# Inequality and Crisis: Conspicuous Consumption as the Missing Link in the Portuguese Case

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**Abstract:** Portuguese household debt increased above GDP between 2000 and 2007. This article uses conspicuous consumption to explain credit demand dynamics. The author develops an institutionalist framework and consider how rapid high inequalities and increasing top income share favored conspicuous consumption and climbing household debt.

Portugal is notorious in the European Union (EU) for three regrettable circumstances: for how it was hit by the recent Eurozone crisis, for its sizeable household debt, and for its large income inequalities. My article brings together these three issues and maintains high inequalities fueled household debt. Although I do not analyze the link between debt and the recent crisis, I assume household debt growth above GDP was a source of instability (Brown 2008).

There is substantial literature on household debt as a reaction to growing inequalities in the United States. Particularly, post-Keynesian economics maintains financial deregulation and wage share decline has led households to use debt in order to compensate for declining relative income (Onaran, Stockhammer, and Grafl 2011; Stockhammer 2015; Stockhammer and Wildauer 2016; Onaran and Obst 2016). Likewise, focusing on the United States, different authors consider growing income inequalities that contributed to the recent crisis (e.g. Brown 2008; Barba and Pivetti 2009; Wisman 2009, 2013; Greenwood and Holt 2010, 2012; Rajan 2010; Wunder 2012; Cynamon and Fazzari 2016; Scott and Pressman 2015).

The United States is an extremely informative case and these analyses bring new light to the factors behind the subprime crisis. On the other hand, Portugal is a very small economy, where no sub-prime credit developed. Nevertheless, we propose Portugal is an interesting and enlightening case. Portugal was severely hit by the recent Eurozone crisis. Although the International Monetary Fund/European Central Bank/European Commission sponsored adjustment program focused on public debt, household debt was extremely high and continues to burden the financial system.

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Between 2000 and 2007, Portugal experienced a current account deficit, coupled with growing capital inflows. Financial institutions allocated capital inflows to household loans. Additionally, over the same period, consumption grew steadily and household debt climbed, in spite of sluggish GDP growth and unemployment growth.

João Rodrigues, Ana Santos, and Nuno Teles (2016) maintain that unlike the United States crisis, increasing household debt in Portugal was not a consequence of increasing inequalities but of financialization. In fact, income inequalities declined in Portugal. Furthermore, debt concentration in the top income groups reflects credit supply conditions. While I agree that credit supply partially explains debt distribution by income groups, I argue that credit demand should also be examined.

Household debt distribution data shows younger intermediate education and middle-income households took higher debt-to-income ratio. This article maintains these households used loans to fill the gap between their lifestyle aspirations and their income. I consider conspicuous consumption can help us understand why such a gap developed. My framework highlights the impact of urbanization, tertiarization, as well as educational and income inequality dynamics on household spending.

The article starts with a brief literature review on household spending determinants. I then outline the main stylized facts on income inequalities and household debt in Portugal. I focus particularly on the period between 2000 and 2007, as this was the moment when household debt dynamics outpaced GDP growth. Nonetheless, since socio-economic transformation is slow and cumulative, I also consider longer trends in Portuguese development. I subsequently analyze how an institutionalist framework based on conspicuous consumption improves understanding of the stylized facts.

### *A Literature Review on Household Spending and its Determinants*

In macroeconomics, household spending is determined mainly by income. According to John Maynard Keynes (1936, 66), "[t]he fundamental psychological law, upon which we are entitled to depend with great confidence both a priori from our knowledge of human nature and from the detailed facts of experience, is that men are disposed, as a rule and on the average, to increase their consumption as their income increases, but not by as much as the increase in their income." Therefore, Keynes expected that as income increases, the APC (average propensity to consume) would decline.

Nonetheless, Simon Kuznets demonstrated, using reconstructed data, that despite increasing income from the latter half of the nineteenth century and the first half of the twentieth, the average propensity to consume remained relatively constant in the United States. This is known as the Kuznets puzzle (Brown 2008).

Different macroeconomic consumption theories endeavored to explain this paradox, namely Modigliani's Life Cycle Theory and Friedman's Permanent Income Hypothesis (Mason 2000). Both these theories rely on a substantive rationality framework. Conversely, this article builds on institutional economics explanations of consumption. These, in the lineage of Thorstein Veblen (1899) and James Duesenberry (1949), emphasize that consumption is guided by social norms, including emulation.

Veblen (1899, 50) maintained consumption is driven by "emulation–the stimulus of an invidious comparison which prompts us to outdo those with whom we are in the habit of classing ourselves." Therefore, contrary to what Keynes (1936) would expect, Veblen's

conspicuous consumption holds APC even if income increases (as Kuznets would establish later) or if it declines.

