

Economics and Social Status

Abstract:

Social status is a social reward that affects the incentive structure facing individuals. If status is provided to educated people, more people will obtain an education. The choice of occupation is affected by the social status associated with different occupations, establishing a link between social status, the equilibrium wage structure and the allocation of workers among occupations. When status is not directly observed, people try to signal it by changing their consumption choices or behaviour. The narrow paradigm of *homo economicus* should be extended to include social status among the basic motivations for economic decisions.

People are social animals who care about their standing in society and about what other members of society think about them. Stated differently, people care about their 'prestige' or the 'respect' that they are accorded by individuals with whom they interact. Many people would gladly pay large sums of money for a knighthood. Similarly, the value of the Nobel Prize lies not entirely in the monetary prize itself; hence, we would not be surprised to find that many people might actually be willing to pay to obtain this prize. These observations on human nature are far from new. Hobbes, for example, wrote that: 'Men are continuously in competition for honour and dignity' (cited in Hirschman, 1973, p. 634).

While the focus of traditional economics has been on the monetary rewards that are exchanged through a market mechanism, sociologists have stressed social status and other social rewards as important motivations for human behaviour. The term 'social status' was first introduced by Max Weber as 'an effective claim to social esteem in terms of negative or positive privileges' (Weber, 1922, p. 305).

One of the important factors that distinguishes societies and determines their success is the form of the incentives they provide to their members. Generally speaking, there are three broad types of such incentives: (a) private monetary rewards,

such as wages and profits; (b) social rewards including status and prestige; and (c) rules, laws and regulations that enforce certain types of behaviour while penalizing others. Societies may differ in the mix of incentives and rules that they employ. This mixture has a significant effect on economic performance. Social status is thus part of the incentive structure provided to individuals in every society. These incentives affect an individual's choice of actions, occupation, education level and so forth. They thus are of significant economic importance (see also the review in Weiss and Fershtman, 1998).

If prizes, knighthoods and other status symbols were up for sale like any other commodity, their value would be deflated. The value of a medal, award or title will be small if it were obtainable by many people. Thus, the value of status symbols depends on the allocation rule that determines who is eligible to receive a particular symbol, who is excluded from eligibility, and the number (and certainly the identity) of its recipients. This property distinguishes social status from economic rewards. Giving a medal to one individual (may) reduce the medal's value for another individual. Social status may thus be viewed as the ranking of individuals, or groups of individuals, in society. This ranking may be based on personal attributes, actions, occupations or group affiliations. Yet, by definition, if someone climbs up in rank, someone else climbs down.

Ranking matters only if people agree on how ranking is established. For social status to matter, a society must generally agree about the relative position of its members. The crucial feature of social status is that it 'rests on collective judgement, or rather a consensus of opinion within a group. No one person can by himself confer status on another, and if a man's social position were assessed differently by everybody he met, he would have no social status at all' (Marshall, 1977, p. 198). An interesting – and relatively unexplored – issue is the role of social status in a multicultural society where every group maintains its own ranking, each of which may be affected by different characteristics. Fershtman, Hvide and Weiss (2005) have shown that the gains made from (social) trade in a culturally diverse society can be translated into higher output and wages.

The categories comprising social status are diverse. We can distinguish between 'status group' and 'individual status'. In the first category, originally conceived by Weber, social status is obtained by affiliation with a group, be it a social class, profession, club, etc. Members of the status group share a similar status. In the

second category, social status is obtained through individual attributes or actions. One should also distinguish between status that is acquired through specific actions or group affiliation and status that has been inherited. People may have social status simply by being born into an aristocratic class. The specific structure for gaining and maintaining status thus plays an important role in determining its effect on the economy.

One of the major problems in incorporating social status into economic models is that it is not directly observed. How do we measure status? How do we identify the ranking that determines who is perceived as important and who is not? And how do we quantify this ranking? Another task necessary for modelling is identification of the variables that affect social status. What determines social status in different societies? Conducting surveys by asking people to rank occupations according to their 'prestige' or to state which of the individual's attributes affects his or her social status has been the accepted method for responding to these questions. Treiman (1977), for example, found that the ranking of occupational status is stable over time and similar in different societies. Moreover, status rank has been found to be systematically dependent on occupational attributes; that is, occupations requiring high levels of education and providing high income also confer high social status.

