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Aspirations, Health and the Cost of Inequality*

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Abstract

How does inequality motivate people and at what cost? In a model of perpetual youth, people have heterogeneous upward-looking aspirations. They value their consumption relative to the conditional mean of those above them in the distribution; their survival depends on health capital produced from time investment and health goods. Higher fundamental inequality, working through the aspirations gap, motivates people to work and save more. Economic outcomes improve but income and consumption inequality worsen because the poor have less capacity to respond on the labor market. By diverting resources from health production, aspirations also worsen mortality, especially for the poor. Though relative income has a strong negative effect on personal health, inequality has a weak effect on population health, explaining an empirical puzzle on the relative income and health gradient.

KEYWORDS: Inequality, Aspirations, Consumption externality, Health, Grossman model, Relative income and health gradient, Heterogeneous agents

JEL CLASSIFICATION: D31, D91, I14, J20

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