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The Age of Deconsumerism

Discussion Paper

Canada

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As observed in the US, Europe and Japan, economic slowdowns, uncertainty with regard to employment and personal wealth, and social changes are driving a cutback in household spending which the author refers to as "deconsumerism." Were it to become more entrenched, this trend would create major changes in consumer behavior, GDP growth, and public governance. This article explores the causes and presents possible consequences of such a phenomenon.

Representing a growing proportion of the GDP since 2000, especially in the US, personal consumption is a major component of the economy of the largest industrialized nations. Personal consumption expenditures account for 56% of Canada's GDP on average (between 1975 and 2008) and 66% of the US GDP (70% in 2008). The financial and economic crisis of 2008-2009 revealed the strategic importance of the consumer society, with the decreased spending in late 2008 and early 2009 affecting both company and government revenues. (The Canadian Consumer Confidence Index fell by 29.6% in 2008, one of the worst drops on record.) Despite the unprecedented monetary expansion and fiscal generosity seen on the part of government finance departments worldwide, many consumers have limited their spending while others have taken advantage of low interest rates to incur even more debt.

In late 2009, the credit consumer society, as promoted in the US, Canada and elsewhere, is still in the Great Recession hot seat, though it may have reached its limits and its capacity may be decimated. Its excesses and financial and environmental impacts, along with the divide between the rich and poor, have given rise to much discussion. Hence, the driving forces and the impact of an "Age of Deconsumerism" have yet to be fully explored.

The Acceleration that Precedes Deceleration

In the past two decades, the massive advent of goods manufactured in China and other rapidly industrializing countries that are overproducing goods (and with a cheap migrant work force) led to an escalation of low-cost consumption worldwide. Trade deficits soared in the US and elsewhere, but inflation remained low. Then, after the burst of the dot-com bubble and 9/11, the US reference rate was close to 1% from 2002 to 2004, which favored credit spending and killed saving. Spending in relation to the proportion of disposable income in Canada and the US exceeded 95%. Between 1982 and 2007, the saving rate dropped from 20% to 2.7% in Canada and from 11% to 0.7% in the US Household debt exploded to reach 136.5% of disposable income in Canada in 2008 (138% in the US).

The average consumption growth rate rose by 2.7% in Canada from 2003 to 2007, more than that of the GDP (2.4%). According to Statistics Canada, from 1980 to 2005, per capita consumer spending in Canada rose from $6,870 to $23,560 (340%). Disposable income increased at a slower rate, from $8,390 to $24,400 per inhabitant (290%). Canada's consumer credit growth rate was about 7% from 2000 to 2008, with a peak of 11% in 2005 (8.2% when considering only the one issued by the banks). Even worse, the use of consumer credit to pay non-durable goods is on the rise, a recent trend in Canada.

Financial and Economic Constraints

The financial downturns of 2008 and 2009 were historical and widely analyzed. The consequences in terms of financial constraints obviously vary from one country to another, but three of them will be the drivers of the "Age of Deconsumerism."

1. Debt Reduction

End of the "Golden Age of Credit" and Higher Interest Rates

The world economy from 2001 to 2008 was marked by a certain synchronicity. On the one hand, there were US consumers (virtually subsidized by Chinese goods and government revenues and an undervalued Chinese currency) and more new conspicuous consumers (emergence of the middle classes), while on the other, there were the fruits of a liberalization of trade and internationalization of capital where financial intermediaries and private and public funds increased and stepped up financing. From 2000 to 2006, global asset-based lending rose from US$250 billion to US$3 trillion (3,000 billion). In the US, consumer credit and mortgage loans totalled US$6.1 trillion in debt in 1992 (in 2008 dollars), rising to US$13.8 trillion in 2008 (an increase from 61% to 96% of the GDP).

According to Statistics Canada, from 1980 to 2005, the use of consumer credit for each dollar in personal expenditure rose from 21¢ to 38¢. According to CGA Canada, for each spending dollar, Canadians incurred $1.06 in consumer credit in 2008 (versus 67¢ in 2000). In 2005, Canadians owed $1.16 for each dollar of disposable income (versus $1.24 in the US).

