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# **LUXURY AS AN INDICATOR OF THE COUNTRY'S ECONOMIC DEVELOPMENT**

## **Introduction**

In today's conditions every country of the world strives for improving the welfare of its population. One of the factors determining the welfare of people is their ability to purchase luxury goods.

In recent years, with the intensification of crisis in the most countries of the world, the welfare of people is expected to deteriorate. But, according to the expert's prognosis, in 2012 the world market of luxury goods and services is expected to reach 1,5 trillion US dollars, which is associated with the growth of the middle class in China<sup>1</sup>. Though, such situation is not typical of the economic situation in most European countries at the present time. But, it is well known since ancient times that during the crisis developing countries become powerful. Therefore, we became interested in the investigation of luxury as an indicator of the country's economic development on the example of two countries – Ukraine and Poland.

The object of our investigation is to determine the state of people's welfare in Ukraine and Poland as an indicator of the country's economic development due to their ability to purchase luxury goods.

## **1. Theory and classification of luxury**

Free Encyclopedia treats the concept of luxury as a social and economic phenomenon, which is associated with the process of consumption of goods<sup>2</sup>.

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<sup>1</sup> Real Economy, <http://real-economy.com.ua> (5 June 2012).

<sup>2</sup> The Free Encyclopedia, <http://www.wikipedia.org/>.

The issue of luxury was considered by scientists as far back as in the XIX-XX centuries, namely by: K. Marx, T. Veblen, G. Simmel, W. Sombart, M. Weber, J. Locke, A. Smith and others.

In our opinion, it was W. Sombart, the leader of German classical sociological school, who succeeded more than others in the disclosure of the theory of luxury<sup>3</sup>. W. Sombart considered luxury as the expenses that go beyond the necessary things. The scientist classified luxury into two: subjective, determined by the value judgment, and objective, that is determined depending on the physiological and cultural needs of a person.

We believe that luxury depends directly on the person's social status, that is, the higher the income of a person, the higher his/her needs. Consequently, the need for the consumption of luxury goods increases too. In his researches M. Weber pointed out that with high incomes the motives of person's behavior go beyond the economic objectives to supply the primary needs and these motives are recognized as a status need for luxury goods, which are not necessary<sup>4</sup>.

The American scientist T. Veblen<sup>5</sup> suggested classifying goods into two categories: essential and first-class. His theory is based on the principles of social interaction between the consumers, which confirms M. Weber's theory described above concerning the purchasing of goods as a status need. There is no clear definition of "first-class goods" in his work. The theory proposed by him suggests that the possession of luxury is considered as a symbol of the consumer's social status.

At the present time no scientist can define the concept of "first-class goods", though all the classifiers call these goods the same way. But in scientific literature they are usually identified with the concept of luxury. Therefore, in our research work we use the concept of "luxury goods". To our mind, luxury goods are products or services that a consumer can purchase having high income, and the turnout of these goods is limited and of high value, which can promote the consumer's personal identification.

There are several classifications of luxury goods. Let us examine two of them: the first classification is proposed by company Euromonitor<sup>6</sup>, the other

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<sup>3</sup> В.А. Гутман, А.Л. Хаченьян: *Научный потенциал регионов на службу модернизации*. Межвузовский сборник научных статей с международным участием. Астрахань 2011, с. 236-239.

<sup>4</sup> М. Вебер (1920), пер. с нем. Б.М. Скуратова: *Протестантская этика и дух капитализма. Политические работы (1895–1919)*. Праксис, Москва 2003, с. 135.

<sup>5</sup> Т. Веблен: *Теория праздного класса*. Прогресс, Москва 1984, с. 273.

<sup>6</sup> Euromonitor International, <http://www.euromonitor.com/>.

one is suggested by the scientists Michael J. Silverstein and Neil Fiske<sup>7</sup>. Both classifications are presented in Figures 1 and 2. The company Euromonitor divides luxury goods into 10 groups: designer clothing and footwear; luxury tobacco; luxury accessories; luxury jewellery and timepieces; fine wines/champagne and spirits; super-premium beauty and personal care; luxury travel goods; luxury fine China and crystal ware; luxury writing instruments and stationary; luxury electronic gadgets.

