Consumption
The Fisherian Model

Irving Fisher

Irving Fisher (2)

Some Assumptions
• People live for two time periods
  – Now and Later
• Income is $y_N$ and $y_L$.
• The discount rate is $r$
• Everything is certain

The Key Insight
• People make decisions about consumption over their life cycle
• They have a preference function

\[ U(c_N, c_L) \]
The Fisherian Model

Indifference Curves

The Budget Constraint

• The basic budget reality
  \[ c_L = y_L + (y_N - c_N)(1+r) \]

Maximizing Utility

\[ c_N + c_L \frac{1}{1+r} = y_N + y_L \frac{1}{1+r} \]
Consumption depends on:

- **Current Income**
- **Future Income**
- **Wealth**
- **Interest Rates**

**A rule:**
Lower interest rates increase consumption. We do not worry about special cases.

Consumption rises with:
- Increases in income
  - Current income
  - Expected future income
Consumption rises with

- Increases in income
- Lower interest rates

Consumption rises falls with

- Decreases Increases in income
- Higher Lower interest rates
- Decreased Increased Wealth.

Extensions

- This is a pretty simple model. More complicated versions come to the same conclusions
- You tell me how much math and complications you can tolerate, and I can add it.

Uncertainty

- There is uncertainty about
  - Future income
  - Life Expectancy
  - Interest Rates

Other Issues

- Governmental Decisions
  - Taxes
  - Programs (social security)
- People make decisions as families
It’s Wealth Stupid

End

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