The Lehman Brothers and AIG bankruptcies and the US and European bank bailouts had a major impact on credit. In October 2008, as interbank markets and commercial lending came to a halt, governments had to make massive investments to restore the flow and ensure liquidities (capital and guarantees: US: $700 billion for both / France: US$54 billion and US$432 billion / UK: US$64 billion and $620 billion / Germany: US$135 billion and $540 billion / South Korea: US$30 billion and US$100 billion). Fourteen months later, a large number of financial institutions had to tighten credit requirements. In the US, consumer credit is plummeting with declines recorded during 13 of 14 months between late 2008 and late 2009, for a drop of US$117 billion from the peak of July 2008 to December 2009. The impact on regulations, taxes and governance is still being debated and is under way, but new rules marked by caution, in particular with respect to derivatives and credit insurance, can be expected. They will limit access to credit and will increase rates. The implementation of Basel II and new accounting standards could also potentially affect the banks' lending ability.

The drop in interest rates also levelled off. Over 100 central banks lowered their interest rates in 2008 and 2009. Many countries are dealing with rates around 0.5

to 3% and simply no longer have any leeway; and considering their deficits financing, they will most likely be facing higher rates. Clearly, the latent consequences of the financial crisis will eventually affect certain companies and heavily indebted governments. Hence, more payment defaults *à la* Dubai World could force a rate increase, particularly if a refinancing urgencies end up pitting state against state and governments against companies.

The end of the easy credit era has still not peaked, but the repercussions on consumer financing may affect the "Age of Deconsumerism." Higher interest rates and, possibly, a curtailment of the volume of credit offered by financial institutions over the medium term would incite consumers to be frugal and save more.

Decreased Assets and Increased Saving

The fall of the real-estate and stock markets in the US was spectacular. Nomura Securities evaluated the losses at US$9 trillion (2008 and 2009) and believes that the impact on long-term household expenditures is likely spending cuts of US$300 to 700 billion. McKinsey states that a mere 1% increase in the US savings rate results in +/-US$100 billion in decreased consumption. Obviously, the post-crisis context will tend to make consumers more cautious in terms of saving as they deal with assets that have declined, both in value and in net yield (low interest rate, decreasing or stagnating dividends, no increase in wages compared to growing actual cost-of-living) and unhealthy debt (fixed debt vs. declining net assets). This is especially the case for Canadian workers aged 50 and over whose retirement savings have partially shrunk. Not surprisingly, in the second quarter of 2009, Canadian savings were on the rise, at 5.5%, the highest in eight years. With the notable increase in personal bankruptcies and the personal loan delinquency rate in 2009, which show the financial vulnerability of households, higher interest rates will also likely cause many more people to go under. The Scotia Bank estimates that a 1% increase in the average effective interest rate over five years – assuming stable income and credit growth – would have the effect of increasing the debt service cost in relation to after-tax income by about 1.5%.

As CGA Canada and Canadian banks have stated, Canadians are more concerned about saving and most would now like to clean up their personal finances. Long-term personal financial health will be taken more seriously and, in the absence of an increase in wages and assets, may slow down personal spending.

> "As the prospects for both future income and wealth have deteriorated,
> it may simply be irresponsible to continue consuming at the same rate
> as we did when the prospects for income and wealth were much more positive."
> Where Has the Money Gone – CGA Canada 2009

2. The Return of Inflation

With a slight deflation in the US, Japan and China in 2009, inflation does not seem to be a threat at present. However, from 2006 to 2008, speculators looking for returns caused the price of oil, metals, grain, real-estate, etc. to reach record levels. Though prices collapsed in 2008-2009, they quickly rallied for several commodities. The price of sugar and gold reached historical levels, and petroleum, copper, nickel, aluminum, wheat and potash are on the rise despite the current slow recovery and modest economic growth forecasts in 2010. *The Economist*'s commodity-price index rose from 100 to 217 between 2000 and 2009, a 37% gain in that year alone. The slowdown in petroleum and mining investments and the supply and demand problems in the agricultural sector in recent years are recurring threats that must not be forgotten.

The return of high natural-resource and food prices may well speed up the "Age of Deconsumerism" by creating actual inflation or shortages. Impoverished consumers would have to make choices since the entire value chain would be affected. (If the price of oil once again climbs to around $140 a barrel, who in winter will be able to afford asparagus that have been flown in by plane from Chile?) A cheap breakfast will be hard to come by if the price of grain, oranges, coffee and pork continues to rise. Furthermore, the addition of 100 million Chinese and 230 million Indians to the world's population by 2035 can not translate into lower inflation in the West. Even if Asians consume less than Westerners, their new "middle classes" will be large enough to absorb a low-cost production that, for now, has been exported to the West.