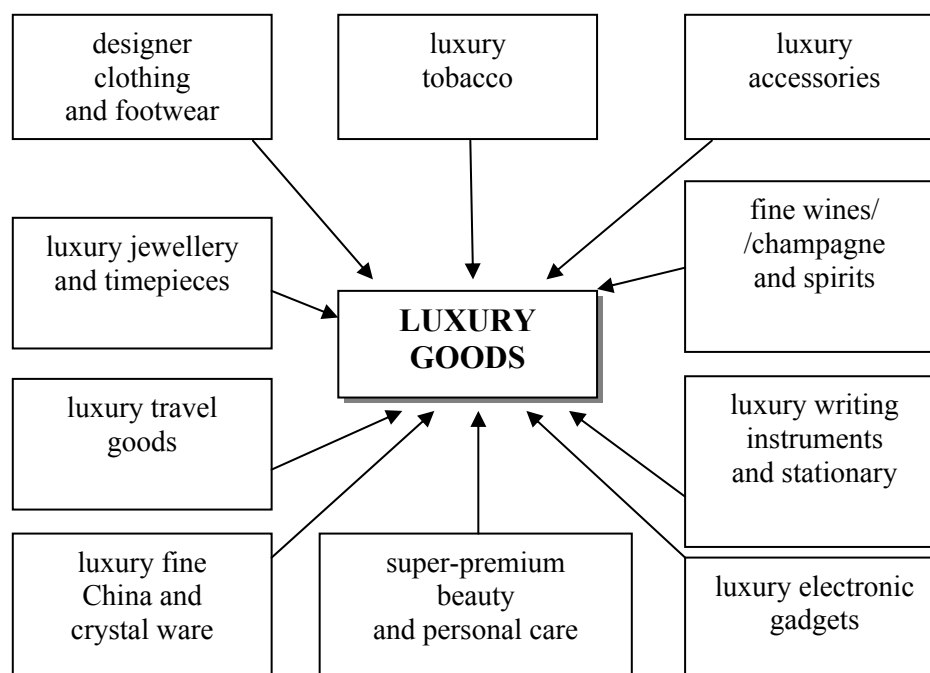


Figure 1. The classification of luxury goods worked out by the company Euromonitor

Source: Euromonitor International, <http://www.euromonitor.com/>.

According to the classification introduced by Michael J. Silverstein and Neil Fiske<sup>8</sup>, all luxury goods are divided into “new” luxury, common goods and “old” luxury. As “new” luxury items they consider the second lines of clothing collections from famous fashion houses or much cheaper models, which bring a high income from sales. As “old” luxury they consider works of art, antiques,

<sup>7</sup> М.Дж. Сильверстайн, Н. Фиск, пер. с англ. Е. Китаевой; науч. ред. И. Лазукова: Зачем платить больше? Новая роскошь для среднего класса. Альпина Бизнес Букс, Москва 2004, s. 112.

<sup>8</sup> М.Дж. Сильверстайн, Н. Фиск, пер. с англ. Е. Китаевой; науч. ред. И. Лазукова: Зачем платить больше? Новая роскошь для среднего класса. Альпина Бизнес Букс, Москва 2004, s. 115.

exclusive jewellery. Financial investment in “old” luxury may be regarded as long-term financial investments. We need to remember Veblen’s<sup>9</sup> researches here, who said, that such kinds of goods like designer clothing, high quality drinks lose their value over the course of time and they are not regarded as luxury goods any longer. Therefore, we can state a fact, that with time “new” luxury goods change into common goods.