Likewise, in Duesenberry's (1949) relative income hypothesis, consumption is driven by social emulation. Duesenberry maintains that as income increases, households will strive to keep up with their reference group. "As everyone else's consumption rises in a growing economy, . . . a household at any given income level will consume more and save less" (Ackerman 1997, 653). As with Veblen's conspicuous consumption, APC will not decline as income increases. This would explain the Kuznet paradox.

Duesenberry's ideas were developed particularly by Robert Frank's formal model of positional competition (Ackerman 1997). While Veblen linked conspicuous consumption to the leisure class, in modern societies, conspicuous consumption forces people to work longer hours and hence threatens leisure (Frank 1985, cited by Ackerman 1997).

While the ideas of social competition and emulation can be akin, they are not interchangeable. As Hamilton (1987, 1542) stressed, conspicuous consumption means "[s]tatus defines what is adequate expenditure, not vice-versa." Or, as in Pierre Bourdieu's *habitus*, conspicuous consumption refers to entrenched and unconscious social practices (Trigg 2001). "The consumption act itself is often not the sole purpose and meaning of the consumption activity" (Todorova 2014, 670). Therefore, conspicuous consumption is not an exceptional behavior (Hamilton 1987). It is not specific to luxury goods either. It is the "particular expression of the predatory practice of pecuniary invidious distinction" (Todorova 2014, 674).

Although Veblen and Duesenberry's contributions have been put aside by mainstream economics (Mason 2000), their contributions are widely accepted in institutional economics (Hamilton 1987; Ackerman 1997). More recently, different authors have used institutionalist models of consumption to explain the recent United States subprime crisis. Writing before the crisis, Brown (2008) explains household debt as a response to relative income decline and demonstrates household debt growth above GDP compromises stability. Furthermore Wisman (2009, 2013) maintains United States income inequality rise and a strong belief in vertical social mobility can explain why United States saving rates are relatively low and decreased steadily from the 1980s. Barba and Pivetti (2009) also consider increasing United States household debt as the outcome of low and middle-income households' struggle to preserve their relative lifestyle in spite of increasing income inequalities. Furthermore, Greenwood and Holt (2010, 2012) maintain increasing inequalities had a negative trickle-down effect, namely in terms of housing prices.

Therefore, all these authors demonstrate that increasing income inequalities fueled United States household debt. I now turn to my case study and present some stylized facts on Portugal. I start by considering income, earnings, and wealth inequalities. I then consider lifestyle, savings, and household debt dynamics. And I consider afterwards which groups were more likely to hold debt and had the highest debt-to-income ratio.

### The Stylized Facts

*Stylized Fact 1: Portuguese income inequalities declined but remain high. Income and wage inequalities increased at the top.*
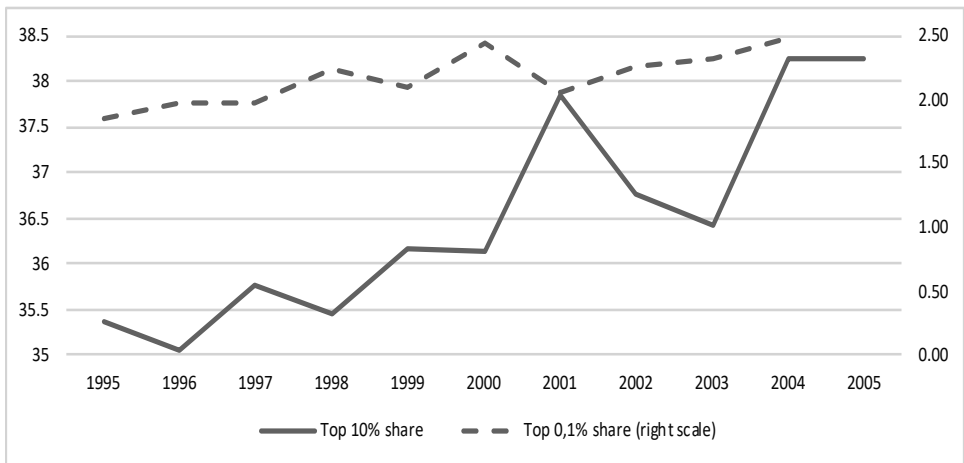
Disposable income inequalities have substantially decreased over the past forty years. By 1974, Portuguese Gini coefficient was about 45 (Pereirinha, cited by Farinha Rodrigues

