while ignoring the true issue - skyrocketing losses.

McCarran-Ferguson is a limited exception from federal antitrust law provided in exchange for the insurance industry's submission to the system of state regulation. The "guts" of antitrust law still apply: prohibitions on boycott, coercion or intimidation. Repealing McCarran-Ferguson will not enhance competition, but may, in fact, reduce it by making it more difficult for new insurers to enter the business or for existing insurers to get into new lines, because they will not be able to use rates based on the prior loss experience of other insurers.

Anti-rebate laws prevent agents from negotiating lower fees with clients. This protects the small insurance purchasers from an agent giving a lower commission advantage to the a wealthier purchaser, while charging a much higher commission to the little guy to offset the breaks for the wealthier purchaser.

Laws limiting bank entry into insurance had their origin in the Great Depression. These laws built legal walls to prevent the concentration of America's capital in a few hands. Those laws have worked well, and may have helped minimize the results of the October 1987 Stock Market Crash.

The key thing you need to know is that many of the regulatory "reforms" you are being asked to endorse may actually have adverse impacts on consumers. In any event, the issues merit your careful consideration.

#### IV. REAL REFORM

##### Highway Safety

Insurers and some consumer groups have a strong record on highway safety. Nonetheless, we need to push for safer car and truck designs through federal safety standards and safer truck drivers through state implementation of model drivers license legislation. We must also work for tougher drunk driving laws with per se blood alcohol levels of .05, rather than the common .10 and automatic license suspensions upon being charged with drunk driving.

##### No-Fault

To respond to runaway lawsuit related costs, must continue to work for strong and effective no-fault laws, such as have provided better benefits and stabilized rates in Florida, New York and Michigan.

No-fault has many supporters. The Rand Institute and United States Department of Transportation studies have concluded, that no-fault systems provide more benefits to more people more quickly and more fairly than do tort liability systems. These conclusions were reaffirmed by the recent AIRAC study. No-fault can also stabilize automobile insurance rates, contrary to public pronouncements of some in the consumer community. The record of no-fault in New York has been to hold down rate increases to lower than 3% in a recent year, and to hold down rates to a mere 2% increase in Michigan last year. Florida, which also has a strong verbal threshold no-fault law ranks 29th in the country for average automobile insurance premiums and is 23rd in the country for its increase last year, according to A.M. Best. A well crafted no-fault system can result not only in better benefits but in stabilized or reduced automobile insurance rates.

Recently, however, a variation of no-fault, the product of Professor Jeffrey O'Connell and Robert Joust is taking hold. Under this version, called "choice no-fault", each consumer decides whether he or she wants a no-fault or a fault policy. The no-fault policy holder cannot sue or be sued and the fault policy holder must buy connector coverage, like uninsured motorist coverage, to give that person a source of recovery if involved in a collision with a no-fault policy holder. While the original concept is relatively simple, many variations are possible.

##### Health Care Cost Containment

While there is a known antidote for lawsuit losses - no-fault - there are few proven remedies for the explosion in health care costs. The medical fee schedule in New York's no-fault law and has worked well to help contain health care costs. Nonetheless, such a regulatory approach should be considered only as a last resort. Copayments and deductibles have been used for some years, to reduce health care

costs on the part of third party payors and to give patients an economic stake in the costs of their own treatment. Peer review, fee schedules, deductibles and copayments appear to be the only available answer for health care cost inflation.

##### Theft and Fraud

On auto theft and fraud, the industry has done much through index bureaus, the National Automobile Theft Bureau and individual company efforts to contain theft and fraud related costs. We may need the government's help, however, to marshal prosecutorial power and law enforcement resources, through creation of state insurance fraud bureaus.

##### Planning

Automobile insurers have traditionally not been involved, to a great degree, in land use and transportation policies. Maybe we should change that. We must help the public understand that increasing traffic congestion means higher losses and higher auto insurance prices.

##### Urban Areas

Urban problems are particularly vexing, because many, although not all, of the people who are least able to afford insurance live in the highest loss areas. Some highway safety measures have a particularly favorable impact in such areas. A recent study in the Journal of the American Medical Association found that the expenses to treat automobile accident patients in Chicago area hospitals who were belted was one third of the cost for treating non belted victims. No-fault also would have a potentially very favorable benefit in urban areas. Efforts to contain auto theft and fraud are particularly needed in urban areas.

##### Working With Consumers and Public Officials

The insurance industry needs to communicate with the public on the service that it provides in return for the money paid. Renewed emphasis on loss control, such as no-fault and auto safety will help the public and the media understand the true nature of auto insurance problems.

Working with responsible consumer groups is also critical to any success. Insurers must listen carefully to each segment of the consumer community and express openness to all consumers. Consumers and insurers should cooperate to lead the efforts for strong and effective no-fault laws and highway safety measures. The groups which recognize the connection between losses and premiums are the ones with which insurers have the greatest possibility of cooperation. The priority in working with these consumer groups must first be on highway safety, then on no-fault, then hopefully on addressing certain other elements of their concerns such as demands for increased data disclosure, consumer participation, and



programs for low-income urban policy holders.

In fact, a dialogue with such consumer groups has already begun on many levels. We have a national consumer health and safety agenda. AIA supports a no-fault bill in California, which is also endorsed by Consumer's Union.

#### A Total Program of Real Auto Insurance Reform

Here is a total auto insurance reform platform. This program will reduce crime on our highways, help eliminate waste, lower insurance rates and assure a stable, secure insurance system. One section should be no-fault or choice no-fault, which will help contain runaway lawsuit related losses, where those losses are a problem. If this is not politically feasible, elimination or reduction of mandatory liability and uninsured motorist coverage should be included in the program to provide consumers more freedom of choice and to help address the low-income problem. Secondly, the program should contain important highway safety measures such as truck safety, drunk driving, and speed limit enforcement proposals. Thirdly, the program should contain measures to attack theft, fraud, auto repair and health care costs. Fourth, the program should contain a remedy for low-income people, along the lines of a government subsidy based on income and clean driving record, which still requires each policy holder to pay something for automobile insurance. The subsidy should be paid directly by the states or indirectly through an identifiable premium surcharge.