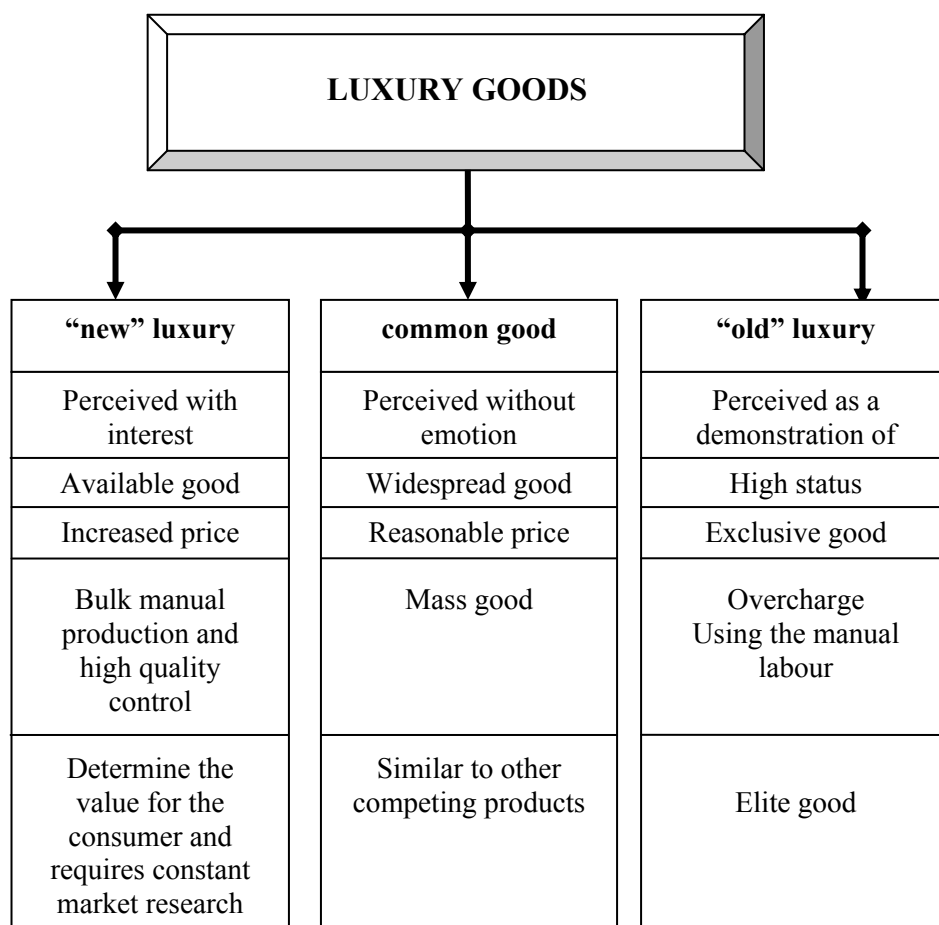


Figure 2. The classification of luxury goods worked out by Michael J. Silverstein and Neil Fiske

Source: М.Дж. Сильверстайн, Н. Фиск, пер. с англ. Е. Китаевой; науч. ред. И. Лазукова: Зачем платить больше? Новая роскошь для среднего класса. Альпина Бизнес Букс, Москва 2004, s. 120.

<sup>9</sup> Т. Веблен: *Теория праздного класса*. Прогресс, Москва 1984, s. 273.

One of the features of luxury goods consumption is distribution models. There are three groups of luxury goods concerning their consumption: for family and individual consumption; goods, which need some experience to be used. Taking into consideration described classification groups, we offer to classify them into one group and add a classification feature, such as “by consumer status”. Suggested classification is presented in Figure 3.

The first classification feature “by kinds of production” includes the list with luxury goods, offered by the company Euromonitor<sup>10</sup>. But we defined one more important group of luxury goods such as “antique production”. We also merged the following groups of goods “fine wines/champagne and spirits” and “luxury tobacco” into one production group “high quality wines, champagne, alcoholic beverages and luxury tobacco goods”, because we think, that these goods are sub excise ones and may refer to one group. Production group “super-premium beauty and personal care” is replaced with “luxury perfumes” in connection with its consumption peculiarity and its emphasis on a person’s status.

Distribution of goods has been carried to the classification feature “by production peculiarity and amount of good”, according to Michael J. Silverstein and Neil Fiske’s<sup>11</sup> classification. We identified what kinds of goods refer to “new” and “old” luxury. In our opinion, next kinds of luxury products refer to “new” luxury: designer clothing and footwear; high quality wines, champagne, alcoholic beverages and luxury tobacco goods; luxury travel goods; luxury stationeries; luxury electronic gadgets.

The following kinds of products: antique production; luxury accessories, jewellery and timepieces; luxury fine China and crystal ware are referred to “old” luxury.

According to the third classification feature “by the method of consumption”, luxury products are divided into: family and personal consumption, and goods that require experience of consumption.

We believe it is the fourth classification feature that is important while determining the status of a person. This classification feature divides all luxury goods taking into account three statuses: goods for the upper class, for the middle class and goods for the low-income class.

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<sup>10</sup> Euromonitor International, <http://www.euromonitor.com/>.