Finally, the "greening" of the economy could not occur without "green" inflation. New environmental standards, cleaner and more expensive products, and all kinds of green taxes and regulations as well as other environmental costs are to be expected. Such an inflation is difficult to quantify for the time being but its source, environmentalism, is covered further on.

3. The Ricardo-Barro Effect

With all the debt incurred to finance their economic recovery programs, the governments of industrialized nations are forced to levy new taxes. In the US, for instance, the Congress Budget Office has estimated the value of the deficits incurred from 2009 to 2019 at US$11 trillion. The gross debt represents 98% of the GDP in 2010. In 2019, if Washington does not make any major changes to its taxation, the debt cost will be US$806 billion per year, taking up 20¢ of each federal revenue dollar. Japan, France, Italy, Germany and the U.K. will also be dealing with a very costly debt.

In Canada, the decreases in personal income tax in the 2000s led to an increase in disposable income in a context of stagnating gross income, still favoring an increase in personal spending and credit. In 2010, few experts expect there to be any decreases in income tax.

Though the validity of the old Ricardian effect is still being debated, its theorem is relevant to the "Age of Deconsumerism." The European Commission submitted the hypothesis that a growth of one percent of the structural deficit would result in a 0.75% increase in saving (in GDP points). Thus, households that anticipate an increase in taxes may reduce their spending and adjust their budgets accordingly. An environment where social costs (e.g. healthcare, education, aging, climate) are constantly on the rise – and this is what experts are predicting – does not favor a rapid rise in consumer spending. In addition, many Canadians are losing trust in the future of social programs and fear that they will disappear or be cut in the not-too-distant future; they anticipate the increase in saving needed for new forced expenditures.

4. Unemployment and Job Insecurity

The Great Recession generated a record number of lost jobs. The International Labour Organization estimated that 20 million people in 51 countries have become unemployed since October 2008. In the US, the number of newly unemployed is estimated at 8 million since 2008. The jobless rate increased from 7.3% to 9.7% in Europe between October 2008 and January 2010 (it was 19.5% in Spain), and from 6.6% to 9.7% in the US (with a real rate of 17.4% in October 2009). Despite the economic recovery or stability, layoff risks persist. Studies conducted in the U.K., Spain and Italy have demonstrated the link between unemployment risk and decreased or deferred spending. Depending on the country, the models and the level of insecurity, decreases of 6 to 11% in consumer spending are being reported for households where there is a risk of loss of employment – job insecurity often incites preventive saving.

According to the *RBC Canadian Consumer Outlook Index*, job anxiety remained steady in early 2010, with one in four Canadians saying that a member of their household was worried about losing their job or being laid off. Job anxiety levels were greater in Ontario and in Atlantic Canada and lower in Manitoba, Saskatchewan and Quebec. The buying intentions of households in these two groups of provinces substantially diverge along the same lines. Still according to RBC, the main financial reasons behind consumer prudence (very present among those who will be taking 'staycations' this winter) include the employment factor. To deal with professional uncertainty and prevent a worst-case scenario, day-to-day financial management and long-term financial security are becoming more important, claims RBC.

In addition, one of the repercussions of the Great Recession on consumer spending was noted by Alan Greenspan in a speech he gave in June 1996 when he stated that after a period of job insecurity or unemployment, workers tend to forego wage increases in favor of job security. After a recession marked by unemployment, we are seeing "fewer strikes, longer work contracts, and flat salaries," he stated.

Note also that as modern-day Western society is generally more individualistic, many unemployed people without a well-structured and affluent family unit or social networks to sustain them for a while, lapse into poverty more quickly than in the past. Thus, when talking about the decline of the American middle class, there is an implicit mention of “deconsumerism” in those who have been unemployed for a while (six months on average, which has not been seen since 1948, according to the Bureau of Labor Statistics). The length of the periods of unemployment makes one wonder about the generational aspect of the Great Recession’s impact on employment.

A sign of an interesting movement, the book and film *Generazione 1000 €* portrays young twenty-something Italians who, without any substantial employment prospects, try to get by on less than 1,000 euros a month. It’s difficult to spend like one’s parents when jobs are scarce and poorly paid, despite being well-educated. In the US, where the unemployment rate is longer from one recession to another and the proportion of the employed civil population was smaller in 2007 than in 2001, this trend stands out among those aged 20 to 30, a generation that appears to be at increased risk and who will most likely be more frugal in their spending. Experts, including Heidi Shierholz from the Economic Policy Institute, believe that the employment recovery will be slow, creating a jobless rate of 8% or more for another four years, mainly among young people. An extended period of unemployment and underemployment will drive “deconsumerism.” And if the outcome of difficult employment conditions found in other economic crises are repeated, in 5, 10 or 15 years, the victims of the Great Recession will have less progressed professionally and will be less affluent.