Social Status and Consumption

Individuals may use consumption choices to signal that they have properties that affect their social status. The most familiar form of such signalling is 'conspicuous consumption', a signal relevant whenever relative wealth is a factor in determining social status. Yet the quest for social status may affect other consumption choices as well. For instance, individuals may buy and display books or go to the theatre to signal the level of education they have obtained. They may join clubs, buy a house or hire a maid if such actions signal their desired status.

The concept of 'conspicuous consumption' was first introduced by Veblen (1899), who argued that individuals often consume highly attention-getting goods and services in order to signal their wealth and thereby achieve greater social status. 'In order to hold the esteem of men it is not sufficient merely to possess wealth or power. The wealth and power must be put in evidence, for esteem is awarded only on evidence' (Veblen, 1899, p. 36). The extreme form of such behaviour is known as the 'Veblen effect', witnessed whenever individuals are willing to pay higher prices for

functionally equivalent goods (for a discussion, see also Leibenstein, 1950, and Frank, 1985a, 1985b). The Veblen effect may indeed be empirically significant in some luxury good markets (see Creedy and Slottje, 1991, and Heffetz, 2004).

Veblen distinguished between (a) ‘invidious comparison’ – whenever an individual from a higher class consumes conspicuously to distinguish himself from an individual from a lower class, and (b) ‘pecuniary emulation’ – whenever an individual from a lower class consumes conspicuously to imitate a member of the upper class. Bagwell and Bernheim (1996) used a signalling model to investigate the conditions under which the Veblen effect may result from the desire to signal wealth (see also Ireland, 1994).

Conspicuous consumption may lead to excessive consumption and suboptimal saving but this conclusion depends on the specific details and timing of the ‘conspicuous consumption race’. As Corneo and Jeanne (1996) have shown, if the signalling is typically done late in the life cycle, conspicuous consumption may actually encourage saving.

Letting social status be determined by relative wealth may help to explain some of the puzzles we observe in human behaviour. The empirical evidence indicates that saving continues in old age and hardly declines with wealth. These observations imply that saving behaviour cannot be explained solely by consumption motives. Status concerns derived from relative wealth may provide some explanation of this phenomenon.

It is important to note that the striving for social status is not the only explanation for conspicuous consumption. Such behaviour may also signal professional success or ability. Simply think about a situation in which you need to choose a lawyer without any knowledge about the candidates’ ability. Often a lawyer’s dress, the car she drives or how her office is decorated may affect your choice whenever these items may signal ability or success.

Status and the Labour Market

Some professions enjoy higher status than others. For example, in most countries, being a physician yields a higher status than being a butcher. In such cases, simply belonging to a profession, and not the individual’s characteristics, is rewarded by the relevant professional status. Consequently, individuals choose their occupations not just according to the wages they will be paid but also according to the

status associated with that occupation. However, at equilibrium, wages are also affected by the quest for status. Adam Smith, in *The Wealth of Nations* (1776), was the first to state the argument of compensating wage differences by pointing out that: ‘Honour makes a great part of the rewards of all honourable professions. ... The most detestable of all employment, that of a public executioner, is, in proportion to the quantity of work done, better paid than any common trade whatever’ (Book I, Ch. X). Still, no empirical evidence has been found supporting the phenomenon of high status being associated with low wages, because to do so one would need to control for ability, which is not directly observable.

Status concerns may also explain some degree of wage rigidity. Unemployed individuals are often reluctant to accept temporary but low-paid jobs because doing so implies a loss of status (see Blinder, 1988). On the other hand, immigrants are less reluctant to apply for low-status jobs; they tend to stress wages over occupational status partly because their reference group is new immigrants and not the wider society.

The workplace itself is a venue for social interaction. Relative wages may be important in forming ‘local’ status at the firm level. The willingness of workers to exert effort may be affected by social rewards. When workers are concerned with their ‘local’ status, wage inequality across firms will tend to exceed wage inequality within firms. Within each firm, productivity differentials will exceed wage differentials as some reward is derived from higher status (see Frank 1984a, 1984b; for empirical and experimental evidence for the relevance of wage comparisons, see Clark and Oswald, 1996, and Zizzo and Oswald, 2001).