<sup>11</sup> М.Дж. Сильверстейн, Н. Фиск, пер. с англ. Е. Китаевой; науч. ред. И. Лазукова: Зачем платить больше? Новая роскошь для среднего класса. Альпина Бизнес Букс, Москва 2004, s. 120.

Having considered the classification of luxury goods, we concluded, that in order to determine the readiness of the population of any country to purchase luxury goods we have to estimate its people's welfare.

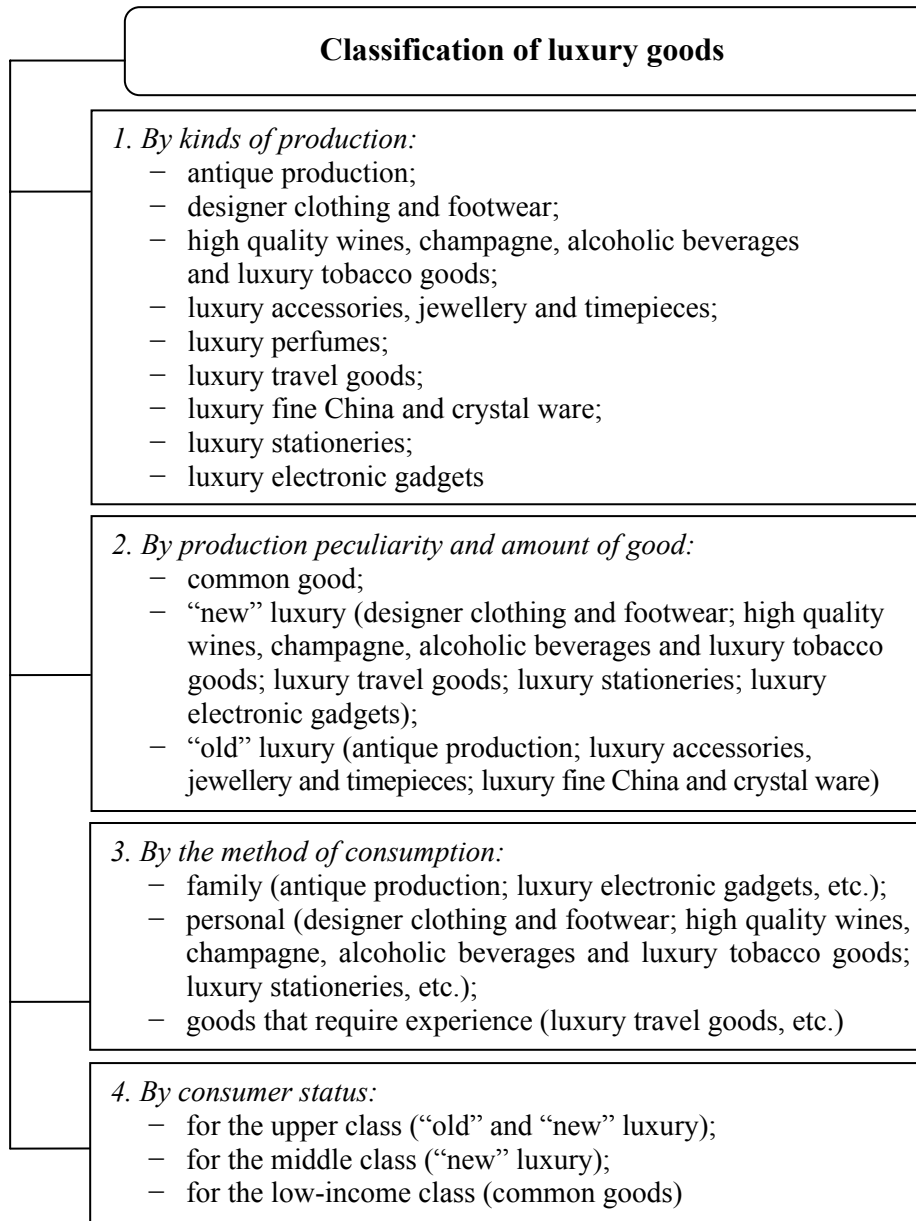


Figure 3. Classification of luxury goods

## 2. Model readiness of the population to consume luxury goods

It was proposed to build a linear model to predict the readiness of the population to purchase luxury goods based on their expenses. We proposed two models for Ukraine and Poland. The dependent variable  $Y$  chosen to represent the population's expenses on goods and services. The following independent variables were chosen: population's income –  $X_1$ , growth rates of the reasonable subsistence –  $X_2$ , correlation of active population to the total population of the country –  $X_3$ , unemployment rate –  $X_4$ , inflation rate –  $X_5$ .

