The End of The US Overspending Addiction?

WASHINGTON – One major factor that caused the current US economic crisis is excessive consumer spending. Excessive spending in turn yielded an unsustainable level of personal debt for millions of Americans. But growing personal debt did not deter them from buying more. And when they maxed out all their credit cards, still eager to spend more, they started extracting equity from their homes, (counting on the hope of ever rising property values), with the delusion that this "wealth" could be a good source for the cash necessary to pay for more spending.

When the housing bubble finally burst, the negative effect of lower home values was magnified by the fact that Americans, because of their debt, had already extracted much if not most of the equity from an asset now worth much less than what they thought. No more home equity money in the hands of alreday strapped consumers caused the economy to tank. So, in practical terms, for millions we have now a lot of debt, no cash and almost zero home equity. Fine. We know all this. But, while these facts are known, nobody really asks basic questions, such as, "Why do Americans overspend so irresponsibly?" And, even more important, "What is the point of all this?" "Does all this overspending provide a demonstrable improvement in the quality of life?"

Well, it would appear that not much quality of life improvement comes as a result of all this overspending. (More on this later). But, if this is so, then extravagant overspending is simply a very bad habit that provides little in terms of increased levels of personal happiness and fulfillment; while, unfortunately, the cumulative effect of a bad habit practiced collectively by millions is the impoverishment of the whole society. Again, if bad habits are at the root of financial distress multiplied by a few million, then the truly remarkable oddity is that personal financial distress for millions, in many cases utter ruin, has been caused in large measure by rather superficial reasons: millions of people living way beyond their means.

Of course we know that some type of extreme behavior, such as substance abuse (illegal drugs, drinking too much), can lead individuals to personal and financial ruin. But now it seems that we should add too many trips to the shopping mall to the list of self-destructive behavior leading not just to unhappiness but to financial jeopardy. Anyway, let’s look first at the compounded economic effects of the sudden end of the era of excessive spending.

The Wall Street Journal, among others, tells us with concern that, because of this deep recession, Americans have been forced to drastically curtail spending; with the net effect of exacerbating the downturn, thus ensuring that it will be much longer than previously anticipated. Indeed, significantly lower spending by millions of financially strapped consumers means much less business and thus decreased revenue for the enormous US retail sector and for the dining and entertainment industry, among others.

This sudden American frugality, imposed by lack of new credit, means fewer vacations; fewer purchases at the mall; fewer toys, for kids and adults alike; not so much dining out, fewer drinks at the local bar. But this newly embraced thriftiness means disaster for department store chains and other retailers large and small. Retailers responded by closing down the least profitable outlets. They fire staff. Some of the big national chains, such as Circuit City, (electronics) or Linens n’ Things, (home products) have gone bankrupt. Many others are struggling and likely to follow suit. If this were an ordinary country, we would take this consumption retrenchment in stride, with the understanding that some belt tightening is necessary, as everybody is trying to cut spending and reconstitute some savings.

But America is no ordinary country. At more than 70 per cent of GDP, consumer spending literally drives the US economy. And thus collective decisions by millions of potential consumers to all of a sudden stop buying have had a devastating impact on an economic landscape largely shaped by sectors that exist –thus creating employment and livelihood for millions– only because they cater to an extremely high level of consumption. Simply stated: poorer Americans who used to spend excessively now do not buy; and thus, all of a sudden, millions who depended on their incessant shopping have become unemployed.

Until yesterday, the American consumer's appetite for spending "on everything" was legendary. Nothing wrong, in strict economic terms, with spending your money however you please. Yet, overtime a propensity towards spending became an addiction. Indeed, Americans started spending more than their income. And over the years the problem got worse. Its impact was disguised by the unprecedented availability of all forms of consumer credit, and by an increased tolerance for a heavier and heavier debt burden.

For homeowners, more debt appeared to be manageable in recent times because of what seemed to be an unstoppable real estate value growth. If people did not make enough money to finance their purchases via their wages, no problem, they turned their homes into cash dispensers, extracting from their dwellings what they believed to be endless amounts of equity.

In all this, the retail sector was thriving; thus adding more capacity to meet the buoyant demand. But in the meantime consumers were getting deeper and deeper into debt, unable to kick a habit that eventually brought about personal financial ruin at least for some and distress for millions of others. As a result of these extravagant habits, millions of people, even in ordinary times of economic expansion, were chronically in debt; with zero savings, barely living from pay check to pay check. Home owners thought that they could get by relying on the equity in their homes as an additional source of liquidity that would allow them to pay back their piling debt. Not exactly a picture of solid financial foundations for the average American. And clearly unsustainable, even in relatively good circumstances characterized by steady employment and growing home values.