Social Status and Growth

The great variability in growth across different economies is a major puzzle for economists. While most of the literature offers an economic explanation for this phenomenon, others claim that some of the variation can be attributed to cultural factors. Social status affects growth primarily by affecting individuals’ choices of occupation, investment and education. For example, it has been argued that contempt for entrepreneurs and the high status of the idle gentleman in 19th-century England were the main causes for its economic decline during that period (see Wiener, 1981).

A common feature of recent growth models is the existence of externalities associated with human capital or certain occupations. Each worker, when choosing

his level of schooling or occupation, ignores the impact of his choice on overall economic performance. Whenever social status is attached to such activities or occupations, it can be perceived as a corrective mechanism. Baumol (1990) emphasizes the role of social status or social prestige associated with ‘non-productive’ (rent-seeking) activities versus ‘productive’ activities. The implications are simple: a status structure that awards higher status to ‘productive’ activities is conducive to growth. Fershtman and Weiss (1993) used a simple general equilibrium model in which wages and social status are determined endogenously to show that changes in the demand for status, triggered by changes in preferences, may affect growth rates.

But status has a collective nature and may be determined endogenously by the type of people who choose each occupation or profession. The drive for status may thus be counter-productive and induce an inefficient allocation of talent among the different occupations. A large emphasis on status may encourage the ‘wrong’ individuals – those with low ability and great wealth – to choose a ‘productive’ occupation or acquire schooling, thereby forcing workers with high ability but little wealth to leave growth-enhancing occupations. This crowding-out effect may, by itself, discourage growth (see Fershtman, Murphy and Weiss, 1996).

Social status as a corrective mechanism

It has long been recognized that activities that generate externalities but cannot be priced are not efficiently regulated by private rewards. It was Arrow (1971) who initially suggested the role of social rewards as a mechanism designed to resolve the inefficiencies arising from externalities (see Elster, 1989, for a critical view for this approach). According to Arrow, an individual who chooses an action or occupation that produces positive externalities is appreciated by other members of the society and obtains social status, whereas an individual who produces negative externalities is treated with contempt (or a negative social status). The use of such a social mechanism is appealing as it implies that the problem of market inefficiencies due to externalities can be resolved or diminished. On the other hand, the use of social rewards is limited in itself and as a corrective mechanism. As mentioned previously, a profusion of medals reduces their value – a property that limits the scope of their use.

Social status and the evolution of preferences

While most economists are sympathetic to the idea that the concern for social status is an important aspect of human decision-making, they remain reluctant to incorporate this variable into mainstream economic modelling. The ruling paradigm of *homo economicus* is that of an individual whose utility depends on his consumption bundle and who makes employment decisions based on the wages to be received for performing a particular job. For sociologists, the dominant paradigm is that of people who, as social animals, wish to maximize their standing in society.

The reluctance to incorporate status concerns into the utility function is rooted in the assumption that models including this variable often allow too broad a range of behaviour and thus ultimately display little predictive power (for more on this view see Postlewaite, 1998). The debate centres on whether status concerns are a ‘direct effect’, reflecting the fact the people are (also) social animals, or an ‘indirect effect’, meaning that people care about social status because status affects the goods and services that they and their children will consume (for an illustration of the indirect approach, see Cole, Mailath and Postlewaite, 1992).

Incorporating preferences for status as ‘hard-wired’ into the utility function raises the question of why people (or other animals) have ingrained preferences for social status. One approach to dealing with the issue, common in economics, is not to deal with the formation of preferences. Social biologists have adopted a different approach. They argue that feelings and social concerns are hard-wired in human actors; moreover, concerns that increase fitness tend to be more common. Fershtman and Weiss (1998a; 1998b) applied an evolutionary approach and showed that caring about social status can be part of stable evolutionary preferences.

Chaim Fershtman

See also: Social Norms, Social norms and the law, Evolution and norms.

Key Words: Social Status, Social Incentives, Conspicuous Consumption.

Bibliography

Arrow, K. 1971. Political and economic evaluation of social effects and externalities. In *Frontier of Quantitative Economics*, ed. M. Intriligator. Amsterdam: North-Holland.