The prediction model of Ukrainian's readiness to purchase luxury goods is based on the data in Table 1.

Table 1

The data to construct the prediction model of Ukrainian's readiness to purchase luxury goods

Year	Y	$X_1$	$X_2$	$X_3$	$X_4$	$X_5$
	Population's expenses on goods and services, thousands hrn.	Population's income, thousands hrn.	Growth rates of the reasonable subsistence, %	Correlation of active population to the total population of the country, %	Unemployment rate	Inflation rate
2000	59858	86833	115,2	46,36	11,6	25,8
2002	153589	185073	109,9	53,25	9,6	-0,6
2004	221713	274241	105,9	52,74	8,6	12,3
2006	385681	472061	107,1	47,87	6,8	11,6
2008	695618	845641	120,3	48,49	6,4	22,3
2009	709025	894286	118,4	53,42	8,8	12,3
2010	838213	1101175	117,7	53,56	8,1	9,1
2011	1030635	1266753	108,4	53,61	7,9	4,6

Source: State Statistics Service of Ukraine, <http://ukrstat.gov.ua/>.

The analyses of the pair correlation coefficients showed that the dependent variable, than is the population's expenses on goods and services, has a close relationship with the population's income, the growth rates of the reasonable subsistence and the correlation of active population to the total population of the country, which in to indicates the presence of multicollinearity. The linear model of the dependence of the Ukrainian population's expenses on goods and services on the population's income, on the growth rates of the reasonable subsistence and on the correlation of active population to the total population of the country is as follows:

$$Y = 0,81X_1 - 1711,65X_2 - 2573,68X_3 + 316949,45 \quad (1)$$

correlation coefficient:  $R = 0,99$ , standard error:  $\Delta = 22761,4$ .

The comparison of the experimental data and data of the model is shown in Figure 4.

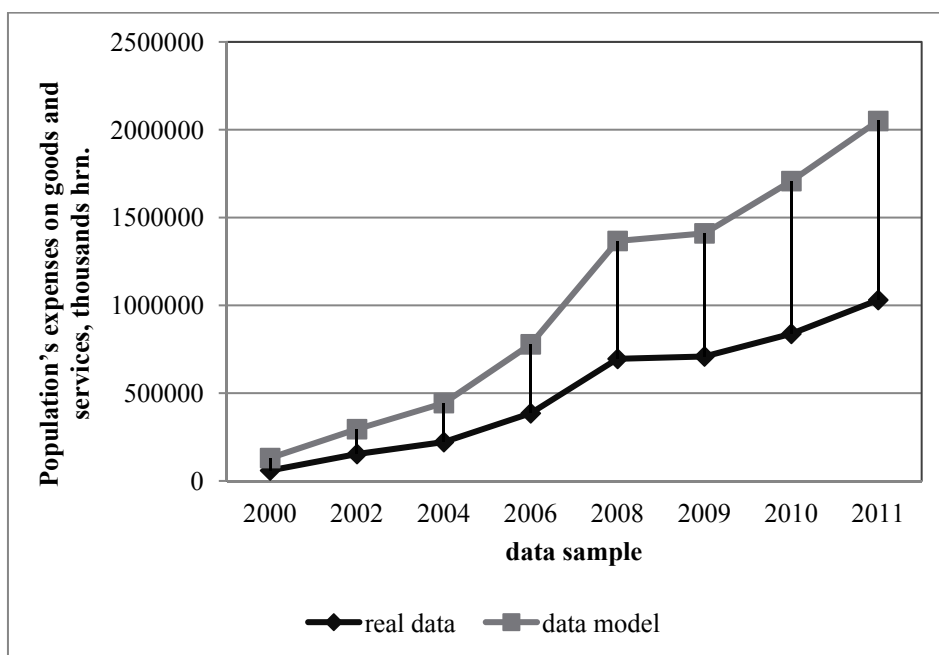


Figure 4. Shift in expenses curve of the Ukrainian population for goods and services, based on actual data and data of the model

The Figure 4 shows that data of the model and actual data do not coincide, there is a disagreement. It is necessary to conclude that the Ukrainian population's expenses on goods and services increase due to the changes in people's income, in the growth rates of the reasonable subsistence and the correlation of active population to the total population size. But, in recent years the opportunity of the Ukrainian population to purchase luxury goods has increased by 8,7 times compared to the year of 2000. The analyses of the data in table 2 gave us possibility to construct a prediction model of the Polish population's readiness to purchase luxury goods.



