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Consumption habits and the distribution of wealth in an OLG model

In the paper, we analyze the role of dependent preferences in the form of external consumption habits in shaping the distribution of wealth. This idea assumes that consumers assess utility of their consumption relative to consumption in some reference group. We use a realistic overlapping generations model with parameters calibrated to match key features of Polish economy. The results of the simulation experiments show that in most cases introducing habits decreases wealth inequality slightly or moderately. However, if the mean consumption in the whole population is taken as the reference point and the habit strength is high a substantial increase in wealth concentration is observed, mainly because of a large fraction of hand-to-mouth consumers. It is also shown that the reference group cannot comprise consumers in the same age alone as it generates unrealistic age-consumption profiles.