- Bagwell-Simon, L. and Bernheim, D. 1996. Veblen effects in a theory of conspicuous consumption. *American Economic Review* 86, 349–73.
- Baumol, W. 1990. Entrepreneurship: productive, unproductive and destructive. *Journal of Political Economy* 98, 893–921.
- Blinder, A. 1988. The challenge of high unemployment. *American Economic Review*, 78 (2), 1–15.
- Clark, A. and Oswald, A. 1996. Satisfaction and comparison income. *Journal of Public Economics* 61, 359–81.
- Cole, H., Mailath, G. and Postlewaite, A. 1992. Social norms, saving behaviour and growth. *Journal of Political Economy* 100, 1092–125.
- Corneo, G. and Jeanne, O. 1996. Social organization, status and saving behaviour. *Journal of Public Economics* 70 (1), 37–52.
- Creedy, J. and Slottje, D. 1991. Conspicuous consumption in Australia. Mimeo. University of Melbourne.
- Elster, J. 1989. Social norms and economic theory. *Journal of Economic Perspectives* 3 (4), 99–117.
- Fershtman, C., Hvide, H. and Weiss, Y. 2005. Cultural diversity, status concerns and the organization of work. *Research in Labor Economics: The Economics of Immigration and Social Diversity*, ed. S.W. Polachek. Macmillan, forthcoming.
- Fershtman, C., Murphy, K.M. and Y. Weiss 1996. Social Status, Education and Growth. *Journal of Political Economy*, 104, 108-132.
- Fershtman, C. and Weiss, Y. 1993. Social status, culture and economic performance. *Economic Journal* 103, 946–59.
- Fershtman, C. and Weiss, Y. 1998a. Why do we care what others think about us? In *Economics, Values and Organization*, ed. A. Ben Ner and L. Putterman. Cambridge: Cambridge University Press.
- Fershtman, C., and Weiss, Y. 1998b. Social rewards, externalities and stable preferences. *Journal of Public Economics* 70, 53–73.
- Frank, R. 1984a. Interdependent preferences and the competitive wage structure. *Rand Journal of Economics* 15, 510–20.
- Frank, R. 1984b. Are workers paid their marginal products? *American Economic Review* 74, 549–70.
- Frank, R. 1985a. *Choosing the Right Pond: Human Behavior and the Quest for*

- Status*. London and New York: Oxford University Press.
- Frank, R. 1985b. The demand for unobservable and other nonpositional goods. *American Economic Review* 75 (1), 101–16.
- Heffetz, O. 2004. Conspicuous consumption and the visibility of consumers' expenditures. Mimeo. Princeton University.
- Hirschman, A. 1973. An alternative explanation of contemporary hurriedness. *Quarterly Journal of Economics* 87 (4), 634–37.
- Ireland, N. 1994. On limiting the market for status signals. *Journal of Public Economics* 53, 91–110.
- Leibenstein, H. 1950. Band wagon, snob, and Veblen effects in the theory of consumers demand. *Quarterly Journal of Economics*, 622., 183-207.
- Marshall, T. 1977. *Class, Citizenship and Social Development: Essays*. Chicago: University of Chicago Press.
- Postlewaite, A. 1998. The Social Basis of Interdependent Preferences. *European Economic Review*, 42, 779-800.
- Smith, A. 1776. *The Wealth of Nations*, Reprinted, Modern Library, New York, 1934.
- Treiman, D. 1977. *Occupational prestige in comparative perspective*. New York: Academic Press.
- Veblen, T. 1899. *The theory of the leisure class: An economic study of institutions*. London: Unwin Books, 1994.
- Weber, M. 1922. *Economy and Society*. Berkeley: University of California Press, 1978.
- Wiener, M. 1981. *English Culture and the Decline of the Industrial Spirit, 1850–1980*. Cambridge: Cambridge University Press.
- Weiss, Y. and Fershtman, C. 1998. Social status and economic performance: a survey. *European Economic Review* 42, 801–20.
- Zizzo, D. and Oswald, A. 2001. Are people willing to reduce others' income? *Annales d'économie et de statistique*, July/December, 39–65.