

## In This Issue . . .

Reagan's strategy to restrain inflation will actually drive prices higher . . . . . page 1

If you are a member of the Fortune 500 Club you'll like the Reagan tax cut plan . . . . . page 2

But if you make under \$25,000 you'll support the AFL-CIO alternative tax proposal . . . . . page 3

"In terrorem tactics" is the legal name for credit contract provisions the FTC is attempting to ban . . . . . page 4

## CFA Notes

**New Board elected.** . . . At the CFA annual meeting in February, member groups re-elected Sharon Stark to a one year term as President of the Consumer Federation of America. Stark is editor of *Everybody's Money*, a publication of the Credit Union National Association. New directors named to the CFA board include: John Brown, Legislative Director of the International Union of Operating Engineers; Marvin Caplan, Industrial Union Department of the AFL-CIO; Clyde Chapman, Director, Consumer Affairs Association; Tom Ryan, President of the Missouri P.I.R.G.; William Winn, President, North Carolina Consumers Council, and Mel Zelenak, Executive Director, American Council on Consumer Interests.

**Coming up.** . . . Mark your calendar now for the 11th Annual Awards Dinner to be held at the Capital Hilton, Washington, D.C. on June 15. Last year's Awards Dinner was a great success and this year's promises to be even better.

## CFA Is on the Move

Effective April 20, 1981, the Consumer Federation of America will have a new address: 1314 14th Street N.W., Second Floor, Washington, D.C. 20005. The new telephone number will be (202) 387-6121. Be sure to make note of these changes in all your correspondence.

# Reagan Inflation Strategy Charts Risky Course

In President Reagan's first full month of office, retail prices increased at an annual rate of 13.2 percent. Many commentators believe the success or failure of his Administration depends on its ability to bring down the inflation rate considerably below double-digits.

In a recent Associated Press interview, CFA Executive Director Stephen Brobeck asserted that Reagan's strategy to restrain inflation "cannot possibly work. Inflation rates will be higher and will fluctuate more dramatically."

The Reagan strategy has three elements:

- Balancing the federal budget, largely through drastic cuts in social programs. A balanced budget, it is argued, would reduce the government's need for credit, and this would bring down interest rates, thereby encouraging greater investment.
- Cutting taxes on businesses and individuals. These reductions are seen as stimulating investment and productivity, and ultimately as increasing tax revenues.
- Eliminating or reducing government regulation of business. This, it is suggested, would free capital used to comply with regulations for investments that would increase productivity.

## Flawed Strategy

The theory behind this strategy, Brobeck said, is that transferring income from poor and middle-income families to the affluent and to corporations will encourage greater investment that will increase productivity and, somewhere down the line, allow increases in real income. These increases diminish the competition of interest groupings for scarce resources, thereby relieving pressure on the government to create more money.

In the AP interview, Brobeck explained why the Reagan strategy cannot work. "In the first place they are not really serious about balancing the budget. Behind all the rhetoric they are simply trying to transfer \$25 to \$30 billion from domestic programs to the military. Although spending on new weapons would stimulate the economy, it would

not increase real productivity because the military hardware is not available for consumption. Yet the government pays defense workers, so the dollar depreciates in value."

Brobeck agrees with Reagan that eliminating regulations and cutting taxes would free more capital for investment. Yet he does not believe that this additional capital would be used to modernize obsolete plant and equipment, and increase productivity in meaningful ways.

## Unproductive Investment

"Recently very little of the discretionary income of the affluent, the main beneficiaries of individual tax cuts, has been invested in ways that provide capital to business for productive capital improvements," Brobeck said. "Most of this income has been used for consumption, for investment in land and other tangible assets (gold, art, etc.), or for speculation in security markets. Both increased consumption and speculation in property feed inflation by increasing consumer demand."

