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The fable of the grasshopper and the ant:

A research project on over-indebtedness and unemployment in Portugal *

Abstract: When a high rate of indebtedness like ours is combined with the deterioration of the labour market, the financial situation of some families can become worse. To test these hypotheses, the Consumer Indebtedness Observatory started a research project to study the relation between unemployment and over-indebtedness in Portugal.

Two empirical studies, based largely on personal interviews, are being carried out: one involves workers who have lost their jobs; the other involves debtors who sought the assistance of DECO to renegotiate their debts with creditors. Based on this, we can identify two general profiles which we have termed, as in a fable, the grasshopper and the ant. These profiles show different consumption patterns and different ways of dealing with money and credit. These differences help to explain the distinct sustainability in the face of unemployment shown by the ants and the grasshoppers.

Introduction

In July, the *Observatório do Endividamento dos Consumidores* (Observatory of Consumer Indebtedness) (OEC) started a one-year project with the aim of analyzing the financial sustainability of families in a situation of unemployment, especially where there are outstanding credit debts for consumption and housing.

Based on the work already carried out, especially the interviews conducted, we have compiled an initial picture of Portuguese society in terms of the relationship between unemployment and over-indebtedness. We can see two, albeit incipient, profiles in this picture which we have termed the grasshopper and the ant, as a kind of fable.

It should be noted that the data dealt with here are of a provisional nature, providing only an initial reading of the reality.

Some aspects relative to the regulations dealing with over-indebtedness in Portugal and the recent trends in the labour market will be outlined first.

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I. Overindebtedness and unemployment in Portugal

1. Consumer credit and indebtedness: a new world to be explored

In Portugal, the development of consumer credit started relatively late compared with most of the European Union's Member States, especially with respect to the countries with a Protestant tradition, in the north of Europe. There occurred converging changes on the side of supply of – deregulation of the credit market – and the demand for credit, in the favorable social and economic climate of the 1990s, which explains the expansion of mortgage and consumer credit. This is a new phenomenon, with the economic, social and cultural consequences that are normally associated with it (Marques and Frade, 2003: 123).

The rate of family indebtedness rose from 20 per cent in 1990 to 40 per cent in 1995 and 110 per cent in 2003. However, the rate payment default is limited (2.5%, according to the Bank of Portugal).

This phenomenon has had a deep effect on the way Portuguese society has come to deal with credit and consumption. A sense of taking advantage of the new opportunities (using the credit that has become accessible and cheaper) exists alongside one of cultural rejection (consuming before saving is contrary to the cultural habits of many Portuguese). This contradiction is reflected in the discussion on public initiatives for regulating over-indebtedness, either supporting them, or categorically rejecting them (Marques and Frade, 2003: 121).

2. Overindebtedness: an undercover reality

2.1. First regulatory steps in dealing with overindebtedness

There is no legal system to deal with the problem of consumers' over-indebtedness in Portugal. Nevertheless, some regulatory initiatives have been put forward, which represent distinct regulatory models. The unfolding debate thus revolves around a judicial approach vs. an extra-judicial mediation solution.

Everything started about eight years ago (1996), when the Ministry in charge of consumer protection set up a Commission to draw up a consumers' code. In 1999, the

Ministry submitted the part corresponding to the remedy for over-indebtedness for prior discussion. This proposal presented a classical civil procedure, extremely formal and slow, taking at least one year for courts to come to a decision. The proposal, in fact, comprises an unduly judicialized procedure, which worsened the already-existing work overload of the courts.

After this initiative, during the consulting process (2001), the Ministry of Justice presented another proposal based on a non-judicial mediation system. It was regarded as being more effective for dealing with such a complex issue as household over-indebtedness. In this proposal, mediation was the key word. It would be provided by public or private institutions, recognized by the Ministry of Justice. It would require the establishment of mediation network centres, able to give *information* and *debt counselling* to consumers, and to help them in *negotiations with creditors* when they are bankrupt. The courts would work as an appeal mechanism when the debtor and his/her creditors were unable to reach a voluntary payment plan.

2.2. The 2004 Bankruptcy Code

When the government changed from socialist to a centre-right coalition, the course of events changed direction. The two proposals then under discussion were, at least unofficially, set aside.

In 2003, the government submitted a proposal to revise the 1993 Bankruptcy Code. This code was aimed largely at the corporate sector, but it did include some rules on the insolvency of private individuals whose application was, however, only ever marginal. The fact that the procedure is complicated and slow goes a long way to explaining why it was scarcely used.

Research on the judicial system conducted by the OEC has shown that cases of bankruptcy of individuals were not only rare, but overwhelmingly related to family businesses. These are small enterprises that collapse, with the result that creditors seek the bankruptcy of the partners, nearly always a couple, who have given guarantees to the company (surety, security).

