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Knell, Markus

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Social Comparisons, Inequality, and Growth

Markus Knell

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Social Comparisons, Inequality, and Growth

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

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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 then 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.

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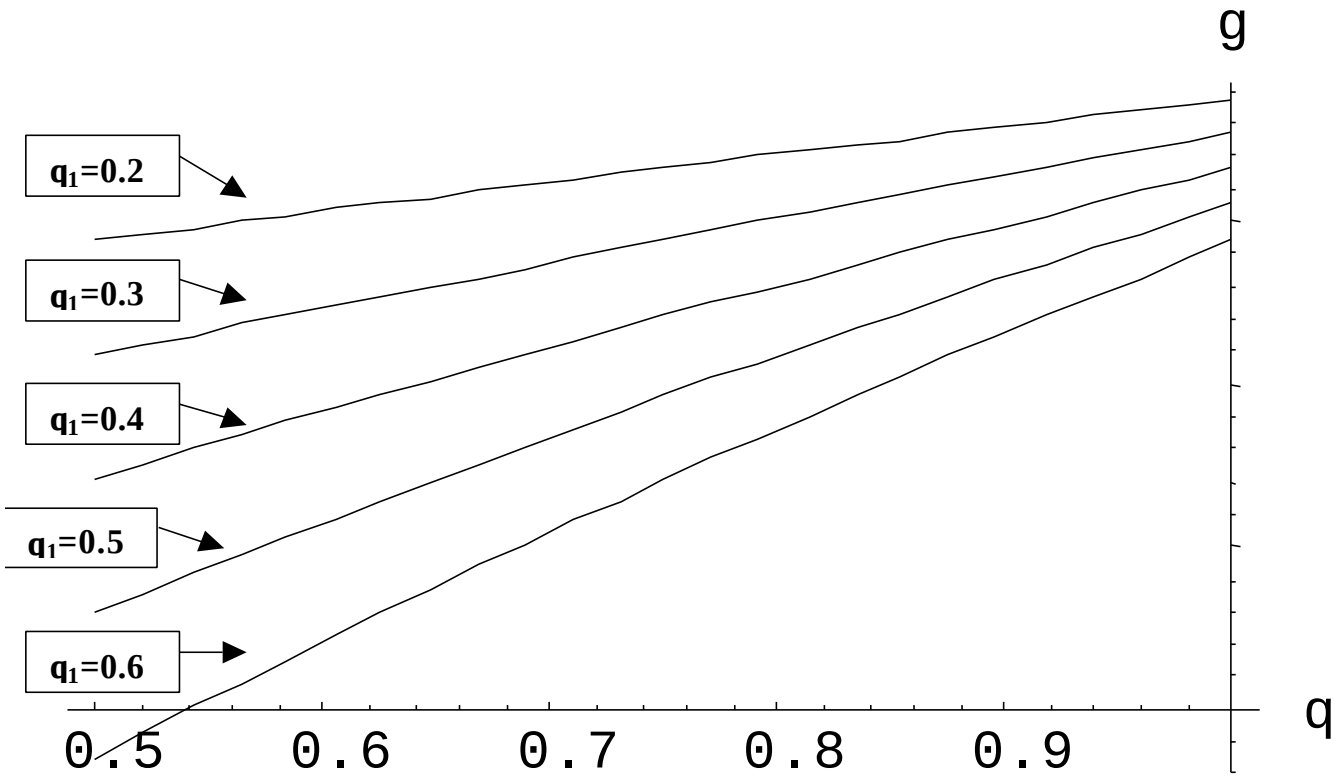
Table 1
Impact of inequality on growth in high-income and low-income countries

GR6085			
	(1)	(2)	(3)
	Largest poss. sample (N=83)	High-Income sample (N=41)	Low-Income sample (N=42)
Const.	0.0159 (1.54)	0.0488 (2.23)	0.0102 (0.735)
GDP60	-0.0046 (-3.42)	-0.0057 (-3.51)	-0.025 (-1.77)
PRIM60	0.04 (5.6)	0.0303 (2.31)	0.05 (4.08)
GINI	-0.0376 (-1.833)	-0.0841 (-2.66)	-0.011 (-0.385)
$\bar{R}^2$	0.28	0.272	0.27

Dependent variable: average per capita growth rate 1960-1985; Data sources: Barro/Wolf (89) [GR6085, GDP60, PRIM60]; Deininger/Squire (1996) [Gini, average value]. T-statistics in parentheses. Own Calculations.