Table 2

The data to construct the prediction model of Polish population's readiness to purchase luxury goods

Year	Y Population's expenses on goods and services, zł/1 person	X <sub>1</sub> Population's income, zł/1 person	X <sub>2</sub> Growth rates of the r easonable subsistence, %	X <sub>3</sub> Correlation of active population to the total population of the country, %	X <sub>4</sub> Unemployment rate	X <sub>5</sub> Inflation rate
2000	2872	4465	111,29	56,57	16,1	8,5
2002	3440	5179	103,77	55,41	19,9	0,8
2004	4296	6444	104,9	54,7	19	4,4
2006	5580	8724	100,1	54	13,8	1,4
2008	8530	13580	105,14	54,22	7,1	4,2
2009	6876	10876	107,81	54,92	8,2	3,5
2010	7524	11809	106,5	55,76	9,6	2,6
2011	8225	13029	105,95	56,31	9,6	4,3

Source: Central Statistical Office, [http://www.stat.gov.pl/gus/index\\_ENG\\_HTML.htm](http://www.stat.gov.pl/gus/index_ENG_HTML.htm)

Having assessed of the pair correlation coefficients, we determined that the Polish population's expenses on goods and services have a close relationship with the population's income and the correlation of active population to the total population of the country, which indicates the presence of multicollinearity.

Dependence of the Polish population's expenses on goods and services on the population's income and on the correlation of active population to the total population of the country is described by the linear model, which is as follows:

$$Y = 0,61X_1 - 19,35X_3 + 1315,69 \quad (2)$$

correlation coefficient:  $R = 0,99$ , standard error:  $\Delta = 70,55$ .

For the purpose of comparison, the experimental data and the data of the model are illustrated in Figure 5.

The data of the model and actual data do not coincide, the discrepancy can be observed, which is actually confirmed by Figure 5. Hence, it appears that the Polish population's expenses on goods and services increase due to the changes in people's income and the correlation of active population to the total population size. In recent years the opportunity of the Polish population to purchase luxury goods increases by 3 times compared to the year of 2000.

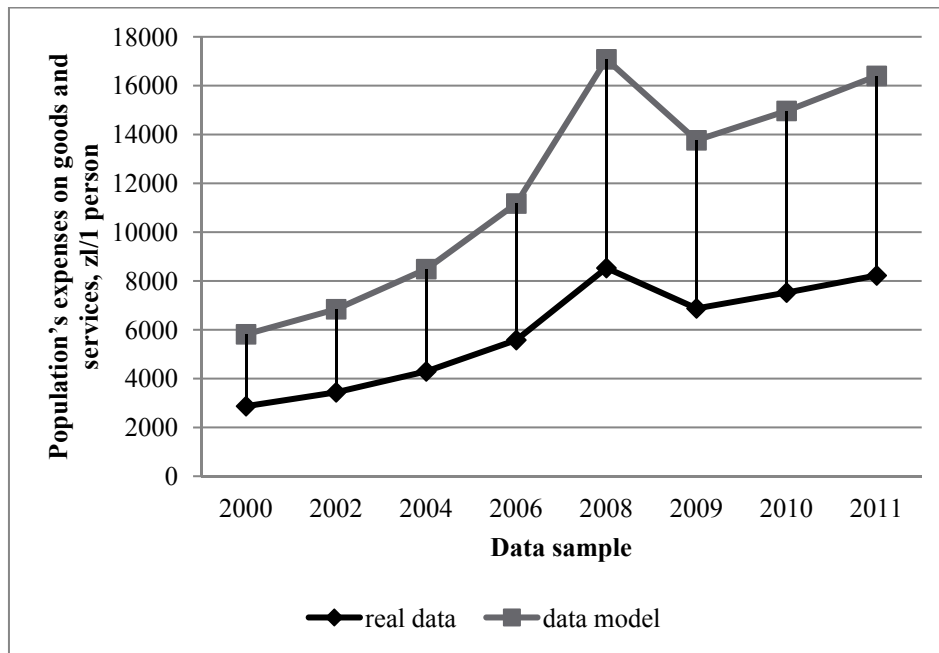


Figure 5. Shift in expenses curve of the Polish population for goods and services, based on actual data and data of the model

