

Consumption

The Fisherian Model



Irving Fisher



Irving Fisher (2)



Some Assumptions

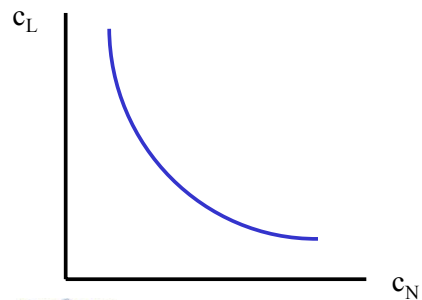
- People live for two time periods
 - Now and Later
- Income is y_N and y_L .
- The discount rate is r
- Everything is certain

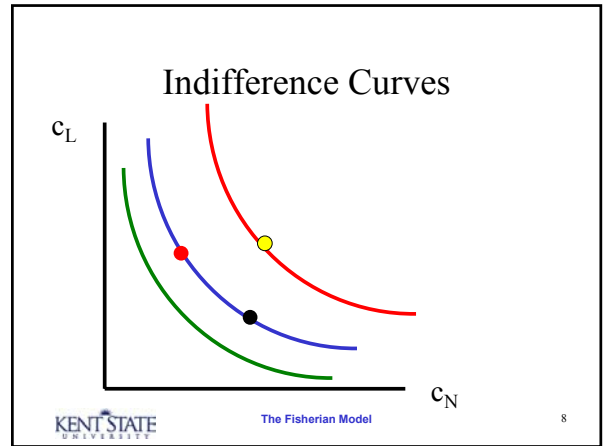
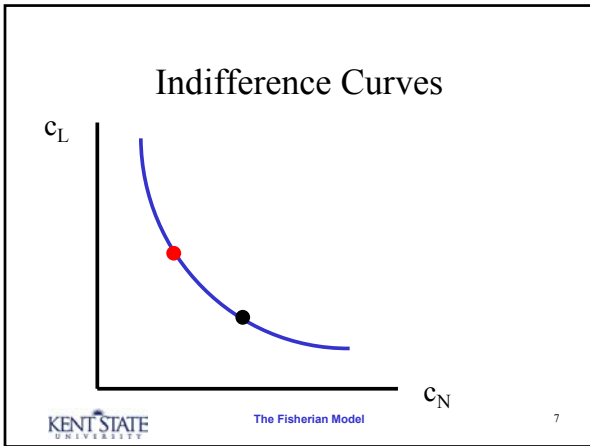
The Key Insight

- People make decisions about consumption over their life cycle
- They have a preference function

$$U(c_N, c_L)$$

Indifference Curves





The Budget Constraint

- The basic budget reality

$$c_L = y_L + (y_N - c_N)(1+r)$$

The Fisherian Model

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The Budget Constraint

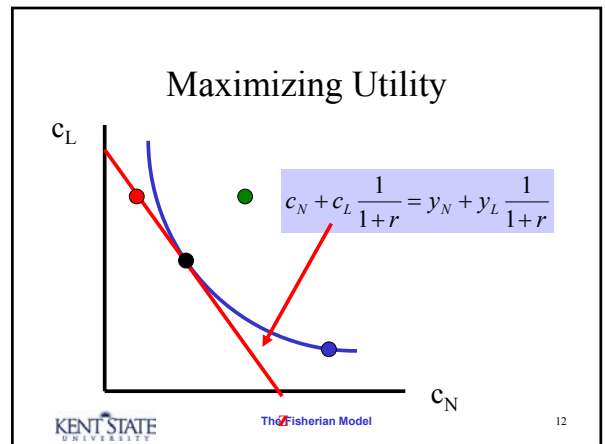
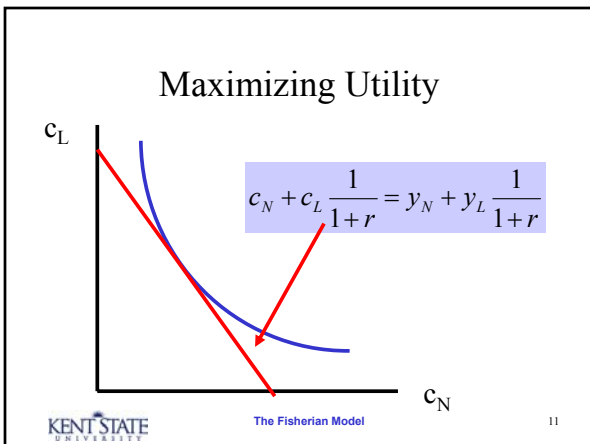
- The basic budget reality