**Figure 1: Income Inequality Indicators for Portugal**
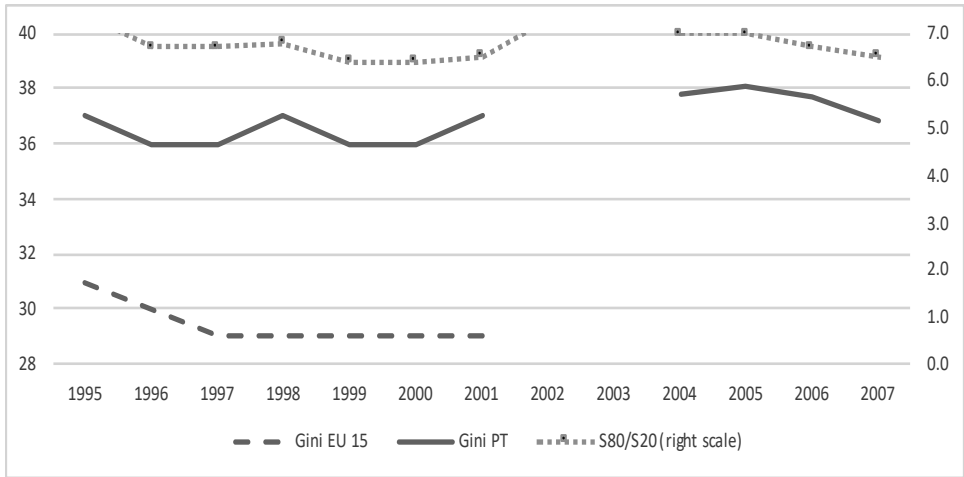
**Figure 2: Top Income Shares in Portugal**

2012).[1] Portuguese Gini coefficient declined by 18 percent over the next twenty years and it continued to decline, although more moderately between 2004 and 2007 (Figure 1).

Yet, present-day income as well as wealth inequalities remain high and are among the highest in the EU. Furthermore, top income shares amplified (Figure 2). According to Alvaredo's (2009) estimations on pre-tax income, the top 10% income share increased by 104 percent between 1980 and 2005, while the top 1% income share increased by 126 percent over the same period. Therefore, differences within the top decile increased over the period.

Furthermore, despite the decline in disposable income inequalities, primary income distribution is remarkably unequal. In particular, the Gini coefficient on gross wages was the highest in the EU (43 in 2006) (European Union Statistics on Income and Living

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[1] This figure is slightly above present-day Gini coefficients for Argentina or Angola.

Conditions). Furthermore, between 1993 and 2007, Gini coefficient increased by 22 percent and inequalities increased within the top wage percentile; for example, the top 0.01% wage share increased by 160 percent (Alvaredo 2009).

Wage inequalities are the outcome of education and occupational differences (Farinha Rodrigues 2012). In 2005, returns to tertiary education were higher in Portugal than in any other European member of the Organization for Economic Co-operation and Development country (60 percent for men and 72 percent for women) (OECD 2010). Returns to college education increased remarkably during the 1980s and early 1990s (Hartog, Pereira and Vieira 2001). Wage premium for college education declined afterwards for less experienced workers but it continued to increase for the more experienced (Alves, Centeno, and Novo. 2010).

Portuguese society experienced a remarkable educational attainment progress since the democratic transition in 1974. While in 1970, less than 1 percent of the population had a college diploma, this percentage had grown to 17 percent in 2015. Yet this share remains low by international standards. As higher education spread, its average returns decreased and unemployment rates for those with college diplomas doubled within ten years after 1998 (from 3.4 to 6.8 percent). Furthermore, in spite of declining wage inequalities for other education groups, wage dispersion among those with college diploma boosted between 1995 and2006 (Alves, Centeno, and Novo 2010) while earnings inequalities among top professionals increased (Farinha Rodrigues 2012).

*Stylized Fact 2: Portuguese household lifestyles upgraded since the 1990s. Household savings declined, and debt increased in spite of sluggish growth between 2000 and 2007.*

Portuguese real GDP grew by an average 4 percent per year between 1986 and 2000. It slowed down afterwards to a yearly average 1 percent growth between 2001 and 2008. In spite of economic slowdown, household debt grew faster than disposable income and the saving rate declined (Figure 3).

