



Research Working Papers

Wealth in the Utility Function and Consumption Inequality

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Consumers' desire for wealth as an end in itself leads to a lower real interest rate, a higher equity premium, and greater consumption inequality.

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Wealth in the utility function (WIU) has been used recently in the literature and can be justified by a few theories, including Max Weber's (1904–05, German; 1958) theory on “spirit of capitalism.” We incorporate the WIU into a general equilibrium consumption-portfolio choice model to examine the effects on consumption inequality, equilibrium interest rate, and equity premium—an unexplored area in the literature. We provide closed-form solutions to help disentangle the effects of the WIU in driving the key results. Quantitatively, we show that a direct preference for wealth can improve the model's predictions in all three dimensions (consumption inequality, equilibrium interest rate, and equity premium) simultaneously. We show our results are robust to more general specifications on the income process and to incorporating macroeconomic rare disasters. Finally, we compare the WIU with a closely related hypothesis, habit formation, and find that they have opposite effects on equilibrium asset returns and consumption inequality.

JEL classifications: C61, D81, E21

Article Citations

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Related Research

- Luo, Yulei, Jun Nie, and Eric R. Young. 2020. “Ambiguity, Low Risk-Free Rates, and Consumption Inequality.” *Economic Journal*, vol. 130, no. 632, pp. 2649–2679. Available at <https://doi.org/10.1093/ej/ueaa045>
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