Social Constraints

1. Greening of the Economy

Spurred on by moral, ethical or spiritual factors, increased environmental awareness among young adults and boomers will modify spending. Whether it’s the interest generated by the impact of and responses to climate change or the collective disappointment in relation to the problem of waste or water and air pollution, sustainable development is becoming a necessity for most Canadians. An increase in popularity has been noted for recycling of all kinds: from flea markets to secondhand clothes shops, to e-Bay and Web sites that promote the recovery and exchange of used goods. This is a trend started in the 1960s, and the “minimalist” lifestyle that had sect-like overtones is currently winning over more moderate followers. Now the talk is about “sustainable consumption”: consumers expect sturdier and more energy-efficient products that are recyclable or have a low carbon and garbage footprint. Governments are implementing policies and standards that favor sustainable development in consumer goods and services, even in their public procurement. We even see some consumers changing their minds about purchasing a product once they are told about the associated environmental costs or risks. Industries such as transportation, energy, water supply, farming, construction, and waste management are all experiencing pressure from environmentalists, consumers and their own employees to "go green." The green movement will undoubtedly have an impact on spending volumes, prices and behaviors.

2. Demographics

Despite considerable immigration, Statistics Canada projections show that the percentage of Canadians aged over 65 will increase from 13% to 21% in 2026 (potentially over 7 million consumers in this category). Major changes in income (drop of 30% to 50%, depending on the economic models and age groups), spending (some talk about a -30% adjustment) and lifestyle are obviously to be expected and carefully studied.

It appears certain that after the financial crisis and in anticipation of higher cost-of-living expenses in the future, a large number of working but aging Canadians will increase their saving and decrease their spending. The main reason for this is because members of the "silent" generation (those born between 1925 and 1944) based their retirement on saving, while Baby Boomers (those born between 1945 and 1964) based theirs on the growth of their assets (now weakened). The aging population is thus deeper in debt and more affected by financial insecurity. According to McKinsey, two-thirds of Baby Boomers in the US did not adequately prepare for retirement and could not spend 80% of their current personal expenditures once retired (if they work and save for an additional five years, i.e. until 70, this proportion would decrease by half). More poverty is expected among seniors in the coming decades. Their health is also in question (increased diabetes and Alzheimer's), as well as the accessibility and cost of healthcare in the future.

The current generation of retirees can live comfortably as a result of their accrued savings, low debt, taxes, pensions and other current public and private support. (A report released in 2007 stated that seniors spent only 14% less, were able to continue to save, and donated more money.) A similar lifestyle is not guaranteed for those who will be retiring over the next few decades. The aging of the population will create greater pressure on household budgets, both among retirees and sometimes among their children, and the value and volume of consumption expenditures will be affected.

3. Post-consumerism

The growing environmental awareness mentioned above is in itself part of another movement, i.e. post-consumerism. In his book *Theory of the Leisure Class*, Thorstein Veblen stated that the "conspicuous consumption of valuable goods is a means of reputability to the gentleman of leisure." This was in 1899. Despite what advertising claims, the two cars, three computers, two TVs and two refrigerators per home (and two homes per family, in some cases) are not necessities. Conversely, the leasing and joint ownership of goods (e.g. cars, snowmobiles, chalets) also appears to be on the rise. In the West, material well-being is being questioned and revisited and is no longer the domain of alterglobalists. Since

2007, the OECD has a comparative study program aimed at monitoring and quantifying quality of life and social progress. The French president launched a commission headed by Joseph Stiglitz on a similar issue. Bhutan has its own "Gross National Happiness" (GNH) indicator. The voluntary simplicity movement favors frugality and investing in wellness (health, spirituality, balanced living, gardening, arts, simple tourism) and the longer term (education, children, friends, the community, sustainability/durability).

The Great Recession also relaunched the debate on capitalism and the role played by consumption (especially credit spending) in economic growth models. This ideological debate remains ongoing due to a lack of concrete alternatives or social rebellion.

Lastly, psychologists and sociologists have detailed the weak relationship between happiness and spending. A multitude of reports and indices now show a certain divergence between wellness and material wealth once a certain level of income has been reached. There is also the Buy Nothing Day and No Shop Day held in late November aimed at raising awareness and educating consumers before the holiday season.