Thus, the correlation and regression analyses of the dependence of expenses on goods and services in Ukraine and Poland indicated that these expenses depend on the following: the people's income, the growth rates of the reasonable subsistence and on the correlation of active population to the total population size in Ukraine; on the people's income and the correlation of active population to the total population of the country in Poland. Also, the opportunity to purchase luxury goods increased the most among the Ukrainians.

Although the performed analyses showed the high possibility of the Ukrainian population to purchase luxury goods, the data of the company Euromonitor<sup>12</sup> does not reflect this opportunity in the geographical structure of expenditures on goods and services for the year of 2011. In this structure Poland takes 0,6% as to the purchasing luxury goods to the total global expenses on them. This data is illustrated in Figure 6.

<sup>12</sup> Euromonitor International, <http://www.euromonitor.com/>.

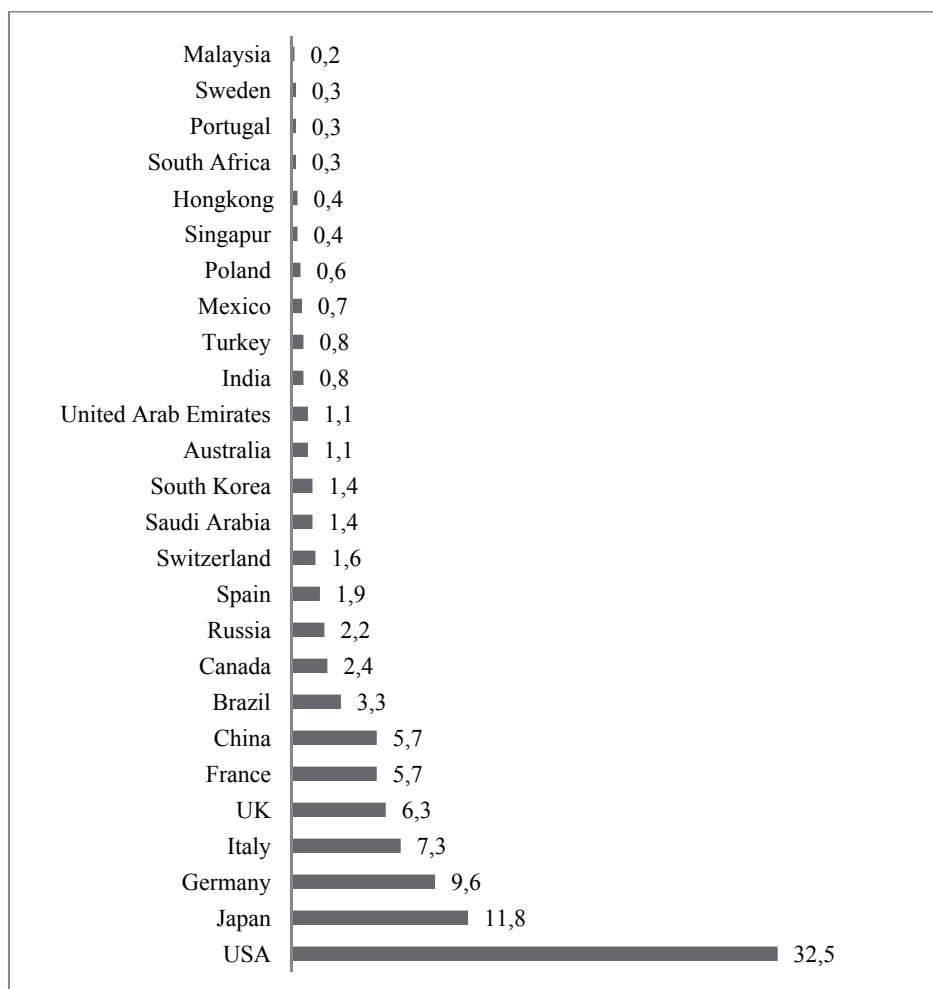


Figure 6. The geographical structure of expenditures on goods and services for the year 2011

Source: Euromonitor International, <http://www.euromonitor.com/>.

