The Issue

- Our consumers are selfish, caring only for themselves (and indeed only cared for by themselves).
- Common sense suggests that there are bequests and inheritances.

Some Assumptions

- Two generations
  - Self and Heir
- Income is $y_S$ and $y_H$.
- The discount rate is $r$
- Everything is certain

The Key Insight

- People have a preference function

$$U(c_S, c_H)$$

The Budget Constraint

- The basic budget reality

$$c_H = y_H + \frac{y_S}{1+r}(1+r)$$

$$c_S + c_H \frac{1}{1+r} = y_S + y_H \frac{1}{1+r}$$
Maximizing Utility

\[ c_H + c_H \frac{1}{1+r} = y_S + y_H \frac{1}{1+r} \]

Does it matter if the government borrows to pay its bills?

Suppose it cuts taxes by $100, with the heir to pay $100(1+r)

The Budget Equation

\[ c_s + c_H \frac{1}{1+r} = (y_S + x) + (y_H - x(1+r)) \frac{1}{1+r} \]
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All we have done is extended the budget line

An obvious qualification. We get this result if and only if (iffi) the consumer is leaving some money to his heir

No change in consumption

The operative phrase is some; it does not matter how much money to his heir
End