Institute for Empirical Research in Economics
University of Zurich

Working Paper Series
ISSN 1424-0459

Published in:

Working Paper No. 5

Social Comparisons, Inequality, and Growth

Markus Knell

April 1999
Social Comparisons, Inequality, and Growth

Markus Knell
Institute for Empirical Research in Economics
University of Zürich*

Revised Version: July 1999

Keywords: Income inequality; Growth; Consumption externalities;

General field: Macroeconomics

JEL classification: E21; O40; D30

* I am grateful to Giuseppe Bertola, Michael Kosfeld, Arno Riedl, two anonymous referees and in particular to Simon Gächter and Josef Zweimüller for valuable comments and discussions.
Abstract

Over the recent years one could repeatedly hear the claim that a rising concern for relative standing (in terms of consumption) was partly responsible for the decline in household savings and in growth that could be observed in some developed countries (particularly in the US) and that the rise in income inequality had further aggravated this process.

In this paper we want to analyze under which conditions (concerning the importance of social comparisons for peoples' behavior and their choice of reference groups) this claim is valid. We show that an increase in a societies' concern for relative standing aggravates a negative impact of inequality on growth if two conditions are fulfilled: individuals have a higher concern for their present than for their future relative standing and individuals have a tendency to find their reference groups among people that are wealthier than they are themselves.

Empirical data suggest that the negative impact of inequality on growth is stronger in highly developed economies. This is compatible with the explanation that is presented in this paper if individuals living in highly developed countries are more likely to have a high concern for relative standing. We will argue (using research on the cultural consequences of economic development) that this is a reasonable assumption to make.
References


<table>
<thead>
<tr>
<th></th>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Largest poss. sample</td>
<td>High-Income sample</td>
<td>Low-Income sample</td>
</tr>
<tr>
<td></td>
<td>(N=83)</td>
<td>(N=41)</td>
<td>(N=42)</td>
</tr>
<tr>
<td>Const.</td>
<td>0.0159</td>
<td>0.0488</td>
<td>0.0102</td>
</tr>
<tr>
<td></td>
<td>(1.54)</td>
<td>(2.23)</td>
<td>(0.735)</td>
</tr>
<tr>
<td>GDP60</td>
<td>-0.0046</td>
<td>-0.0057</td>
<td>-0.025</td>
</tr>
<tr>
<td></td>
<td>(-3.42)</td>
<td>(-3.51)</td>
<td>(-1.77)</td>
</tr>
<tr>
<td>PRIM60</td>
<td>0.04</td>
<td>0.0303</td>
<td>0.05</td>
</tr>
<tr>
<td></td>
<td>(5.6)</td>
<td>(2.31)</td>
<td>(4.08)</td>
</tr>
<tr>
<td>GINI</td>
<td>-0.0376</td>
<td>-0.0841</td>
<td>-0.011</td>
</tr>
<tr>
<td></td>
<td>(-1.833)</td>
<td>(-2.66)</td>
<td>(-0.385)</td>
</tr>
<tr>
<td>$R^2$</td>
<td>0.28</td>
<td>0.272</td>
<td>0.27</td>
</tr>
</tbody>
</table>

Figure 1
Impact of an increase in equality on the growth rate in regime RG3 with $\alpha=1$ and for different values of $\theta_1$.

(In)equality is measured as: $q = \frac{w^\rho}{\bar{w}}$. The growth rate is defined as in equation (2.6), where the following parametrization was used: $\alpha=1$, $\rho=1$, $p=0.8$, $\bar{w}=100$, $B=5$, $k=0.5$ and $\theta_1$ varies from 0.2 to 0.6.
Figure 2
Impact of an increase in equality on the growth rate in regimes RG1, RG2 and RG3 with $\alpha=1/2$ and $\theta_2=0$.

The parametrization is the same as in the example of Figure 1, only that now: $\alpha=1/2$, $\theta_1 = 0.2$ and $\theta_2 = 0$. 
Figure 3
Individualism and GDP

Data Sources: GDP70 (Barro/Wolf, 1989); Individualism Index (IDV) (G. Hofstede, 1982, p. 158).