



Conspicuous consumption and political regimes: Evidence from East and West Germany



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ABSTRACT

This paper investigates the influence of political regimes on the relative importance of conspicuous consumption. We use the division of Germany into the communist GDR and the democratic FRG and its reunification in 1990 as a natural experiment. Relying on household data that are representative for Germany, our empirical results strongly indicate that conspicuous consumption is relatively more important in East Germany. Significantly, although we find some convergence, a considerable gap in conspicuous consumption expenditures remains even 18 years after the German reunification.

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1. Introduction

A large segment of economics research is devoted to designing institutions in order to induce socially desirable choices for given preferences of decentralized agents. However, the institutions themselves may also affect preferences.¹ After more than four decades of separation, the reunification of the communist German Democratic Republic (GDR) and the democratic Federal Republic of Germany (FRG) in 1990 constitutes a unique situation that allows us to explore the potential influence of political institutions on preferences in a natural setting.²

The present paper explores whether the political regime influences preferences by adopting the consumption patterns of households in East and West Germany as the object of study, using a representative dataset covering the period from 1993 to 2008. In particular, we are interested in the importance of so-called *conspicuous consumption*. Conspicuous consumption, a concept that can be ascribed to Veblen (1899), refers to consumption that is intended to communicate one's economic status to others. The category of conspicuous consumption reflects the observation that people compare themselves to others in a multitude of ways, with relative performance being important for subjective

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¹ Such an influence is discussed by Cooter (1998), Fehr and Hoff (2011), and Hwang and Bowles (2011), among others.

² Within this paper, we refer to the political environment of the GDR using the term “communism”.

well-being.³ In the attempt to establish one's economic status relative to others, consumption is often used as a signal. This finding has been derived theoretically by [Corneo and Jeanne \(1998\)](#) and supported empirically by [Heffetz \(2011\)](#), among others. The importance of this type of consumption is due to the fact that many consumption choices (such as which car to drive) are easily observable by others, whereas aspects such as financial wealth cannot be readily observed. Goods that are particularly suited for conspicuous consumption given their impact on social rank are commonly referred to as *positional goods*.⁴ The fact that positional concerns are important and that goods differ with regard to their positionality (i.e., certain goods have a higher relevance for relative standing in society) has been confirmed in several empirical studies.⁵ Our analysis complements these studies by investigating non-experimental consumption patterns from East and West Germany.

The different political regimes experienced by East and West Germans may have shaped their preferences with regard to conspicuous consumption for several reasons. First, in contrast to the experience of West Germans, the communist regime severely limited people's choice sets, thereby restricting the possibilities to signal status through the selection of the upscale product variety (see, e.g., [Fulbrook, 2009](#)). Moreover, the consumption of conspicuous goods in East Germany was often seen as an indicator of collaboration with the state security service (*Staatssicherheit*), as access to such goods was generally restricted to the politically privileged (see, e.g., [Fulbrook, 2009](#); [Schäffgen, 1998](#)); this created the potential for social isolation and stigmatization. In addition, the ideology of the GDR (which portrayed itself as a nation of workers and peasants) included the idealization of the working class, presenting an additional contrast to West Germany with probable repercussions for the relative importance of conspicuous consumption (see, e.g., [Fulbrook, 2009](#)). Moreover, the unobserved heterogeneity in economic success was significantly smaller in East Germany, given the system's emphasis on egalitarianism within and across professions. Consequently, there were substantially smaller differences in individual economic achievements in comparison to West Germany. For instance, in the GDR in 1988, the average net income of individuals with a university degree was 15% higher than that of blue-collar workers, while in West Germany this difference amounted to 70% ([Schäffgen, 1998](#)). As a result, people from East and West Germany were habituated in very different conditions with respect to the use of consumption to reveal one's economic status to others.