Cases of insolvency linked to indebtedness for consumption and housing are rarely found in the judicial system. It does not seem, therefore, that the court is an appropriate

forum for resolving this new kind of dispute, whose profile is unrecognized by those operating in the judicial system.

Nevertheless, this was the solution that the Portuguese legislator upheld when it approved the new Bankruptcy Code, which has just come into force (September). Although it is still mostly concerned with companies, this Bankruptcy Code contains a more detailed set of rules relating to the insolvency of individuals than the previous one. The regulatory model envisaged, based on a “fresh start” philosophy, embraces two alternative procedures.

The first is based on the *liquidation of the debtor’s assets, allowing a discharge of remaining debts*. After liquidation there is a ‘probationary’ period of five years in which the debtor must allocate his disposable income to the payment of the debts that have not been fully met during the insolvency proceedings (assignment). Only after this, and if his conduct has been exemplary, can the debtor apply for exoneration from the liability, thereby obtaining a discharge for what remains unpaid.

The second procedure concerns the approval of a *payment plan*. This voluntary scheme must be submitted to the court by the debtor and is subject to the approval of a majority of creditors. The approval ends the bankruptcy procedure.

Both these procedures take place in the ordinary courts, which can only with difficulty lead to a decision in under a year, which entails financial, social and psychological costs for debtors and creditors alike.

It is thus felt, in Portugal, that negotiated, conciliatory mechanisms should be sought, perhaps combined with a judicial route. Alternative Dispute Resolution (ADR) procedures are faster and inclined to be less onerous. They are also less socially and psychologically stigmatizing. The judicial system should serve as a court of appeal for those cases where it has been impossible to reach an extrajudicial agreement, or when lack of assets means that a feasible payment plan cannot be established.

The interaction between the Bankruptcy Code and the proposed legislation presented by the Socialist Party, in opposition, in 2003, would make the regulatory system globally more appropriate and effective.

The Socialist Party’s proposal argues that the “*juges de paix*”, which combine a phase of mediation with one of judicial decision, would be able to deal with cases of over-indebtedness successfully. The liquidation established in the Bankruptcy Code would be useful in cases where agreement has not been reached or the plan is not feasible.

The absence of such interaction and the failure of the court system in this domain lead us to suppose that over-indebted Portuguese will still not have an effective system available to them, a system that can quickly resolve their problems without leaving them outside the social sphere, the labour market and the market in general.

2.3. DECO and its debt counselling function

As there is no specific system for dealing with consumer insolvency, typical cases of over-indebtedness linked to housing and consumption are only picked up by *consumer protection associations*, notably by DECO, the largest association of that nature in Portugal.

In 2000, DECO set up debt counselling offices for the over-indebted in its head office and in the seven delegations in other parts of the country. Its experts (lawyers) try to renegotiate a payment plan with creditors. Despite the success achieved in renegotiating debts, DECO does not know the degree to which debtors effectively comply with the agreements. A tendency for the number of cases to increase year by year has been observed, which is partly explained by the worsening financial circumstances of some families and partly by the growing visibility of this problem and of the role of DECO in the media.

DECO's initiative is the only visible expression of any sort of debt counselling system in Portugal. Its scope of action is, however, limited in geographic terms. DECO will only intervene when no executory action has yet been applied. Finally, DECO's help tends to be sought only by people with some level of education (middle or higher), who are aware of its role and who, furthermore, live in the country's larger urban centres. It is thus reckoned that there are more over-indebted individuals than those who resort to DECO.

Debt collection firms have been practising indirect and informal mediation of debts.

In the last decade, several foreign companies operating in this field have established themselves in Portugal, and others have been created in the meantime.

Financial institutions, telecommunications and other firms are increasingly opting to outsource the function of "debt collection", entrusting the task to specialized firms. These firms try to get debtors to pay the arrears, and make contact in writing, by telephone or in person. To accomplish their mission, debt collection firms end up by

agreeing a phased payment of the debt, adjusting it according the debtor's financial possibilities. The success of their intervention is in their functioning, like DECO, as a filter for the judicial system, which has been virtually colonized by actions to recover small amounts of debt. But unlike DECO, the renegotiation undertaken by these firms is individual (just one debt) and not collective (several debts). The "mediation" is thus simply a technique that serves the interests of their clients (the creditors), not an activity that has been developed to solve the financial hardship of debtors.

