

## **Economics Seminar, Indian Statistical Institute, New Delhi.**

**SPEAKER:** Debraj Ray, New York University

**TITLE:** Status, Intertemporal Choice and Risk-Taking

**TIME:** 11:30 - 1:00 P.M.

**DAY & DATE:** Friday, November 13th, 2009

**PLACE:** Seminar Room 2, New Building

### **Abstract:**

This paper takes the position that an individual's concern for relative status is expressed in her preferences. We embed this hypothesis in an otherwise conventional model of economic growth, and examine its consequences. The model generates two kinds of equilibrium. In the first, all individuals always follow a deterministic consumption and investment strategy. Such a strategy must be linear in output, is independent of payoffs and technology, and depends only on the discount factor. This sort of equilibrium exists when the individual cares only about status and the individual production function is convex in investment. In contrast, the other kind of equilibrium involves a long run steady state in which there is persistent and endogenously generated gambling. This kind of equilibrium exists in circumstances that are at once more general and more plausible. The individual has a utility function that may depend on consumption per se as well as the implied status. However, the individual investment functions are concave. We characterize the unique steady state in such a situation, and prove that any dynamic equilibrium path must converge to it.

The model obtains risk-taking not from the presumption of a utility function with strictly convex segments (as in Friedman-Savage), but naturally from a view of utility as depending on relative status. Our steady state is broadly consistent with the stylized facts that individuals are prone to both insure downside risk and to gamble over upside risk. The model generates plausible patterns of risk-taking and avoidance across environments with quite different overall wealth levels. Finally, in contrast to Friedman (1953), endogenous risk-taking here is generally Pareto-inefficient.

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