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The economics of Black Friday and Buy Nothing Day

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The economics of Black Friday and Buy Nothing Day

By Louis D. Johnston | 11/21/12

REUTERS/Jessica Rinaldi

Though Black Friday may move Christmas-gift purchases forward into November, consumers make their decisions about spending and saving based on long-run considerations.

What comes to your mind when you think about the Friday after Thanksgiving? Is it Black Friday, a day to get going on your Christmas shopping and perhaps snag some great bargains? Or is it Buy Nothing Day, a time to step back from society's excessive consumerism? (Personally, I like Sarah Vowell's take on the question.)

Does either perspective really matter for the U.S. or Minnesota economies? No. Households, as a group, don't make their purchasing decisions on a whim, driven by the temporary sales of Black Friday or the strictures of Buy Nothing Day. Rather, consumers make their decisions about spending and saving based on long-run considerations such as their lifetime income and where they think taxes will be over the coming years.

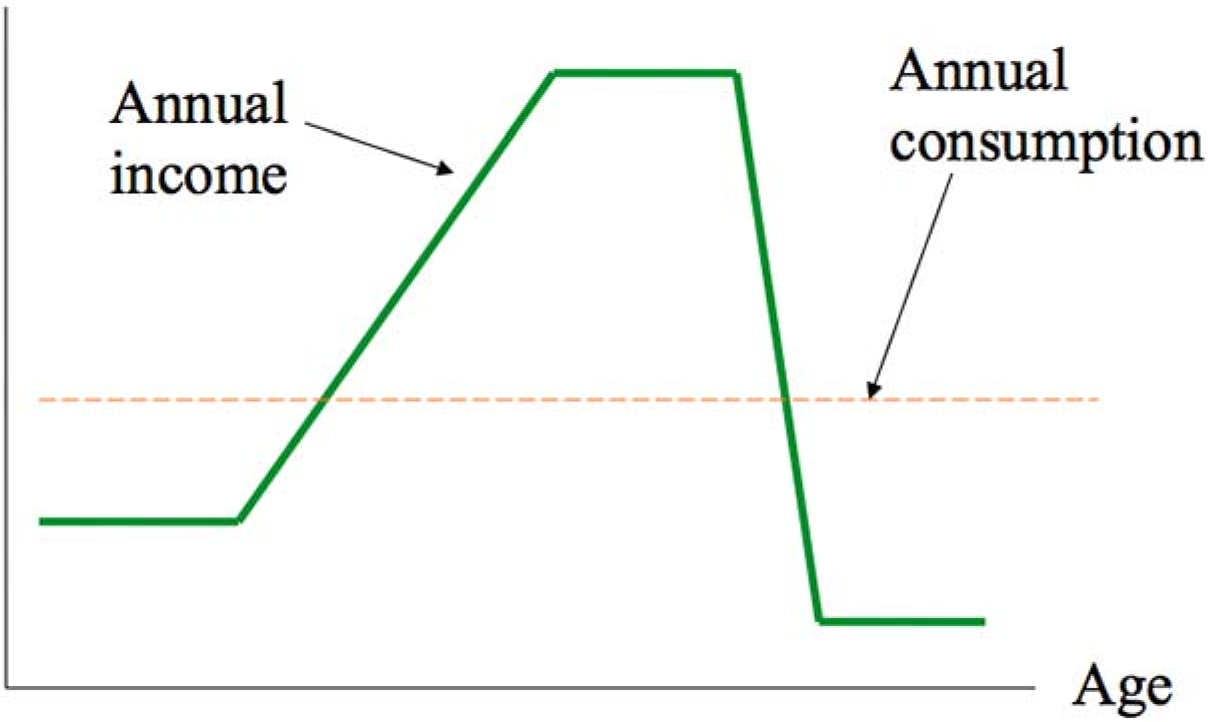
Keeping this in mind will help you better understand the day after Thanksgiving and broader issues of macroeconomic policy.

The life-cycle hypothesis

Franco Modigliani earned the Nobel Prize in 1985 for his work developing the life-cycle hypothesis of consumption and saving. The name expresses the key idea: by identifying the life course we all typically follow, we can gain insight into economic behavior.

Richard Sutch, my teacher at the University of California, Berkeley, put this well in a 1990 lecture entitled "The Life-Cycle Perspective and the Third Task of Economic History." He wrote, "Essentially the life course, or the 'life cycle,' is the consequence of human biology. Birth is followed by dependent childhood. Childhood is followed by adolescence, a period devoted primarily to learning, skill-acquisition, and socialization. Adulthood is typically devoted to production, provision, and child-rearing: hard work. Adulthood is often followed by retirement and then by a period of dependent old age. Death is at the end."

Modigliani started from the premise that most people want to enjoy a stable standard of living over their life course, and thus would keep their consumption fairly constant as a fraction of their income over time. Modigliani summarized the implications of this idea in a simple but powerful model summarized in the diagram below.



When we are young, our income is below our desired level of consumption spending; this means that we are borrowing (for example, taking out student loans to attend college) and receiving transfers (e.g. parents help pay for college.) We then enter the paid labor force and our real income typically (hopefully?) rises over most of our career. Our annual consumption is now lower than our annual income and we save the difference in bank accounts, mutual funds and other financial assets.

Retirement implies a sharp drop in our income, with the income line falling below the consumption line. Now we must draw on the saving we did when we were working to support ourselves.

(Modigliani called this the "stripped down" model, because it assumes that interest rates are zero, the lifetime path of a person's income is known with certainty, and a person knows exactly how long they will live. Economists loosen all of these assumptions when we apply the model to the real world.)

It turns out that the patterns of consumption and saving predicted by the life-cycle hypothesis appear in data gathered from all over the world starting in the early 19th century. According to Sutch, one important implication of industrialization was the creation of "life-cycle institutions" to support this behavior — organizations like banks, insurance companies and mutual-aid societies. Industrialization and life-cycle behavior also led to smaller families, as parents saved in the form of financial assets for retirement rather than by having many children.

The timing of spending versus the amount of spending

Let's go back to Black Friday and Buy Nothing Day. The life-cycle hypothesis tells us that people make their consumption and saving plans long in advance and that Black Friday sales and Buy Nothing days won't change the total amount they spend.

So why are retailers opening ever earlier on Friday and some even opening on Thanksgiving? First, the life-cycle hypothesis is a prediction about groups of people, not individuals. For instance, many individuals and families may not follow this pattern and might vary their spending sharply with changes in retail prices. This could be an important customer segment for many retailers.

Second, retailers might want to move consumer spending from later in the Christmas season to earlier. Specifically, retailers do not want to sit on inventories of unsold goods in mid-December that they must mark down in order to sell. They would rather sell their merchandise at a slightly lower price earlier in the season and know with certainty that they've hit their sales targets.

Black Friday might bring some spending into November that might have waited until December, and Buy Nothing Day vice versa. But the total amount spent won't change.

Policy implications

The life-cycle hypothesis makes a broader public-policy point: Temporary changes in economic policy won't affect household behavior much, if at all. For example, temporary tax cuts or limited-time increases in unemployment compensation won't have much effect on consumer spending, and thus won't stimulate the economy. These types of policies are thus not very effective ways to get an economy out of a recession.

A broader policy implication, though, might be to call a halt to the arms race that is Black Friday. Opening earlier and earlier isn't going to do anything to help the economy; it's just going to make workers spend their Thanksgiving at the store and ruin the holiday for others. JC Penney, for instance, declared that it will not open until 6 a.m. on Friday so that employees can spend Thanksgiving with their families. I hope that others follow its lead.

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