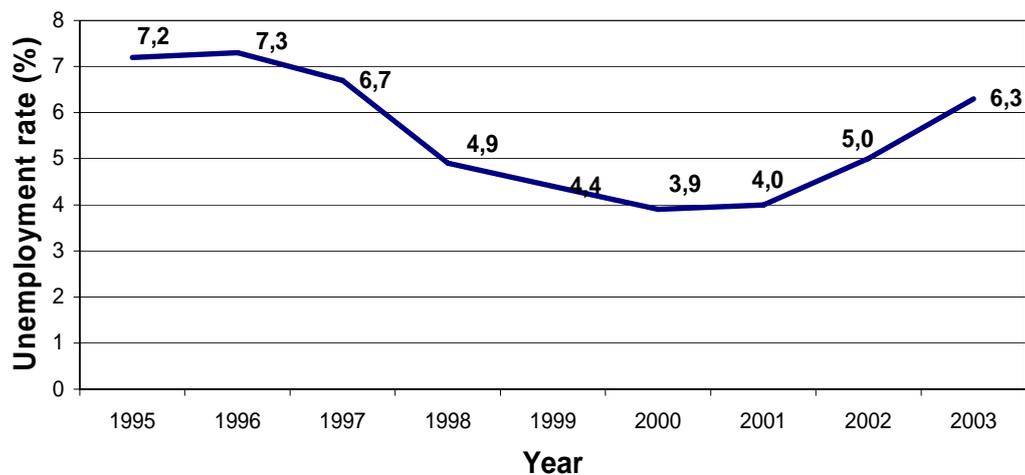
3. Unemployment: some statistical data

When a high rate of indebtedness (even though the effort rate stays at 25-26%) is combined with the deterioration of the labour market, conditions favourable to a worsening of the financial situation of some families are created. This worsening is even more marked when there is definitely no effective system for dealing with over-indebtedness.

The Chart below shows the evolution of the unemployment rate in Portugal over the last few years.

Chart 1

Unemployment rate in Portugal (1995-2003)



Source: INE

After a sharp drop at the end of the 1990s, the jobless total has been rising steadily since 2001. In the first quarter of 2004, according to the Instituto Nacional de Estatística (INE) the rate was 6.8%.

Looking at the distribution of those becoming unemployed due to end of contract, in 2003, it was found that the main reason was directly related to the insecurity of the job, in that about 26% of the unemployed were jobless because their fixed term employment contracts had come to an end. A further 19% had been fired. Unemployment caused by the closure of firms and mass dismissal accounted for 13% of the unemployed.

The Bank of Portugal's annual figures for the past few years show that default on loans to individuals remained at "historically low levels". Nevertheless, the negative trend in the labour market enables us to advance the hypothesis that failure to meet debt obligations will tend to increase in the near future. And if this does not occur, it will be (second hypothesis) because mechanisms have been put in place in the market and/or society to "cushion" the negative impact experienced by families when jobs are lost.

To test these hypotheses, the Consumer Indebtedness Observatory recently initiated a research project designed to study the relation between unemployment and over-indebtedness in Portugal.

For this, two empirical studies are being carried out, based largely on personal interviews. The first study involves interviews conducted on workers who have lost their jobs and who used to work for large companies which have closed or relocated. The second set of interviews was conducted with debtors who had sought the assistance of DECO to renegotiate with creditors and debtors who had been contacted by debt recovery firms. In the first instance, we were looking for any over-indebted individuals among the unemployed. In the second we were trying to find from the over-indebted to what extent unemployment or job insecurity had influenced their insolvency.

Below are the first results of this ongoing research.

II. A research project on overindebtedness and unemployment: preliminary outcomes

The two empirical studies have been revealing the existence of different patterns of consumption and indebtedness, which arise from distinct socio-economic lifestyles

and scales of values. These divergences in turn show the different sustainability of families in the face of unemployment and job insecurity.

The interviews conducted resulted from a random sample and the conclusions drawn from them cannot be further extrapolated for the universe of the families.

First empirical study: interviews of the unemployed

In the first study, workers from various industrial plants that have closed were interviewed (textiles, metalworking, ceramics, food industry), to learn if and how they had managed to continue paying their debts, or if they had failed to do so.

The interviewees were factory workers whose average age was forty, with low levels of education and few professional skills (especially know-how), although some had reached middle grade positions. Salaries were relatively low, almost always less than €600 a month (not including overtime).

As these companies had been established in the market for many years, some workers had been working for them for over thirty years. Some had started at the age of 12 and had never worked anywhere else.

The firms had closed at the beginning of this decade and in no case was closure due to lack of orders. The reason was almost always relocation or a change in company strategy.

All the workers were receiving unemployment benefit, which was now coming to an end for some of them. Hardly any had found new jobs. Their relatively advanced age, poor qualifications, crisis in the sector where they had worked and the long-term unemployment benefit were some of the reasons mentioned for this.

Although the companies were in large towns or cities, or just outside them, the workers had continued to keep to a strongly rural or semi-urban lifestyle, in line with their socio-economic origins.

Their consumption was neither as intense nor as diversified as that found in the second study. There was a strong habit of saving, even though wages were low.