Taking for granted the validity of our identifying assumption that observable differences in behavior are driven by the populations' experiences under the different political regimes for a moment (we will provide a detailed discussion in [Section 2](#)), we now consider possible hypotheses. We would not observe any systematic differences between East and West Germany after reunification when controlling for factors such as household income, socio-economic household characteristics, education, and the distribution of income in the state (*Bundesland*) of residence if the political regime had no effect on individual preferences. Alternatively, if the regime had an effect, in principle two directions are possible. One possibility is that people in East Germany would emphasize conspicuous consumption more than individuals in West Germany, perhaps in an attempt to make up for the restricted choices they experienced before reunification. Another reason to expect conspicuous consumption to be more important for East Germans after reunification is that East Germans seem less likely to attribute economic outcomes to luck than people from West Germany (see [Alesina and Fuchs-Schündeln, 2007](#)). This perception of the determinants of economic success also corresponds with the finding that more East Germans believe in the importance of hard work ([Corneo, 2001](#)). When differences in economic outcomes are perceived to be driven by differences in ability and/or effort, this could support the impulse to signal one's economic success to others. The opposite hypothesis is that people might have internalized the emphasis on egalitarianism of the political regime in the GDR (at least to some extent) and would thus be less inclined to distinguish themselves from their peers by engaging in conspicuous consumption. Models of conspicuous consumption usually consider a setting in which everybody knows that a given individual belongs to a group for which the distribution of income levels is commonly known (see, e.g., [Bilancini and Boncinelli, 2012](#); [Charles et al., 2009](#); [Glazer and Konrad, 1996](#)). With regard to the distribution of income in divided Germany, it is clear that inequality was much lower in the GDR than in the FRG; this continued to be the case for a brief period after reunification as well ([Fuchs-Schündeln et al., 2010](#)). However, inequality in real household market income in East Germany overtook that in West Germany some years after reunification (see, e.g., [Grabka et al., 2012](#)). However, such differences in inequality are not easily translatable into hypotheses about conspicuous consumption in East and West Germany, since theoretical predictions concerning the impact of low levels of inequality are conditional on the modeling.⁶ One could argue that conspicuous consumption should be a relatively more important phenomenon in West Germany, given that average earnings are higher in the West (e.g., [Corazzini et al., 2012](#); [Hopkins and Kornienko, 2004](#)).

This paper uses a dataset covering the period from 1993 to 2008 that is representative for Germany and includes household characteristics, a detailed breakdown of household expenditures, and information about household income. Our empirical results indicate that there are indeed significant differences between consumption patterns in East and West Germany, and that these differences support the hypothesis that conspicuous consumption is relatively *more* important in

³ For instance, [Dohmen et al. \(2011\)](#) provide evidence for the importance of relative income for subjective well-being using functional magnetic resonance imaging (fMRI). Further empirical evidence of the importance of relative income positions for individual happiness and actions can be found in [Stutzer \(2004\)](#) and [Frey et al. \(2008\)](#).

⁴ The expression "positional good" was first introduced by [Hirsch \(1976\)](#) and has been taken up by other scholars, including [Frank \(1985a, 1985b, 2008\)](#) and [Solnick and Hemenway \(1998, 2005\)](#). Cars are usually considered a prime example of a positional good. Along these lines, [Winkelmann \(2012\)](#) establishes for Switzerland that the prevalence of luxury cars in an individual's own municipality decreases income satisfaction, and [Kuhn et al. \(2011\)](#) find that the neighbors of people who have won a car in the lottery have significantly higher levels of car consumption than the general population.

⁵ See, for example, [Alpizar et al. \(2005\)](#), [Carlsson et al. \(2007\)](#), [Carlsson and Qin \(2010\)](#), [Caporale et al. \(2009\)](#), [Clark et al. \(2008\)](#), [Clark and Senik \(2010\)](#), [Hillesheim and Mechtel \(2013\)](#), [Johansson-Stenman et al. \(2002\)](#), [Solnick and Hemenway \(1998, 2005\)](#), and [Solnick et al. \(2007\)](#).

⁶ [Bilancini and Boncinelli \(2012\)](#) show that whether the status function is ordinal or cardinal decisively influences the impact of greater equality on consumption expenditure. In [Glazer and Konrad \(1996\)](#), the result hinges on the curvature of conspicuous consumption as a function of income.

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