**Figure 3: Real GDP Growth and Saving Rate (Household Savings as a Percentage of Disposable Income) (Left Axis) and Total Household Debt (% Disposable Income) (Right Axis)**
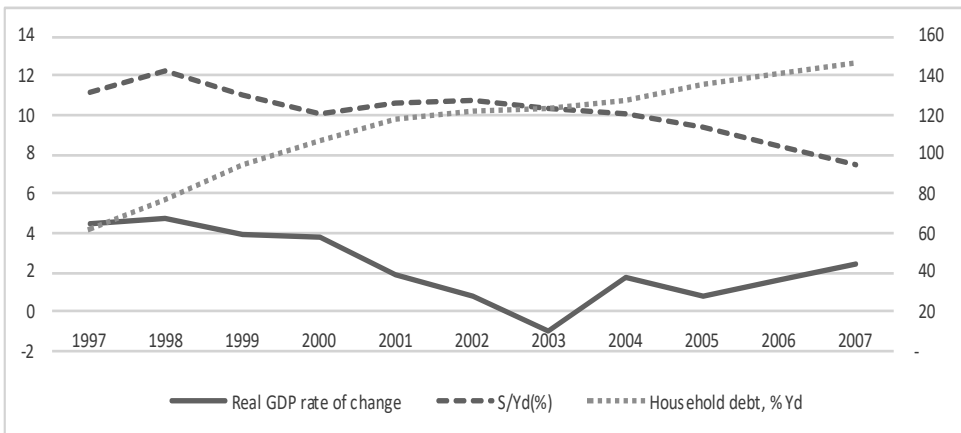


*Source: INE (real GDP rate of change and savings) and OECD (Household debt).*

Portuguese households experienced a significant consumption catching-up with EU partners. Mean household consumption expenditure grew from 45 percent of EU15 average in 1994 to 63 percent in 2010 (Eurostat). Such quantitative progress followed qualitative lifestyle changes. I highlight particularly three expenditures: housing, automobiles, and private education spending.

The spread of homeownership steered household debt increase, as mortgage loans represented 80 percent of household debt (Farinha 2003, 2007). Whereas half the dwellings were owner-occupied in 1970, this share had increased to 76 percent by 2001. A noteworthy rental market shortage (Rodrigues, Costa, and Teles 2016; Ribeiro 2007) can explain this expansion. Indeed, although there were vacant dwellings in the rental market, these were old, and owners did not invest in upgrading.

Housing prices increased steadily up to 2004, although at a slower pace than in the United States, Ireland, or Spain. Particularly, mortgaged property price increases between 2000 to 2005 was equivalent to one year's (average) disposable income. Real estate price growth was the outcome of increased demand, enhanced comfort, as well as an upsurge in upmarket homes and gated properties (*condomínio fechado*).

Homeownership is spread fairly across income distribution. While 65.6 percent of the households in the lowest quintile own their homes, these are 80 percent in the top decile (Inquérito à Situação Financeira das Famílias 2010). However, dwelling median value is very unequal. By 2010, the mean home in the lowest quintile was worth 52 thousand euros, while the corresponding figure was 200 thousand euros for the top decile.

On the other hand, non-mortgage loans were mostly used to buy cars (Farinha 2007). Cars are relatively expensive in Portugal because of high specific taxes. However, public transportation is perceived negatively, and cars are status symbols. Specifically, Catarina Oliveira (2015) finds a link between using private car, income, and occupation. Furthermore, while only half of those in the first quintile own a motorized vehicle in 2010, the corresponding share was 90 percent at the top decile (ISFF 2010).

Whereas the number of new car registrations declined between 2000 and 2006, the share of upmarket car sales almost doubled over the 2000s. In 2000, the total sales of Mercedes, BMW, and Audi were 5.8 percent of total car sales in Portugal. In 2008, the corresponding share was 10.4 percent.

Spending on private schools also increased. According to National Statistical Office (INE) data, while 7.7 percent of students attended private high schools in 1990, this share climbed to 24 percent in 2009. In elementary education this share doubled, from 7 to 14 percent. Between 1995 and 2009, Portuguese household spending on education increased by 857 million euros yearly. This is paradoxical, since the Portuguese government spent 4 to 5 percent of GDP a year on education over the same period.

Consequently, spending on real estate, upmarket cars, and private schools did not contract with economic slowdown between 2000 and 2007. This entailed a gap between household spending and income dynamics that was filled by savings and household debt. Still, albeit household debt expansion, only 37.7 percent of the households held debt in 2010 and only 24 percent had a mortgage on their home (ISFF 2010).

*Stylized Fact 3: Top income groups and more educated households were more likely to hold debt. Nevertheless, debt-to-income ratio is greater for middle income and intermediate educational groups.*