The relationship with credit was nil or extremely limited (buying a house and, in some cases, a car). A feeling of great mistrust, to the point of refusing credit, predominated. This feeling was bolstered by the loss of their job, and very few of the

interviewees admitted they would be likely to resort to credit in the future. Credit cards are not used, and in many cases this was a totally unknown means of payment.

Low levels of consumption, low indebtedness and the existence of personal savings still do not entirely explain the almost complete absence of defaulting on credit commitments. Other factors are also involved.

In the first place, given the low wages of this group, there is very little difference between what they earned when they were working and what they are now getting in unemployment benefit. In addition, they have tried to top up their income by taking on small informal jobs (domestic cleaning, for instance), or by their spouse working more overtime, when possible.

These people try to restrict their family expenditure as far as possible. Their priorities are feeding their children and paying the banks. They have almost all given up personal spending (clothes, hairdressers, leisure, holidays and sometimes even medicines).

In spite of the hardships they are facing, these people maintain a very strong ethical attitude in relation to their debts: honour the commitment made. To this ethical aspect is added the sense of preventing at all costs the loss of what they have achieved with their labours (home), and they will make untold sacrifices for this. Losing these assets would be like losing twice: first the job and then what they have achieved thanks to it.

There is another important feature in the life of these interviewees. They have quite strong informal solidarity networks. Friends, and above all family, help to keep these individuals integrated and they are the ones who sometimes stop them from entering into default. Although the support may take the form of money, it is much more likely to be in kind (food, clothes).

The pattern of behaviour found makes it possible to classify these interviewees, symbolically, as the *ants* of society.

It might be said that the greatest vulnerability stemming from job loss is not felt by these people – the ants – at the financial level, but at the psychological one. Loneliness, lack of prospects for the future, no plans and projects, low self-esteem (too old to get another job, too young to retire) are the aspects observed in these ants, which in some cases have already led to depression and even alcoholism.

Second empirical study: interviews of the over-indebted

In the second study, as mentioned earlier, interviewees were conducted on individuals who had sought help from DECO to renegotiate deals with creditors, and on some who had been contacted by debt collection firms.

Nearly all the interviewees lived in Lisbon. Their ages varied, but the 25–40 age groups are dominant.

Not all were unemployed, but unemployment was the main cause of their defaulting, followed by health problems and excessive debt combined with bad management of the family budget.

A great many of the interviewees have, or have had, insecure jobs. Short-term contracts and high job turnover were common. In some cases we found what Sullivan *et al.* (2000: 88) called ‘job skidding’: the interviewees were finding work, but always with less professional responsibility and lower pay. Nevertheless, some of the interviewees had had a longer-lasting job, which was lost for various reasons.

Most of the interviewees had schooling to the middle or higher level, though there were a few with low educational levels.

Wages were between €750 and €1000. This sum was almost doubled when a couple was involved. The level of saving was low.

The prevailing lifestyle was urban; consumption was intense and varied.

Credit was commonly used, and not only for buying a house, but also for consumption (car, household appliances and even trips and holidays). The credit card was a familiar means of payment. Credit facilities and a lifestyle where having goods of a particular kind and personal image are of considerable social importance encourage a certain temptation to consume, and to use credit.

When unemployment strikes there is a greater tendency for there to be a gap between earnings from work and unemployment benefit. This means that informal jobs are often resorted to.

These people may be symbolically termed *grasshoppers*. They find it hard to satisfy a high level of indebtedness and to establish financial priorities, especially when they lose their jobs or suffer ‘job skidding’.

From the ethical point of view, grasshoppers still consistently manifest an intention to pay their debts. Their willingness to make sacrifices in consumption and

exert great financial discipline does not seem to be as strong as that shown by the ants. This situation is aggravated by the fact that their informal solidarity networks are more fragile and less operational.

It may thus be concluded that the grasshoppers – who to a certain extent correspond to the “fragile middle class” referred to by Sullivan *et al.* – are more vulnerable to the financial consequences of job loss, even though they generally have a higher disposable income. This vulnerability is expressed in more frequent defaulting on debts, due to a more intense consumption pattern and higher indebtedness.

To sum up:

It is early days yet to compile a final portrait of Portuguese society in terms of over-indebtedness and unemployment. The profiles described here are not only incomplete, but they are also quite simplified. There are ants among the grasshoppers and the opposite is also true. Furthermore, there is nothing to indicate that all the behaviours existing in Portuguese society have been exhausted: this is just an initial reflection, which needs to be deepened and strengthened.

It does, however, suggest that Portugal has a long way to go before it arrives at the central theme being discussed at this meeting. What is being disregarded is whether it will arrive sooner than predicted and end up by being added to all the other issues that are still only just beginning to be tackled.

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