And now we are in extremely extraordinary circumstances. Indeed, excessively high real estate values turned out to be a bubble, now burst. But it is to be stressed that the housing crisis precipitated the country into a major recession also because millions of people were counting on their home equity to help them finance their consumption related debt. So, millions of people suddenly discovered that they were without the extra means –home equity– to finance their life style. Hence the abrupt break on spending. Some stopped spending as a matter of newly discovered prudence; but the majority as a matter of urgent necessity.

Looking at this as a new historic trend predicated on a rediscovered balance between real income and spending, all in all, this sobering up, even if disruptive, should be good news. The average consumer is spending less, paying off debts and rebuilding a bit of a nest egg. But, while this may be so in the long run, at least in the short and medium term, the impact is devastating. Because of the extravagantly large consumer spending component within the overall economy, in America deep spending cuts in a time of drastic retrenchment turns misery into disaster. Again, this is more than 70 per cent of the US economy. The size, shape and the rate of growth of the US GDP is largely due to how much Americans spend. So, sudden decreases in spending do not cause just ripple effects. We have had an earthquake with immediate and devastating consequences. Simply stated, there are millions of Americans, (no doubt over spenders themselves), who could go to the grocery store and to their own restaurants only because they had a job in a shopping mall or in a restaurant. No customers at the mall means no more jobs in retail and thus additional people forced to cut down their own spending, even on vital necessities.

So, this is the predicament and it is not pretty; indicating a longer and deeper recession that may stop only when a sizable number of Americans will feel confident enough about their finances so that they will start spending again.

But if this so, how did we get here? Why all is this overspending? There is no easy answer. Much of this overspending was on discretionary items. In other words, in most cases, people did not get into debt to buy daily necessities, such as food. So, we have debt caused by extravagant habits. Motivated by what? While this picture of widespread misery may not be the ideal moment for some reflections, let me try nonetheless.

The subject of the "consumer society" is not exactly new. The marvel of capitalism is to have created reasonably widespread prosperity whereby most people can afford what used to be until not too long ago real luxuries, available only to the very rich. Air conditioned homes, large TVs, a car, dining out, a cruise vacation in the Caribbean –all these are now within the rich of tens of millions. And, while the wealth produced by capitalism is not evenly spread and while we know that many are still poor or at the edge of poverty, the affluence produced is astounding.

But capitalism is only a means to an end. It is a system that, relatively speaking, allows a more productive and more efficient use of capital. Capitalism does not dictate precise spending levels, nor can it recommend what should be individual priorities. A well oiled capitalistic economy creates a market place, while it allows larger numbers of people to have the discretionary income that may be spent on items aimed at increasing the quality of their lives. And in a buoyant, flexible, adaptable economy where jobs are plentiful, it may not be very risky to spend with confidence, even at the cost of a lower level of savings, because the chances of long term unemployment are relatively low. Indeed, while the job churning machine turns endlessly, destroying employment on a daily basis, usually more jobs are created than they are destroyed; so that most people can find a way to be employed and make some money, without having to hoard a lot of cash as a shield for the rainy days to come.

Fine. So we stipulate that in a capitalistic economy people confident in their future are free to spend "more". But spend more for what? Freedom of spending should be about the free pursuit of one's own happiness. Which is to say that it would be good if the goods and services purchased, even at the expense of a smaller nest egg, would be the necessary ingredients for a happier, more fulfilled life.

But here the topic gets tricky, as social research seems to have found that when basic human needs (shelter, food, clothing, health care, etc.) are met in a satisfactory manner, (and this is in general possible for most people in a capitalistic economy), the correlation between acquiring more things or more entertainment and a higher level of personal satisfaction is thinner and thinner. Which is to say that, while the drive to consume is ostensibly about satisfying some need, the reality is that, beyond a certain basic threshold, the satisfaction provided by getting "more" is minor, transient or non existent. Therefore, consuming more does not translate into feeling better.

Alright. But if this is indeed so, we should come to the conclusion that a huge part of the US economy exists mostly to cater to imaginary needs that in reality are not fulfilled, as the acquisition of more "things" does not work as intended. If this is so, then it would appear that millions of people spent stupidly and also unwisely, creating financial jeopardy or utter ruin for themselves, while millions of others make a living catering to these whims. And all this happens for rather superficial reasons; as no profound needs are truly fulfilled through this never ending consumption process –and the enormous apparatus created and increased to cater to it.

