

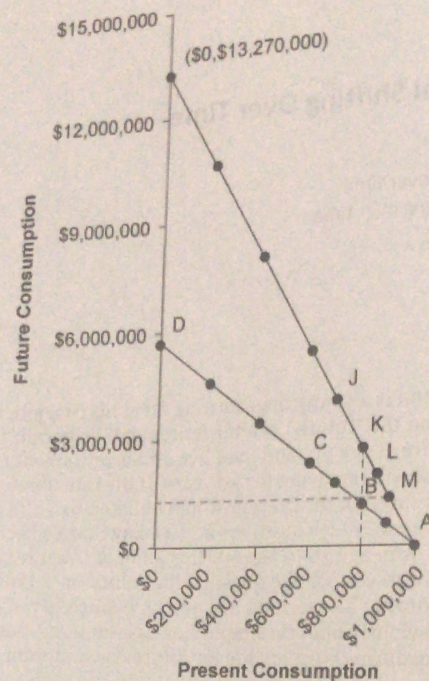


Figure 2. Yelberton's Choice: The Intertemporal Budget Set. Yelberton will make a choice between present and future consumption. With an annual rate of return of 6%, he decides that his utility will be highest at point B, which represents a choice of \$800,000 in present consumption and \$1,148,000 in future consumption. When the annual rate of return rises to 9%, the intertemporal budget constraint pivots up. Yelberton could choose to take the gains from this higher rate of return in several forms: more present saving and much higher future consumption (J), the same present saving and higher future consumption (K), more present consumption and more future consumption (L), or more present consumption and the same future consumption (M).

Yelberton will compare the different choices along the **budget constraint** and choose the one that provides him with the highest utility. For example, he will compare the utility he would receive from a choice like point A, with consumption of \$1 million in the present, zero savings, and zero future consumption; point B, with present consumption of \$800,000, savings of \$200,000, and future consumption of \$1,148,000; point C, with present consumption of \$600,000, savings of \$400,000, and future consumption of \$2,296,000; or even choice D, with present consumption of zero, savings of \$1,000,000, and future consumption of \$5,740,000. Yelberton will also ask himself questions like these: "Would I prefer to consume a little less in the present, save more, and have more future consumption?" or "Would I prefer to consume a little more in the present, save less, and have less future consumption?" By considering marginal changes toward more or less consumption, he can seek out the choice that will provide him with the highest level of utility.