Human Capital: Adding Consumption Preferences

BC with N=3:

$$C_0 + \frac{C_1}{1.05} = 55.7k$$

Suppose person has PC preferences:

$$\frac{C_0}{C_1} = \frac{1}{1}$$

$$C_0 = C_1$$

Finding the optimal bundle:

$$C_0 + \frac{C_0}{1.05} = 55.7k$$

$$C_0\left(1 + \frac{1}{1.05}\right) = 55.7k$$

$$C_0 = 28.5k$$

$$C_1 = 28.5k$$

Borrowing or saving?

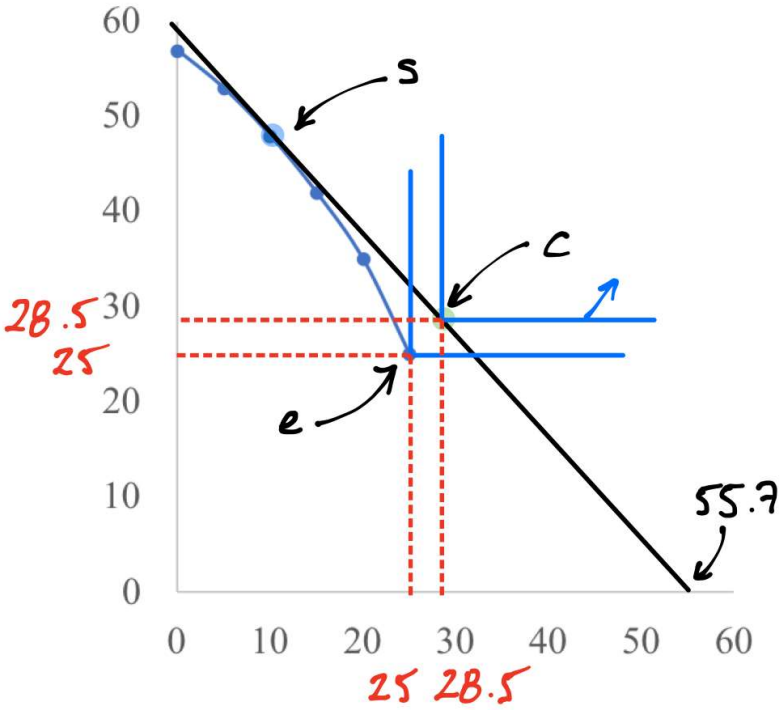
$$I_0^{net} = 10k$$

$$C_0 = 28.5k$$

Borrows in period 0:

$$B = C_0 - I_0^{net} = 28.5k - 10k = 18.5k$$

Graphing:



e = endowment
s = net income with school
c = consumption bundle

Key observation:

Chooses N=0 *without* access to borrowing
Chooses N=3 *with* access to borrowing

- Financial market separation:
  Allows human capital decision (N) to be separated from the consumption decision