In Figure 6 we see that the leader of purchasing luxury good are the populations of the USA, Japan, and Germany.

To determine the reasons of such tendency we have investigated the peculiarities of the development and the need for the consumer buying process in Ukraine and Poland.

The development of the Ukrainian luxury market began in 1990. By 2003, the market worked erratically, the most luxury products were sold unofficially. The majority of Ukrainian consumers were buying luxury goods abroad. The

luxury society<sup>13</sup> indicated that in the period from 2004 to 2008 there was the most dynamic growth of the luxury market, reaching estimated 60-70% annually. The highest consumption peak by the Ukrainians occurred in 2006, when the revenue of the market totaled 500 million euros. At the same time the demand was outgrowing supply and the Ukrainian consumers were queuing to purchase expensive luxury goods. It was then, that the most official distributors of luxury goods appeared on the Ukrainian market.

The economic recession has affected demand for luxury goods. The interminable political instability also influenced the decline of the demand for them.

Today the relative stability can be observed and the consumers begin to make their usual purchases. In 2012 there was a significant increase in sales of luxury goods.

Hence it can be concluded why Ukraine was not included into the structure of expenditures on luxury goods for the year 2011 according to the company Euromonitor<sup>14</sup>. This is due to the dearth of luxury goods in Ukraine and mass purchasing of such goods abroad because of the lack of most products in Ukraine.

The research done by KPMG<sup>15</sup> showed that Poles depending on their status spend on luxury goods respectively: with high income status – 18%; middle – 15%; low – 9% of their own incomes. Thus, it makes up on average the following expenses incurred by citizens: high income status – 27000 zloty, middle – 5700 zloty, low – less than 2000 zloty a year.

Expenses on luxury goods in Poland increased by 4,4% over 2011. The major fact that forced the growth of expenses on luxury goods was the increase in income per head by 1,1%. We believe that the reason for a low share in the structure of world's expenses on luxury goods is population size (almost 5 times less than in the USA and Russia) and correlations between citizen's status.

A peculiarity of high demand for luxury goods in Ukraine is the citizens' wish to confirm their high status. The majority of European consumers, including Poles, buy luxury goods for themselves.

In the past two decades the definition of luxury developed from inaccessible into allowable. Thus, the classification considered by us has been confirmed, i.e. "old" luxury changes over the course of time into a "new" one and "new" luxury changes, in its turn, into common goods. Nowadays, not only citizens with high status have an opportunity to consume luxury goods, but also these ones with middle and low status and that is a world's trend.

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<sup>13</sup> Luxury Society, <http://luxurysociety.com/>.

<sup>14</sup> Euromonitor International, <http://www.euromonitor.com/>.

<sup>15</sup> KPMG in Poland, <http://www.kpmg.com/pl/en/pages/default.aspx>.

## **Conclusions**

After the goods classification has been investigated, it was determined that there isn't a single approach to it in scientific literature. That's why we offered a classification with diving into 4 subgroup. We think that such approach will help to estimate population's possibilities of any country correctly and it will give a chance to determine their socioeconomic status.

The constructing of linear dependence model of expenses on goods and services in Ukraine and Poland gave us an opportunity to evaluate their readiness to purchase goods and luxury. It is shown that examined countries have possibilities to buy such goods although only Poland is represented in the structure of world's expenses on luxury goods. It is determined that Ukrainian population purchases luxury goods mainly abroad in connection with their low supply in the middle of the country.

Thus, it is offered to increase supply of luxury goods in the market of examined countries at par. This offer will help the population of these countries to purchase without going abroad. For the country in whole it will help to increase its share in the structure of world's expenses on luxury goods without spending more than at the present stage. That is why the examined countries should sign agreements about their presence in the home market of luxury goods brands at the state level. These steps will help to attract capital inflow into the country.

## **LUXURY AS AN INDICATOR OF THE COUNTRY'S ECONOMIC DEVELOPMENT**

### **Summary**

The essence of the conception "luxury goods" is considered in this article. The classification of luxury goods with taking into consideration citizens' status of the country is considered and offered. The constructing of linear model to evaluate readiness to purchase goods and luxury by Ukrainian and Polish population is carried out. Modern conditions of luxury goods market development in the examined countries are estimated. Ways of perfection of supply and demand of luxury goods in home markets of Ukraine and Poland are offered.