

## **Conspicuous Consumption and Generation Replacement in BY-OLG and RA Models**

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### **Abstract.**

This paper investigates household decisions in an overlapping generations model in which individual utility depends on a weighted average of consumption of ones peers. In contrast to representative agent economies, the consumption externality generally affects savings and growth rates. The effects critically depend on the rate at which labor productivity changes with age. For a high (low) rate, the externality lowers (raises) the steady state propensity to consume out of total wealth. The optimal allocation can be decentralized by a (reverse) unfunded social security system if the rate of labor productivity decline is high (low). In contrast to discrete time OLG models, the optimal steady state capital income tax is zero, in spite of the externality.

The results not only hold true for “neoclassical technology” but also for “AK technology”. Eventually, it is shown that the prior literature investigating the effects of conspicuous consumption by representative agent (RA) models is mistaken. Contrary to results in the prior literature, the results presented here carry over to RA economies.