Moreover, most increases in corporate profits would not be used for long-term improvements, Brobeck added. "The problem is not that businesses lack capital; it is that they are unwilling to invest their capital in productive ways." (see *Washington Perspective*, p.2.).

## Regulation Restrains Inflation

Compliance with government regulations does cost business money, admitted Brobeck, but these costs are greatly exaggerated (CFAnews, Jan-Feb issue) and, in part, are offset by benefits including the restraint of inflation. These benefits include:

- Direct control over prices. The regulation of natural gas price controls, for example, holds down energy costs for tens of millions of American households.
- Elimination and prevention of fraud. Such regulation increases the purchasing power of American consumers by billions of dollars each year.
- Required information disclosure. Regulations, such as the proposed FTC funeral practices rule, require corporate disclosure of information that permits consumers to shop more rationally and that promotes a more competitive marketplace.
- Anti-trust enforcement, which also helps ensure a more competitive marketplace in which business has incentives to restrain prices and maintain product quality.
- Protection of consumer health and safety. Any weakening of effective regulations in this area tends to increase consumer expenses for medical care, litigation, and insurance.





by Stephen Brobeck  
Executive Director

The following are excerpts of Mr. Brobeck's testimony before the House Ways and Means Committee

The Reagan tax program assumes that a reduction of taxes, especially on Fortune 500 corporations and wealthy individuals, will stimulate a significant amount of productive capital investment. In Treasury Secretary Regan's words, the President's tax cut will "... expand incentives and opportunities for socially productive efforts and savings for all taxpayers." Put another way, the Administration assumes that by throwing more money at corporate management and the rich, the problems of declining productivity, stagnating real wages and double digit inflation levels will disappear.

It is, of course, necessary to increase productivity in order to expand real wages and restrain inflation. The Reagan program, however, may be just throwing good money after bad. Not only will the Administration's program do little to stimulate "socially productive efforts," it may even retard such efforts.

### Tax-cuts Not the Fountain of Long-term Investments

It is highly unlikely that a reduction in marginal tax rates for individuals will increase long-term business investment by much. During the past decade, personal savings began flowing out of the long-term market for stocks and bonds. Individual investors began putting their money into appreciating tangibles, such as antiques, silver and real estate. More recently, people have been turning over their money at an even faster rate in thirty day money markets or with six-month money market certificates and Treasury Bills. Given

high interest rates and favorable deductions and exemptions on mortgage interest and capital gains, this shift in investment strategy is entirely rational, though injurious to productive capital investment. But there is no reason to assume that a tax cut would somehow persuade investors to return to long-term investment in stocks and bonds.

Given persistently high inflation rates and a more speculative attitude by those who can afford investment, individual tax savings would probably be spent in about four different ways. A portion of the tax savings would be used by the more affluent to reduce their work effort. Another portion—probably the bulk—would be spent on maintaining an eroding consumption level. Out of the remainder, a large part would be invested in real estate and collectibles as a further hedge against inflation, leaving only a small portion for capital investment. Even so, if the recent past is any guide, these investments would tend to be short-term ventures, not the type of long-term investments which account for so much of our past growth.

### The Incentive to Write-off, But How Much Investment

Though supply-siders view speeding up depreciation allowances as essential to their program, it is difficult to see how

# Choosing a Tax Cu

If you are a member of the Fortune 500 club you'll like the Reagan plan ...



CFA Executive Director Brobeck emphasizes his opposition to the Reagan tax cut plan in testimony before the House Ways and Means Committee. Other witnesses from the Chamber of Commerce, National Association of Manufacturers, and Americans for Democratic Action listen.

CFAnews photo by Anne Averyt

### For Decades, Corporate Business Has Had the Capital to Invest

Year	Corporate Savings(%)
1955-59	13.6
1960-64	13.3
1965-69	13.9
1970-74	13.3
1975-79	14.3

Source: The National Income and Product Accounts of the U.S., 1929-74. Survey of Current Business, July issues, 1976-80.