**Figure 4: Share of Households Holding Debt by Income Groups**
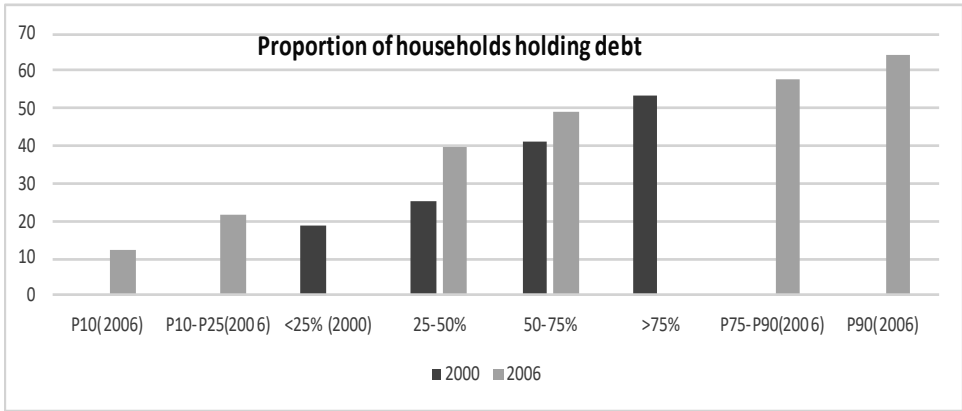


*Source: Farinha (2003, 2007)*

Figure 4 shows the share of households holding debt is higher in the top income group. Additionally, between 2000 and 2006, the share of households holding debt increased for every income group above P25 (Figure 4). Furthermore, more educated households are also more likely to hold debt (Figure 5).

**Figure 5: Share of Households Holding Debt by Educational Attainment**
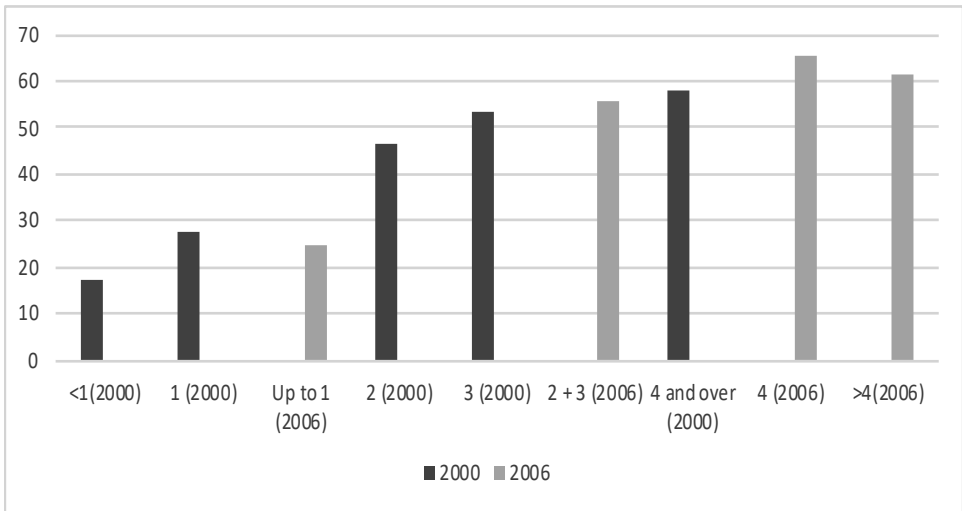


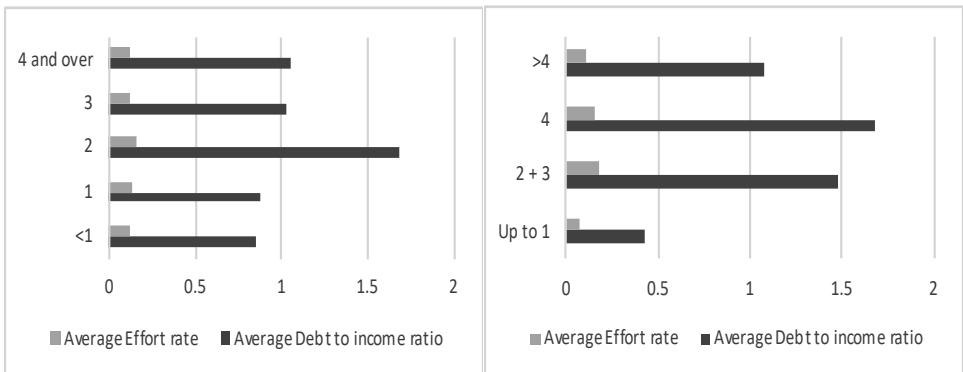*Source: Farinha (2003, 2007)*

Nevertheless, debt-to-income ratio was higher for middle income groups (Figure 6). Both in 2000 and in 2006, middle income groups' effort rate (i.e. the monthly installment to income ratio) was significantly above that of the top decile. Furthermore, if we focus on education, then intermediate educational groups experienced the highest strain in repaying their loans (Figure 7).