So, more than 70 per cent of the US GDP, the sum total of millions of purchases on the part of an army of tireless consumers, serves….what purpose? Well, we do not know exactly, but whatever it may be, it is nothing really essential.

Of course, we should take this in context. Within that 70 per cent of GDP due to consumer spending we have milk for children, medicines for the sick, surgeries and medical care for the elderly. This is important and necessary stuff. And our thanks to a system that makes these services and goods available.

But most of the rest is not essential, in many cases unnecessary and probably frivolous. How many flat screen TVs does the average family need? And how large do they need to be? And how many hundreds of toys does the average child need in order to feel alright and not deprived? And how many pairs of shoes does a professional woman need? And how many beers should one have at the local bar in order to feel satisfied? Of course nobody knows and nobody can dictate this. These are individual choices.

But for a society to be healthy we need to assume that people would have some built in common sense in evaluating what is really good for them. That is to say that they would instinctively know, at least on average, what is necessary and thus good for their own happiness, as opposed to what is superfluous, unneeded and frivolous. Not to mention consumption that can be dangerous: illegal drugs, smoking, overdrinking and overeating.

Indeed, a significant percentage of US consumption goes into food. But national statistics indicate an explosion in the level of obesity with the consequent increase in the incidence of diseases related to excessive weight, such as circulatory problems and diabetes. A staggering 34 per cent of Americans are obese, while another 32.7 are considered overweight. So, we can safely conclude that people unwisely spend excessive amounts of good money on bad eating habits that will jeopardize their health. Where is the increased happiness in all this?

The problem with a society in which oversized consumer spending drives most of the economy is that we end up wasting enormous resources on things that are not necessary, that create very little satisfaction, while in some instances they are definitely harmful. Of course, this is a generalization and thus most likely wrong in many instances. But it is largely correct as a consideration regarding aggregate spending. People would like to think that their consumption enhances their happiness. Hence the incentive to keep this behavior, even when this meant getting deeper and deeper into debt. But the data does not provide confirmation of this assumed correlation between spending and personal fulfillment. The super spenders are not super happy.

Now this long established trend has ended because of this deep and probably long recession. But the silver lining in all this would be if people, forced to cut down by adverse circumstances, would stop and reflect on their level of happiness, once they have been deprived of what they considered to be many of their necessary pleasures.

Of course I am not talking about the real problems for those particularly hard hit, those who cannot make ends meet. I am talking about those who will not buy a new car this year; those forced to cancel the family trip to Orlando; those who will buy just one pair of shoes instead of five and who will not eat out that much; those who will buy the 50 dollar present for their child instead of the 200 dollar gift.

If this retrenchment forced by circumstances does not cause psychological distress, then it may be worthwhile to think again about one’s real needs and priorities and thus future spending choices. And here the goal is not to transform the average American into a dry, passionless puritan who will forgo anything fun and interesting because it is wasteful or sinful. It is about rediscovering what is really important, and why and in what amount.

Again, the point is that capitalism is about a more efficient use of resources. But it is only an instrument; it does not provide a value system in terms of how individual income should be allocated. And, sure enough, capitalism is predicated on demand for goods and services that will be met by efficient producers. We cannot have a functioning capitalistic society without consumption. But the level and quality of demand is a function of available income and personal predilections based on what people deem to be important. And this has a lot to do with psychology and very little to do with economics.

In America the theoretical healthy balance between a realistic perception of needs, income and spending was lost long ago. The evidence is that the predilection to spend, for whatever reasons, morphed into compulsive, at times maniacal behavior; so much that millions of people were spending regardless of income, getting themselves and the whole economy –if one considers the aggregate effects of this behavior– into trouble. And what is worse is that there is no clear indication that this excessive spending, with its built in harmful consequences in terms of family finances, made people that much happier. So, we have the paradox of widespread financial distress for no good reasons.

Can this be changed? Could we have a thriving, healthy capitalistic America with a lower level of consumer spending? Of course we could. Do we know what an appropriate balance between spending and saving should be? No, we do not know and nobody should be in a position to dictate this. But, as a minimum, it could be safely stipulated that negative savings and chronic debt do not constitute a good model of a sustainable life style.

In the end, the individual consumer, in a free society, will choose how to allocate his/her resources. But if the drastic spending reduction caused by the recession does not cause widespread spiritual misery, it may be a good idea to reflect on what motivated all that extravagant consumption that we were so used to. If it was not about increasing real happiness, may be it was not worth that much.

If this rethinking about personal priorities would cause the composition of US GDP to change, that is a lower percentage of GDP due to consumer spending, it may not be such a bad thing after all.