Note: Corporate Savings are undistributed profits and depreciation reserves as a percentage of gross domestic corporate product.

further write-offs on plant and equipment will stimulate much capital investment. For over two decades there has been little decline in the rate of corporate savings. Business has had capital to invest; in fact, since 1955, they have invested in plant and equipment at a disappointingly steady pace given the attractive tax incentives, including faster depreciation, they have received during this period.

In addition to costing the U.S. Treasury tens of billions of dollars, these gained incentives made U.S. business tax breaks more generous than those in other industrialized countries with higher capital investment and productivity growth rates than ours. The International Monetary Fund has found that the U.S. actually subsidizes nonresidential fixed investment, while Germany, Japan and France tax this investment. Yet our capital investment rates remain well below those of these three countries.

### Some Investment, But Will Productivity Increase

Even if individual tax cuts and faster depreciation schedules increase capital investment by some, these increases would not expand productivity significantly. Over the past three decades, there has not been a close correlation between capital investment and productivity growth rates.

Though the independence of investment and productivity rates is not fully understood, it reflects, in part, the counting of certain non-productive business expenditures as capital investments. This is certainly the case with much of the spending for the construction of new office buildings and for the purchase of many company cars. It is also noteworthy that while capital

investments related to the production of military hardware may expand productivity, as it is currently measured, they do not allow for the expansion of real income because these products are not available for consumption.

### 10-5-3 Tax Plan Fails Productivity Test

The abundance of capital to invest suggests that additional corporate savings would not greatly stimulate business investment. But even if a shortage of savings existed, would the implementation of the 10-5-3 plan reverse the historically low correlation between investment and productivity by directing capital funds into the most needed investments? It is unlikely.

First, the 10-5-3 plan would provide the greatest benefits to those industries that need them the least. Oil companies, for example, would benefit as much as any industry, yet they are awash in capital. Given the limited opportunities for expanding oil production, we can expect a flurry of new acquisitions in non-oil related firms to result from further acceleration of depreciation allowances.

Second, not only would 10-5-3 not help many industries, it may actually harm those industries most in need of capital. According to Economics Professor Robert Eisner, the proposed three-year capital recovery on cars and small trucks would be less advantageous for the auto industry than what is currently available. Moreover, he adds, the 10-5-3 plan would tend to draw capital away from small businesses, especially high technology, research-oriented firms.

See BROBECK, page 3

### While Investment Has Gone Up, Productivity Has Gone Down

Years	Investment(%)	Productivity(%)
1950-54	9.0	3.7
1955-59	9.2	2.4
1960-64	9.1	3.6
1965-69	10.6	2.5
1970-74	10.5	1.7
1975-79	10.2	1.4

Source: Economic Report of the President, 1981.

Notes: Investment is nonresidential fixed investment as a percentage of Gross National Product and is calculated in 1972 dollars. Productivity is the annual percentage change in output per hour of all persons in the private business sector.

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# Cut: 2 Perspectives

**... But if you make under \$25,000 you'll support the AFL-CIO alternative**

## SPEAK OUT

by Lane Kirkland,  
President, AFL-CIO

*The following are excerpts of Mr. Kirkland's testimony before the House Ways and Means Committee.*

The President's tax package is grossly unfair and much too costly. It would add to inflation, exaggerate fundamental economic problems and dissipate funds needed for their resolution.

Despite claims to the contrary, there is no tax cut under the Administration's proposal for some 15 million low income working Americans. Their taxes went up this past January as a result of the Social Security increases; this same group will be among the first to feel the impact of the Administration's cuts in social programs.

### The Rich Get Richer

A family at the national median of approximately \$20,000 would receive \$228. But at \$100,000 the cut is \$1,840—eight times as much. This upside down notion of "equity" means that the three year program amounts to a 9.2% increase in after-tax income of the

\$100,000 a year salary earner compared to 3.4% for the \$20,000 family and only 1.9% for the \$12,000 wage earner.

