Life-cycle savings, bequest, and a diminishing impact of scale on growth

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The present paper shows that the savings motive critically affects the size and sign of scale effects in standard endogenous growth models. If the bequest motive dominates, the scale effect is positive. If the life-cycle motive dominates, the scale effect is ambiguous and may even be negative.

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1. Introduction
An important difference between the two workhorse models in macroeconomics, the Diamond model and the Ramsey–Cass–Koopmans (RCK) model, is that they emphasize different motives for saving. In the Diamond model the bequest motive is absent, whereas life-cycle considerations play no role in the RCK framework. If we turn to data for present-day developed economies, the relative importance of bequest and life-cycle savings for capital accumulation remains unresolved (Dynan et al., 2002). Hence, from this perspective it is not obvious which framework is a better stylized representation of the process of capital accumulation. Moreover, the difference is far from trivial because it translates into different links between wage and capital income on the one hand, and the rate of capital accumulation on the other. In an RCK framework all wage income is consumed (along a steady state trajectory), whereas all capital income is consumed in the Diamond model (Bertola, 1993, 1996).

From this emanates radically different answers to questions of first-order importance. Consider the impact of taxes on growth, whereas a capital income tax reduces growth (or long-run income) in an RCK model, it can raise growth in the Diamond model (Uhlig and Yanagawa, 1996; Caballe, 1998). Likewise, the two models hold different predictions with respect to the prospect for cross country income equalization, whereas the steady state is unique in the RCK model, supporting the Conditional Convergence hypothesis, multiple steady states may arise in the Diamond model, supporting the Club Convergence hypothesis (Galor, 1996). Finally, whereas endogenous growth is feasible in convex RCK growth models (Jones and Manuelli, 1990), the same is not true in a Diamond environment (Jones and Manuelli, 1992).
2. The model

Consider a closed economy where activity extends infinitely into the future, but where each individual lives for only two periods. Time is discrete, and denoted by \( t = 1, 2, \ldots \). The economy produces a homogenous good that is either consumed or
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