Figure 1

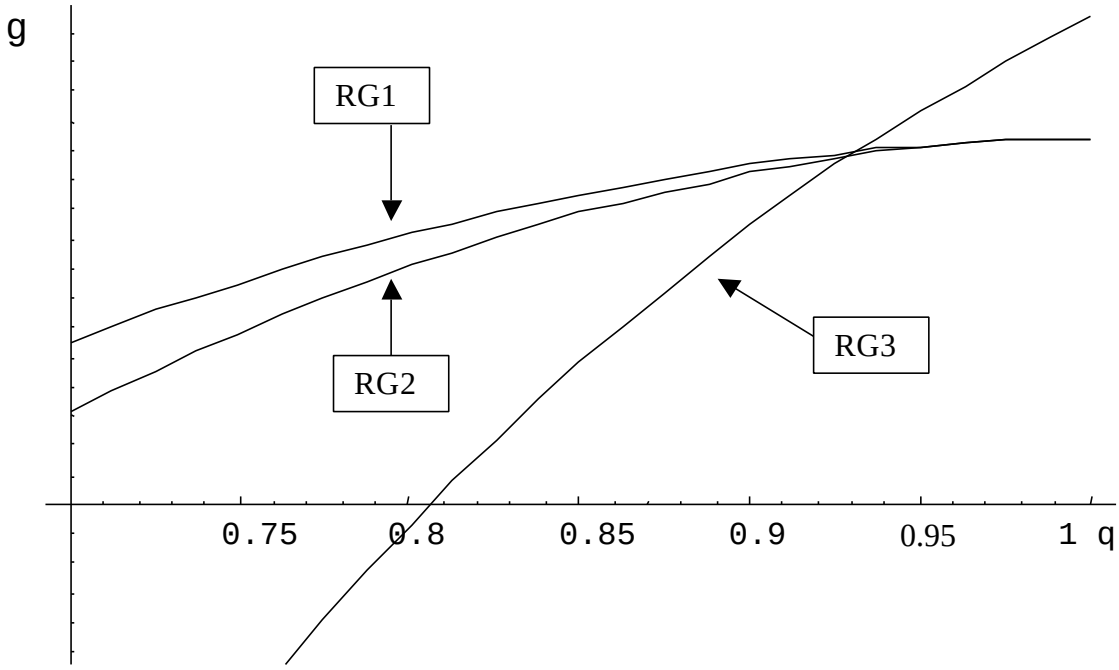
Impact of an increase in equality on the growth rate in regime RG3 with a=1 and for different values of q_1.



(In)equality is measured as: $q=\frac{w^p}{\overline{w}}$. The growth rate is defined as in equation (2.6), where the following parametrization was used: α=1, ρ=1, p=0.8, $\overline{w}=100$, B=5, k=0.5 and θ_1 varies from 0.2 to 0.6.

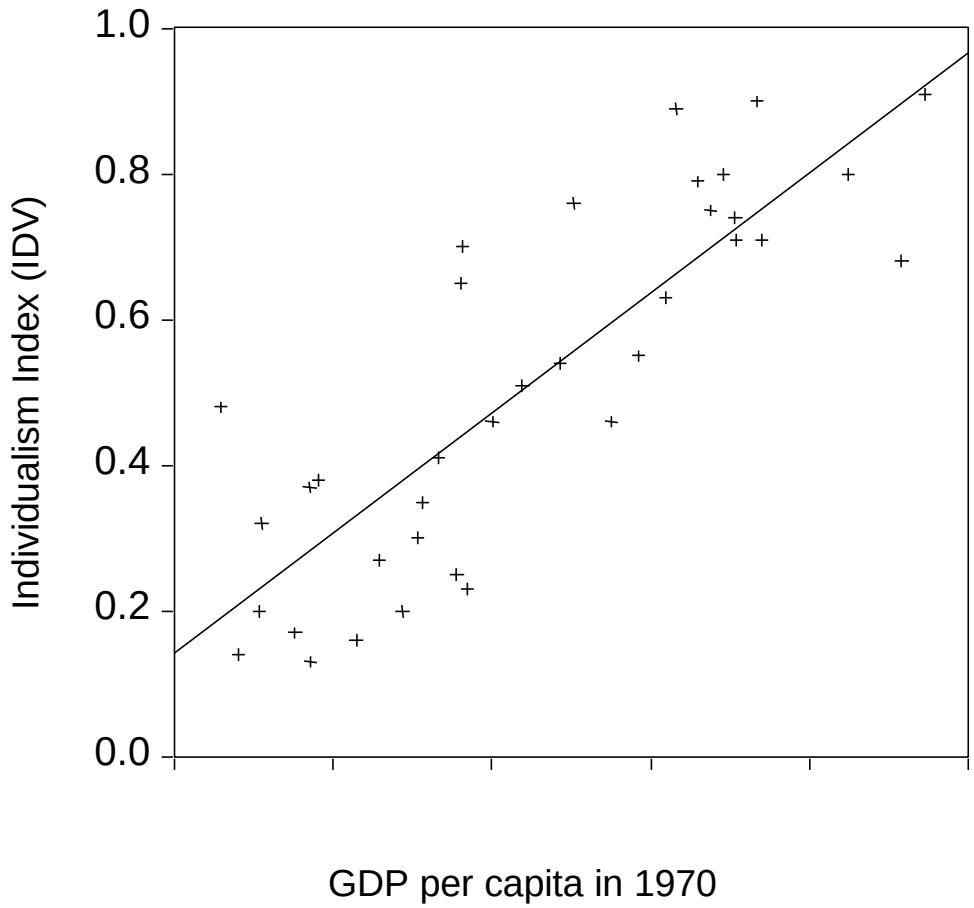
Figure 2

Impact of an increase in equality on the growth rate in regimes RG1, RG2 and RG3 with a=1/2 and q_2=0.



The parametrization is the same as in the example of Figure 1, only that now: α=1/2, θ_1 = 0.2 and θ_2 = 0.

<u>Figure 3</u>
Individualism and GDP



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