The AFL-CIO Executive Council has proposed an alternative individual and business income tax cut which would be fair, much less costly and much less likely to add to inflationary pressures. The individual tax cut is quite simple—a refundable credit equal to 20% of worker's social security payments. For 1981, the maximum reduction would be \$395 for a family with one wage earner and \$790 if both husband and wife are working.

The AFL-CIO proposal means:

- Most moderate and middle income taxpayers in the first year would receive as much or more than under the Administration plan.
- The 15 million low income workers ignored in the President's program would receive a reduction.
- The first year cost would be about

## REAGAN vs. AFL-CIO Individual Income Tax Reduction Proposals

Wage or Salary Income	Reagan Proposal Family of Four		AFL-CIO Proposal
	1981	1st Full Yr.	
\$ 5,000	\$ —	\$ —	\$ 66
10,000	26	52	134
15,000	75	150	200
20,000	114	228	266
25,000	153	306	333
30,000	191	382	395
40,000	324	648	395
50,000	478	956	395
100,000	920	1,840	395

\$16 billion compared to the Administration's \$30 billion.

- Taxpayers in the \$30,000 and below group would receive 60% of the benefits compared to the Administration's 40%.
- Taxpayers in the \$50,000 and over income group would still get 10% of the cut—twice their population share. But, that's in sharp contrast to the President's proposed 30% share to this group.
- And, the measure does not lock Congress into a three year program that would risk continued inflation, huge deficits and unconscionable interest rates.

We also recommend that equivalent reductions be granted to public and railroad employees not covered by Social Security. And, that employers receive a 5% Social Security tax credit—this would cut business taxes by about \$4 billion and be of particular help to smaller, more labor intensive firms.

## Redirecting National Resources

The reindustrialization business tax cut alternative we urge you to consider would efficiently target funds to the industries and areas where the needs are greatest at minimal cost and risk. It would represent a major beginning toward the revitalization and rehabilitation of this nation's basic industries and economically distressed areas.

Briefly, we recommend the establishment of a tripartite—business, labor and government—Reindustrialization Board. Under this Board, a Reconstruction Finance Corporation (RFC) would be set up to channel public and private funds into reindustrialization projects primarily in areas most in need.

The RFC should have initial authority to allocate \$5 billion in tax expenditures and an additional \$5 billion in loans, loan guarantees and interest subsidies. Emphasis would be on basic industries, and allocation decisions would include factors such as eliminating capacity "bottlenecks," helping new U.S. industries with a high growth potential and aiding firms that have difficulty competing because of unfair foreign trade practices.

We would also like to see the funds of the RFC augmented by allocations from pension plan funds, as well as other sources of private capital. Pension plans today are the single largest source of funds for new investment—their total assets amount to more than \$600 billion. To assure that the interests of the pensioners are protected, the government should guarantee a minimum return on the invested funds that are placed in the RFC.

Mr. Chairman, we are convinced that curbing inflation, reducing unemployment and solving fundamental problems requires a redirection of the nation's resources. Additional capital investment is needed in many, but not all industries and areas. Tax burdens are too high for many, but not all individuals, and the problems of the poor and the disadvantaged must be solved, not aggravated.

The program we recommend reflects those convictions and we urge your support.

## Brobeck, from page 2

Third, by expanding incentives to purchase short-lived equipment, accelerated depreciations may reinforce corporations' growing preoccupation with short-term profit-maximization rather than long-term growth.

Fourth, the 10-5-3 plan would expand tax shelter opportunities in areas such as equipment leasing and commercial real estate to such an extent that, according to Harvard economist Dale Jorgenson, the shelter business would "deserve its own line on the GNP accounts."

Fifth, there is no discouragement in 10-5-3 of wasteful and speculative investment. The increasing capital spent on corporate mergers and acquisitions—an estimated 44.3 billion last year—and speculation in real estate, currency, precious metals and collectibles has diverted capital from much more productive uses.

