

Chapter 2

Popular Culture and Peer Effects in Consumption: Survey of Economic Consequences

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ABSTRACT

People are not living in isolation and they are largely affected by the people around themselves. People's consumption decisions are also influenced by the decisions and actions of their peers, what is called "consumption peer effects." In the last decades there have been two major changes in the social and economic life that has affected masses: the internet revolution and the rise in inequality. Consequently, peer effects have become more important in consumption decisions and so has been its aggregate impact. This chapter provides a survey on consumption peer effects and its economic consequences by relying on recent empirical findings. It starts with a discussion on peer effects and conspicuous consumption, why and how comparisons are made, and how culture affects peer effects. Following is a discussion on the recent changes in the popular culture, their effect on peer effects and the resulting consequences. The chapter concludes with some policy recommendations.

INTRODUCTION

Evidence from social psychology, neuroscience, econometrics, and experimental economics indicates that people observe those around themselves and select a *reference group* with whom they compare themselves. The reference group is basically used as a standard to evaluate oneself and the outcome of that engagement reflects on one's sense of well-being. Consequently, people's decisions are influenced by the decisions and actions of this reference group. This indicates the presence of what is called *peer effects* which can also referred to as *social interactions effects*.¹

There is a large literature on peer effects. This literature shows that the behavior of the reference group has a significant impact on important decisions such as how to allocate leisure time, which job to choose, how to spend money, what to consume or even choices such as whether to get married or not, or

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how many kids to raise. Hence peer effects have many consequences as they influence people's choices on labor, leisure and consumption. In this chapter we intent to look into the impact of peer effects with a focus on the economic outcomes and especially in relation to its effect on consumption decisions. We provide a review of the findings on consumption peer effects and bring into attention its growing impact in today's popular culture.

When peer effects are present, people start comparing their own consumption with that of others. In such a situation, an individual will engage in consuming more than he/she otherwise would. This behavior is referred to as "conspicuous consumption", introduced to the literature by Veblen (1899). It is based on the thesis that besides consumption, individuals also gain certain utility by their status in society. So, in addition to the utility gained by consuming a specific good, the change in status (or relative ranking) in the social hierarchy gained through consuming that good also becomes important in individuals' consumption decisions. Hence, to create a perception of higher status, individuals may increase their consumption of certain products considered symbols of high status, or imitate the consumption patterns of those in higher income classes.

Reference group theory argues that individuals compare themselves to not just anyone, but to people who are similar in many respects, for example those who come from the same social group and have similar beliefs, values, income, and/or aspirations. Models of social preferences (i.e. Bolton and Ockenfels, 2000; Charness and Rabin, 2002; Fehr and Schmidt, 1999; Mui, 1995) predict that the poor envy the rich, and reference group theory predicts that the poor (and the rich) envy others from the same social group or class.

Although there is no standard in reference group determination, two main approaches stand out in the literature. The first approach, which can be called "proximity," relies on the assumption that comparisons are made with people nearby and argues that interaction is based on physical proximity. The second approach, which can be called "similarity," relies on the assumption that one compares oneself to those who have similar socio-demographic characteristics, such as being the same age, education level, race, and/or gender.

Today means of mass communication have eliminated physical boundaries and the importance of proximity. Moreover, it has created a common culture, what can be refer to as the "popular culture". Through social media, we no longer need to be close to others to see and observe them. We have gained access to and are influenced by the lifestyles of people kilometers and hours apart. We follow superstars, celebrities all over the world. Hence peer groups are redefined and people are influenced by their newly defined peer group(s) or by the popular culture. Another recent trend that ran parallel is the increasing trend in inequality. The question is how these two changes combined have affected the consumption behavior and specifically whether there has been increase in consumption peer effects.

In this chapter we try to address this question by drawing on the recent studies in the literature. After a conceptual introduction on peer effects we discuss the impact of peer effects relying on the empirical findings. We provide a rich survey on the studies on consumption peer effects with a focus on the associated economic consequences.

Firstly, we provide a conceptual background on peer effects and look into the reasons for conspicuous consumption. Specifically, we will discuss why individuals engage in this type of behavior. In doing so we will also discuss the nature of comparisons, specifically with whom people compare themselves. It is also important which products are consumed to signal status. The idea is that spending should be on items that are visible by other people. Heffetz (2011) created visibility indexes for different goods based on a telephone survey to determine which type of consumption was more striking. For example,

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