Consumption Convergence: Theory and Evidence

Hakan Yetkiner
Izmir University of Economics,Turkey
hakan.yetkiner@ieu.edu.tr

Bahar Taş
Burdur Mehmet Akif Ersoy University, Bucak Business Administration Faculty ,Turkey
bahartas0925@gmail.com

Gamze Öztürk
Dokuz Eylül University, Faculty of Business, Department of Economics,Turkey
gamze.ozturk@deu.edu.tr

Abstract

The objective of this paper is to develop a solid theory of consumption convergence and to empirically verify its validity. To this end, we use a Solovian framework, in which the Keynesian exogenous saving-consumption allocation rule plays an essential role. We show that the convergence performance is determined not only by the marginal propensity to save, but also by the marginal propensity to consume. In the empirical part, we estimate the consumption convergence equation by employing the system GMM approach on a panel data set of 177 heterogeneous countries, and for four different income groups over the period 1970-2019. We show that the dominant statistically significant effect in the convergence process originates from the marginal propensity to save rather than the marginal propensity to consume. The remaining two main results mimic the well-known empirical regularities on income convergence: (i) absolute convergence among higher income countries and absolute divergence among lower income countries, and (ii) strong evidence of faster conditional consumption convergence in high- and middle-income countries compared to those among the low-income group. The key policy implication emerging from our analyses is that lower income countries aiming to achieve consumption convergence should focus on raising marginal propensity to save, which has a greater impact on convergence dynamics compared to marginal propensity to consume.

Keywords: Consumption Convergence; β-Convergence; Marginal Propensity to Consume; Marginal Propensity to Save; Dynamic Panel Data; Solow Model

JEL Codes: C23; E21; O41; O47; O57