Sixth, the plan's three year phase-in would encourage a delay in any new investment until 1985, at which time it would be subject to the most favorable tax treatment.

## Reagan Has Our Nation's Priorities Reversed

In summary, President Reagan's tax proposal, if enacted, would do little to check declining productivity, stagnating real wages or double digit inflation rates. To increase what Secretary Regan called "socially productive efforts," we must restrain energy prices and interest rates and introduce incentives to encourage long-range planning and a more productive use of resources.

Until very recently, our society was self-sufficient enough to tolerate waste and inefficiency without reducing our standard of living. Now that we have become extremely dependent on foreign producers, our prosperity, as well as our national security, requires a more productive allocation of resources. A Federal tax policy is an important tool for accomplishing such a re-allocation by rewarding socially useful investments and penalizing wasteful, speculative ones. Reagan's tax policy, however, reverses the order of rewards and penalties necessary to stimulate and stabilize the economy.

## Giveaways, from page 4

position. Credit costs in these states are actually slightly lower than the national average.

Notwithstanding the force of the staff findings and CFA's comments, the battle for a strong rule is ultimately a political one. Even in the Commission issues a strong rule, the legislative veto provisions of last year's FTC amendments may come into play.

If so, the fight to eliminate unfair contract terms will shift to Capitol Hill, where banks and loan companies can exert their power in a much more direct and outspoken way. Consumers better be ready for a very difficult fight.



CFAnews photo by Anne Averyt



# Hidden Giveaways

by David I. Greenberg,  
Legislative Representative

Would you be willing to give up all your furniture if you missed a payment on your color television, or hand over the deed to your home if you couldn't meet a scheduled payment to a loan company for your car? And would you agree in advance that if the company sued you they would automatically win the suit even though you missed the payment because you were laid-off from work?

Without knowing it, you may have agreed to these possibilities. By signing an installment loan contract you agree to the dense, nearly incomprehensible legal boilerplate at the bottom or on the back of the contract. That language often promises the lender control of your home and all your personal belongings in the event you miss a payment.

The new, Republican-controlled Federal Trade Commission will decide this spring whether to adopt a proposed trade regulation rule (the Credit Practices Rule) taking away some of the most offensive hidden contractual give-aways.

CFA has been actively involved at the Commission, working for the strongest rule possible. But the early resignation of FTC Commissioner Robert Pitofsky—

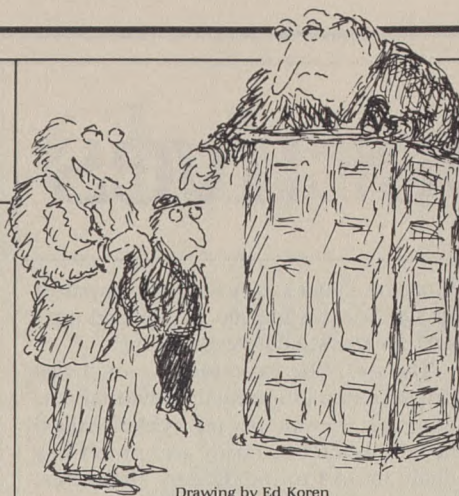
combined with the possible legislative veto of the final regulation—throws the status of the credit practices rule into serious doubt.

