A Variety Expansion Model of Growth with External Habit Formation

Junko Doi† and Kazuo Mino‡

May 2005

Abstract

This paper introduces consumption externalities into one of the base line models of growth in which continuing expansion of product variety sustains long-term growth. We assume that consumers set a benchmark stock of consumption for each good so that there are commodity specific external effects. Each good is produced by a monopolistically competitive firm and the firm exploits the presence of consumption external effects in determining its profit-maximizing price. Given those settings, we show that the introduction of consumption externalities may affect the balanced-growth characterization, transitional dynamics and policy effects in fundamental manners.

†Kyoto Sangyo University, Motoyama, Kamigamo, Kita-ku, Kyoto, 603-8555, Japan (phone: 81-75-705-1768, e-mail: jDOI@CC.KYOTO-SU.AC.JP)
‡Graduate School of Economics, Osaka University, 1-7 Machikaneyama, Toyonaka, Osaka 560 0043, J A P A N.
E-mail: mino@ECON.Osaka-U.AC.JP

*We thank Hideyuki Adachi, Masahiro Ashiya, Elias Dinopoulos, Ryo Horii, Tamotsu Nakamura, Paul Segerstrom and seminar participants at various occasions for their helpful comments on earlier versions of this paper.