Some Consequences to Consider

Private Sector

If this period of "deconsumerism" simply tended to keep spending at the same level or to reduce it by -0.5% annually, executives would be dealing with a decreasing market (not necessarily a declining GDP). Hence, without an increase in international demand, companies will have to review their investments to avoid over-production. This may be followed by a wave of downsizing (search for greater productivity), consolidation (controlling the supply) and downgrading; as growth ratios are no longer the same, the value of assets related to production or the distribution of goods and services will have to be revised, just like the price of securities.

Companies will thus need to respond to the age of frugal spending strategically:

- Innovation, which allows cheaper goods and services to be produced (and private labels), despite higher input costs;

- Developing new products and services focused on "non-material" features, "wellness" and "green" aspects;

- Reinvented marketing: customers who make less frequent purchases (thus whom we don't want to miss) and more cost-conscious ones (who are seeking information) will require even greater attention on the part of goods and services suppliers. A marketing strategy that is less centered on conspicuous spending (from the old "selling value for the customer" to the new "selling to customer's values") and a focus on after-sales service;

- Increased international sales and investments to keep up with the emergence (in terms of numbers) of the new middle classes in Asia and elsewhere.

> "As consumers across the world become more conservative, it is believed that economic growth may be slower, not only in one or two years but well after the recession. We need to focus more on R&D, globalization and customer service because growth will be difficult, different, and we'll need to work harder to achieve it."
> Jeff Immelt, Chief Executive Officer, GE

Public Sector

Since government revenues are based on taxes of all kinds (e.g. GST, PST, property tax, capital tax, fuel and liquor taxes, custom duties, etc), there will be a decrease in public revenues and adjustments and new approaches will be needed.

According to Statistics Canada, the total consumption taxes in Canada (excluding custom duties, taxes on gasoline and fuel, and liquor and gambling profits) totaled $78.35 billion in 2009 ($67 billion for the general sales tax), which is approximately 13% of both the revenues and expenditures of the federal and provincial governments. GST alone accounted for $25.7 billion in 2008-2009 ($33 billion in 2005-2006), representing 13.4% of the federal government's tax revenues. With expenditures of $207.8 billion plus $31 billion for debt servicing, GST represented 10.7% of the total. It is difficult to accurately simulate the effects of a 10% drop in consumption on federal government revenues, but a theoretical decrease of at least $4 billion could be expected.

In Quebec, total consumption taxes represented $13.6 billion in 2009, accounting for 19.5% of the province's revenues (25.4% of its independent revenues). Based on data from the Institut de la statistique du Québec, a 10% decrease in consumer spending would result in a theoretical loss in revenues of $1.24 billion for the Quebec government. (If a 10% drop appears inconceivable, one simply needs to look at the figures attained during last year's financial crisis in the Baltic States, where consumer spending dropped by 30%; no one died of hunger and there were no riots.)

Unfortunately for the government, the shortfall associated with the "Age of Deconsumerism" could coincide with an increase in the social costs related to healthcare, the aging of the population, an increase in government spending on infrastructures and adapting to climate change, and possibly even an increase in the cost of debt. In short, this would be coming at a very bad time.

The tax implications are numerous and should be carefully studied by civil servants and elected representatives. For instance, to compensate for decreased revenues, should the government privatize services or increase sales taxes and favor shifting the tax base toward:

- A tax on personal wealth;
- A tax on financial transactions (real-estate and securities);
- Taxes on polluting or non-recyclable products;
- A tax on certain exports;
- An increase in income tax (in particular on capital gains);
- An increase in government tariff rates.

As it progresses, the "Age of Deconsumerism" will heighten the debate on the government's role and means and will require that difficult but necessary choices be made to maintain the solvency of the Canadian socio-democratic model, social cohesion, federal-provincial unity, and the economic future of later generations.

Reports published a few decades ago already hinted in their own way at the specter of “deconsumerism,” including *The Limits of Growth* (Club of Rome, 1972) and *The Brundtland Report* (1983). But as we begin a new century, the “Age of Deconsumerism,” which implies a decrease that is forced (financial constraints) or assumed (social choices) in relation to the volume and value of consumer goods over an extended period of time, appears to be increasingly plausible. This trend is still not strong, but there are enough signs to confirm its emergence and to merit decision-makers taking note, requiring in-depth analysis and commensurate planning. The Stone Age did not end because of a lack of stones. Nor will the consumer age end for lack of supermarkets or consumers. But a transition characterized by new economic and social realities and by our innovative thinking and willingness will carry us into a new era.