**Figure 6: Effort Rates and Debt to Income Ratio by Income Groups, 2000 (left) and 2006 (right)**
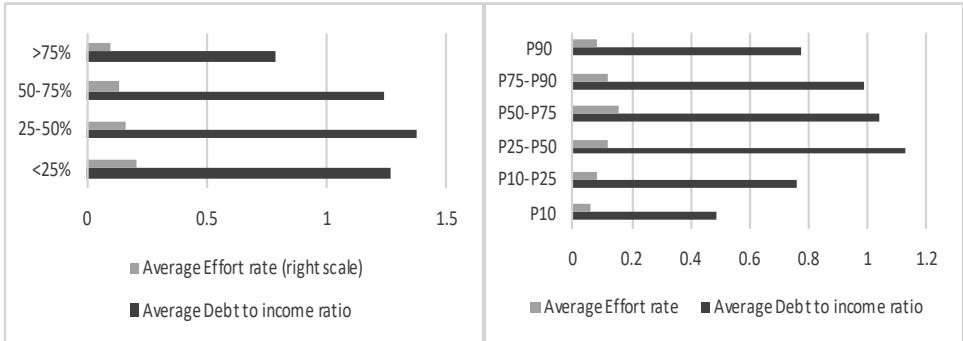


*Source: Farinha (2003, 2007)*

**Figure 7: Effort Rates and Debt to Income Ratio by Educational Attainment, 2000 (Left) and 2006 (Right)**



*Source: Farinha (2003, 2007)*

Credit supply conditions alone cannot explain these higher ratios, since there is no reason why banks might find lending to middle income and intermediate educational groups less hazardous. Therefore, we need to understand why these households applied for loans that were a higher share of their income than did the income and education groups above them.

Moreover, since the top decile is extremely heterogeneous,[2] and we do not have data for the distribution of households holding debt within the top income group, it is also interesting to analyze debt distribution by wealth groups.

*Stylized Fact 4: As we move up the wealth scale, the share of households holding debt increases and then declines.*

The share of households holding debt increased with wealth up to the last decile and then declined (Figure 8). Furthermore, debt-to-income ratio and effort ratios increased with wealth but decline among the wealthier 30 percent.

[2] In 2000–05, the top decile threshold was under 30 thousand euros, while the top 0.1 percent average income was over 350 thousand euros.

**Figure 8: Share of Households Holding Debt by Wealth Groups (2000)**
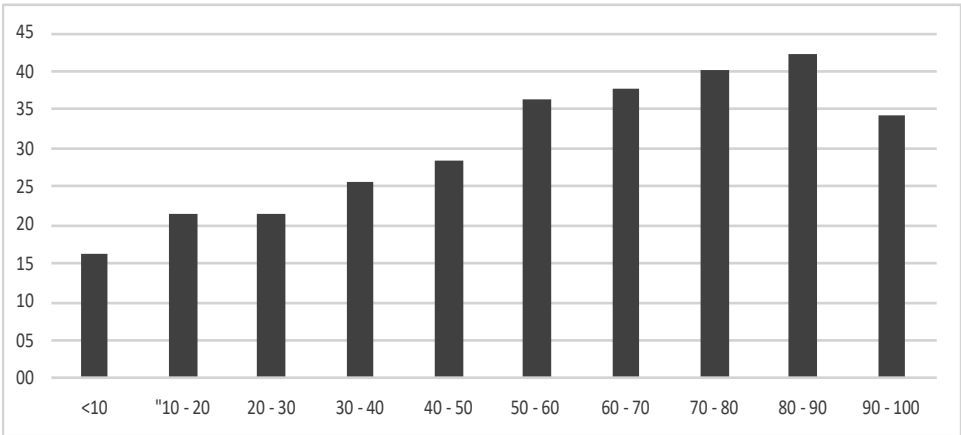
Therefore, we have established higher income, middle wealth, and educated households were more likely to hold debt. Furthermore, middle income households, as well as those in the middle of the wealth distribution had higher debt-to-income ratios. The next stylized fact considers the impact of age.

*Stylized Fact 5: Younger households are more likely to hold debt and their effort rate and debt to income ratio are also higher.*

Households up to 40 years old were more likely to hold debt and the share of indebted households decreases with age (Figure 9). This is partly the outcome of rental market shortage (Ribeiro 2007), which affected these cohorts significantly. Furthermore, younger cohorts had access to subsidized mortgage interest rates (up to 2002).