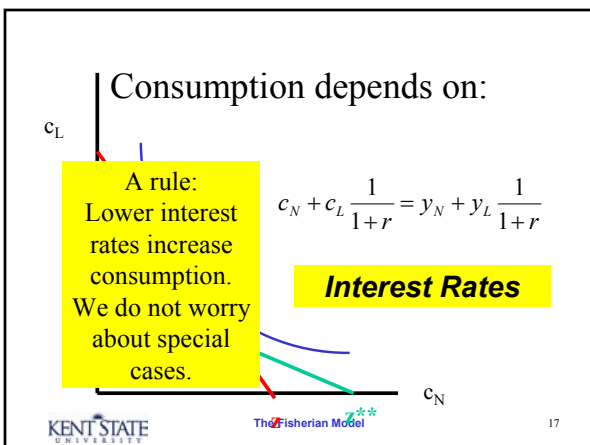
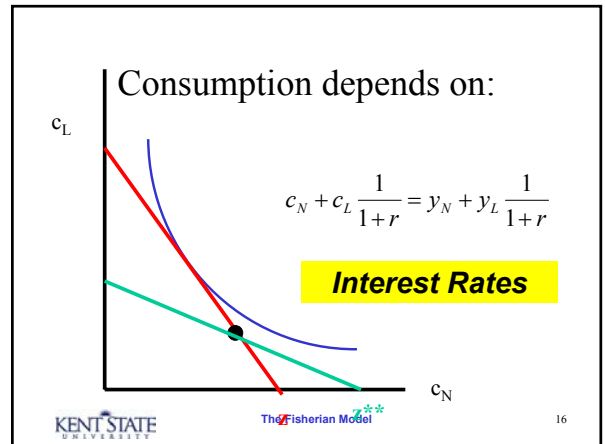
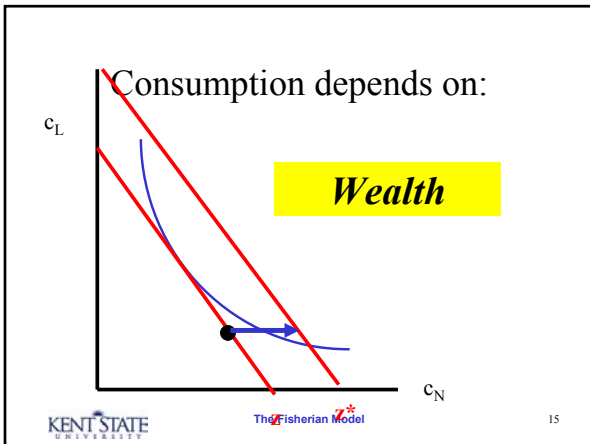
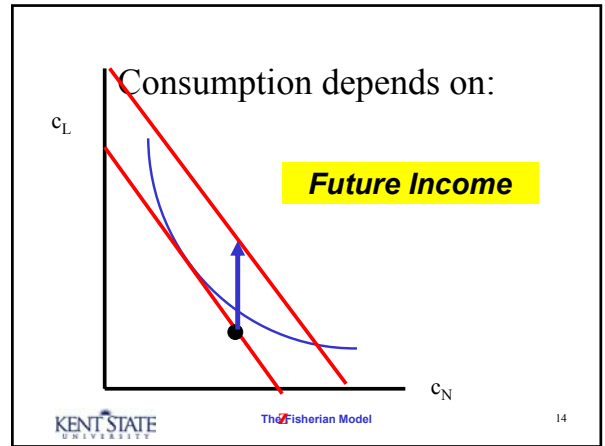
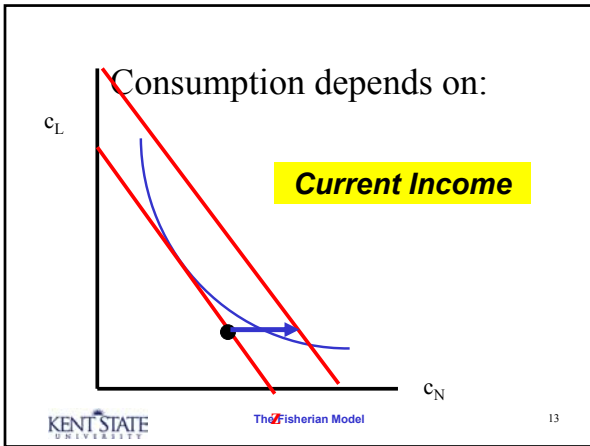
$$c_L = y_L + (y_N - c_N)(1+r)$$

$$c_N + c_L \frac{1}{1+r} = y_N + y_L \frac{1}{1+r}$$

The Fisherian Model

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Consumption rises with

- Increases in income
 - Current income
 - *Expected* future income

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Consumption rises with

- Increases in income
- Lower interest rates

Consumption rises with

- Increases in income
- Lower interest rates
- Increased Wealth.
 - Stock Market
 - Housing
 - Lottery Tickets
 - Inheritances

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.

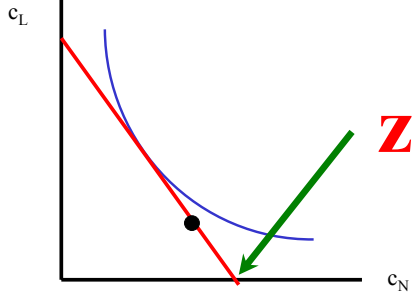
Uncertainty

- 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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