Does Idealistic Investment Behavior Matter and Do We Need it? A General Equilibrium Analysis*

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Abstract

When does idealistic investment behavior at the individual level have aggregate effects? The present paper analyzes this question in an overlapping generations framework with two-period lived investors and endogenous capital accumulation. The population consists of idealistic and materialistic investors who channel their savings to the formation of clean and dirty capital. Idealists invest only in clean capital while materialists invest only in capital with the highest return. We first study how this behavior affects the aggregate accumulation of clean and dirty capital in both the short and long-run. Our main result shows that the presence of idealists affects the formation of clean and dirty capital if and only if their population share exceeds a threshold level determined by technology parameters. Hence, a sufficiently large number of rent-seeking investors can fully neutralize any idealistic efforts. We also demonstrate that a sufficiently large share of idealists will actually decrease the formation of clean capital due an adverse income effect ultimately dominating the substitution of clean for dirty capital. We also explore the social welfare effects of a larger population share of idealists under the assumption that the latter derive utility from clean capital. Our main result determines an optimal share of idealistic investors that maximizes aggregate welfare determined by a social welfare function.

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