**Figure 9: Share of Households Holding Debt by Age Groups**
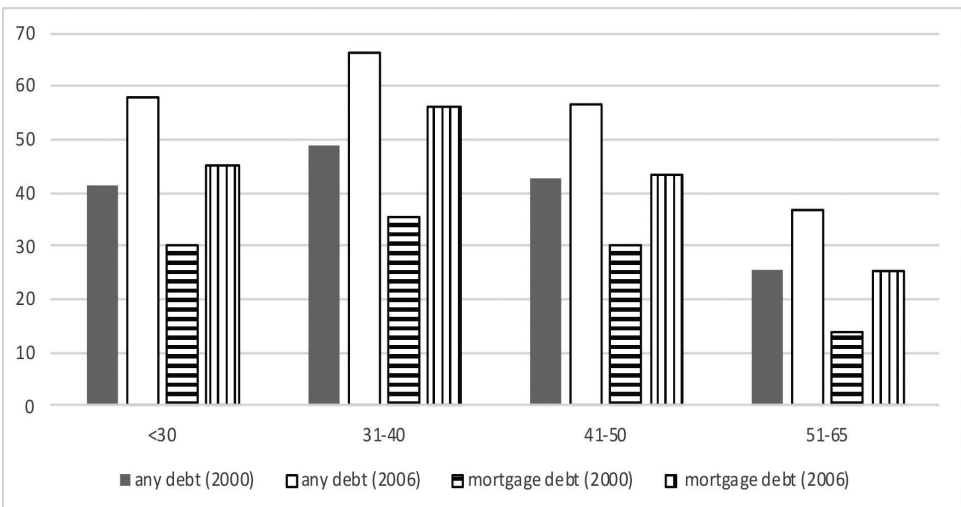
**Figure 10: Effort Rates and Debt to Income Ratio by Age Groups, 2000 and 2006**
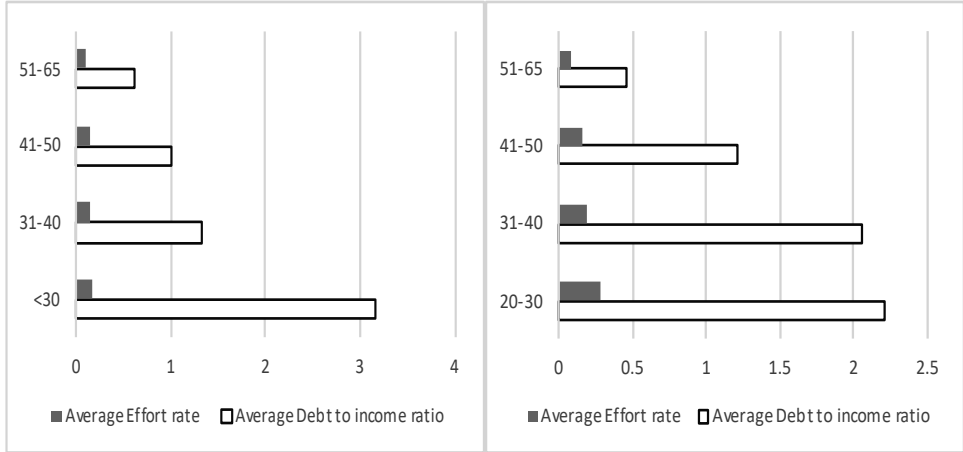


*Source: Farinha (2003, 2007)*

Younger households also have a higher debt-to-income ratio and an effort rate above other age groups (Figure 10). Indeed, data for 2010 shows that younger households' home value is higher (the median value of the homes of those younger than 44 is 1.1 times the median value for the 45-64 year olds and 1.5 times the median value of the 65–74 year-olds (ISFF 2010).

### *Inequalities, Debt and Consumption: Bringing the Pieces Together*

This chapter considers how an institutional economics framework can account for household debt increase (stylized fact 2) and the distribution of indebted households and debt-to-income differences (stylized facts 3, 4, and 5).

I do not question *financialization* had a substantial impact on household debt expansion, as highlighted by Rodrigues, Costa, and Teles (2016). Bank credit allocation strategies undoubtedly explain why indebtedness is lower for high risk groups. Moreover, only a very small share of those in the lowest quartile hold debt (Figure 4). In fact, in 2000–08, the lowest quartile was under Eurostat at-risk-poverty threshold. Therefore, this group's credit risk is very high, and it has very limited access to the credit market.

Nevertheless, in order to explain the stylized facts, we also need to understand why households applied for loans. My explanation focuses on conspicuous consumption. The Portuguese case study I now consider shows lifestyle aspirations influence household consumption decisions. Conspicuous consumption denotes consumption is influenced by and simultaneously reveals status. Household consumption needs and wants are framed by what households consider to be the reference groups' standard lifestyles.

Institutional change is incremental and slow, but transformation can be stark. Portugal was extremely poor in the 1970s. Inequalities were high and social mobility was extremely low (Bago d'Uva and Fernandes 2017). Hence different group consumption habits were isolated. With a 24 percent savings rate in 1972, Portuguese households were remarkably frugal.