## "In Terrorem Tactics"

Currently, the rule has no effect, so the contract remedies still retain the force of law. Before signing any new contract you should ask yourself whether you are willing to strike the following bargains with a loan company or retail merchant:

- If I don't pay, you can take all the goods I own. (Blanket Security Interest Clause)
- If I don't pay, you can come take even the personal belongings state law would allow me to keep. (Waiver of State Property Exemption Clause)
- If you ever sue me because I haven't paid, I agree, in advance, that you should win—even if I have a good reason for not paying. In fact, your lawyer can represent me. (Confession of Judgment Clause)
- It's a real hassle for you to sue me to collect, so I'll pay for your lawyer. (Attorney's Fees Clause)

After five years of study, hearings and comments, the Federal Trade Commission has issued a preliminary rule ban-



Drawing by Ed Koren  
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## Confession of Judgment Clause:

*If you ever sue me for nonpayment, I agree in advance, that you should win—even if I have good reason for not paying. In fact, your lawyer can represent me."*

ning these and other burdensome contract terms. During its investigation, the Commission staff compiled a record full of real-life stories of what can legally happen to consumers under these contracts; lost jobs, houses emptied of all furniture and personal belongings, harassed friends and relatives are not uncommon. The emotional distress implicit in some of these practices is illustrated by their legal name: "in terrorem tactics."

## Uphill Battle for Approval

Even given the proven unfairness of these so-called adhesion contracts, the proposed rule faces an uphill battle to gain full FTC approval. Trade associations representing loan companies and banks object to much of the rule, allegedly on the grounds it will raise the cost of credit and reduce credit availability.

With a public participation grant from the FTC, CFA examined the economic arguments favoring the rule. CFA Director of Governmental Affairs Jim Boyle and Legislative Representative David Greenberg worked with Harvard Professor of Economics Dr. Harvey Leibenstein on a 40-page comment focusing on both the theoretical and economic impact, and the likely practical effect of the proposed rule.

CFA's comment demonstrates economic theory does not inevitably support the special interest groups' argument that the rule will raise credit costs. In fact, the rule may actually lower the cost of credit: lenders will be forced to evaluate borrowers more carefully. This will encourage borrowers to take more care in their budgeting and expenditure patterns to meet the tightened eligibility criteria. Resulting loans are likely to be less risky and therefore less costly.

The practical experience of three states—Connecticut, Wisconsin, and Iowa—with credit statutes similar to the proposed rule supports CFA's

See GIVEAWAYS, page 3

## CPSC: First Budget Cut Victim

The Consumer Product Safety Commission (CPSC) has become the first target of the Reagan Administration's promised purge of health and safety regulatory agencies. Congressional committees are currently considering an Administration proposal to cut 30% of the CPSC budget, even though the Commission has already undergone substantial budget reductions over the past five years due to inflation.

"The proposed cuts are both irrational and ill-advised," CFA Governmental Affairs Director Jim Boyle recently told the House and Senate subcommittees holding the CPSC reauthorization hearings. "They are not designed to impact the nation's economic recovery, but to send a clear message to other regulatory agencies to 'Clean up your act.' This is a symbolic attempt to reduce a Federal agency, which happens to be the first in a series to come up for reauthorization." Boyle pointed out that the CPSC is considered, even by the Administration, to be a model for other agencies in adopting regulatory reform measures. The Commission instituted cost-benefit procedures two years before it became the battle cry of conservative political reformers, he said.

The mandate to the CPSC when it was created by Congress in 1972 was to reduce the growing risks of unsafe products to the health and safety of American consumers. Congress was responding to a national problem: by 1970, 20,000 deaths, 30 million injuries and 110 permanent disfigurements occurred annually. The costs to consumers were in tens of millions of dollars. CPSC drastically reduced those statistics through an effective combination of safety standards, product recalls, hazard warnings and, when necessary, product bans.

Reagan Administration budget chief David Stockman, in testimony before the House Government Operations Consumer Subcommittee considering the budget cuts, acknowledged the Commission's success, using it as an argument for the reductions. The CPSC's mission to "ferret out hazardous products and correct the situation" . . . has "largely been accomplished," he said, and therefore the agency has a "diminished need for resources."

The proposed CPSC budget cuts represent \$10 million in savings out of a multi-billion dollar national budget. But because of the budget cuts, Boyle said, the Commission will lose much of its ability to carry out its mandate to protect consumers. "It will be a disaster for consumer safety," he warned.

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