Between 1972 and 2007, the savings rate declined threefold whereas real disposable income doubled. Over the same period, Portugal joined the European Economic Community (which later became the European Union), educational attainment improved, females massively entered the labor market, employment in services prospered, and cities developed swiftly. Portuguese households rapidly adopted consumerism.

During the 1990s, economic growth and decreasing unemployment allowed households to upgrade lifestyles rapidly. In addition, as income inequalities declined, a consumption cascade (Levine, Franck, and Dijk 2010) developed and the saving rate decreased accordingly. Following Veblen, "a fresh advance in conspicuous expenditure is relatively easy; indeed, it takes place almost as a matter of course" (Veblen 1918, 49). Employment in services increase as well as female labor market participation facilitated the consumption cascade.

While income inequalities decreased, they remained high. Therefore, the consumption cascade was restricted and the lowest income group was essentially excluded. Such consumption cascade boundary also impacted debt distribution. As we saw, debt involves mainly the top half of income distribution (stylized fact 3).

Cohorts born in the 1970s experienced a higher social mobility than any previous generation (Bago d'Uva and Fernandes 2017). This was the outcome of progress in education. Nevertheless, social mobility remains beneath EU average and social reproduction in education is high by international standards (Causa and Johansson 2010). Specifically, men's wage premium for father's education was higher in Portugal than in any other OECD EU country.[3]

When these cohorts entered the labor market in the 1990s, they expected high social status coupled with a college diploma wage premium. These shaped their consumption aspirations and reference groups. However, the college diploma wage premium decreased for the less experienced while it continued to increase for the more experienced (stylized fact 1). If we consider the latter as the reference group, this created a gap between young educated people's reference groups and their own earnings. I maintain debt was used to fill this gap.

As lifestyles upgraded in the top decile, the middle classes with intermediate education also updated their consumption aspirations. Nevertheless, since  wage inequalities remained sizable, reference groups remain far apart in terms of income. In order to keep up with their reference group, households required debt to fill the gap between their income and their lifestyle aspirations.

Those on the bottom of the top decile try to keep up with those above. This fueled debt in this decile (stylized fact 3) and appears more clearly in debt distribution by wealth groups (stylized fact 4). Furthermore, those beneath the top decile, emulate the lifestyles of those slightly ahead. And so forth. This inflated effort rates and debt-to-income ratio of middle income groups (stylized fact 3).

Cohorts born between 1970 and 1980 lived in urban areas, were more educated, and experienced rapid growth. If we consider expectations are based on recent experience, then it is realistic to assume they were optimistic in 2000–07 in spite of growth slow down. Furthermore, as they typically worked in services and these activities are non-tradable, their wages increased above the national average between 2000–07.

Younger households were more educated, travelled, lived in urban centers, and worked in services. As they are more educated than previous generations, they expected their financial situation would improve and match their lifestyle aspirations. They suffered from

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[3] The inter-generational wage premium is the increase in the offspring's wage of having a father with tertiary education relative to an offspring whose father had upper-secondary education.

rental market shortage but preferred to purchase new and renewed dwellings to renting old dwellings (left vacant in the rental market). Therefore, younger households were more often indebted, had higher mortgage debt, took up greater debt-to-income ratios than other age groups, and faced higher effort rates (stylized fact 5).

To conclude, my framework brings together progress in education, urbanization, and decreasing but high inequalities (stylized fact 1). I maintain a lifestyle cascade developed during economic growth in the 1990s. Owing to income inequalities and access to credit conditions, lifestyle trickle-down was restricted to the upper half of income distribution. These upper middle-class households increased debt-to-income ratio (stylized fact 3). Therefore, household debt increased in spite of economic slowdown (stylized fact 2). As Veblen (1899, 50) puts it "[t]he difficulty in the way of receding from an accustomed standard is the difficulty of breaking a habit that has once been formed."

## Concluding Remarks

This article offers an institutionalist account of household indebtedness increase based on conspicuous consumption. I considered how a consumption cascade developed rapidly and fueled household debt, particularly within the top half of the income distribution.

Nonetheless, household debt increase above GDP endangers financial stability (Brown 2008). Hence, in 2008–09, Portugal experienced significant macro-imbalances. By 2011, the Government signed a memorandum of understanding with the IMF, European Commission, and the European Central Bank. The subsequent adjustment program focused on containing public spending and promoting exports. Nevertheless, unlike Spain or Ireland, bank non-performing loans to gross loans ratio continued to increase after the macroeconomic adjustment program. Furthermore, if conspicuous consumption based on the reference groups' lifestyles is path dependent, it may nurture credit demand during economic expansion. This may remain a source of instability in the future.

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