

Part I

State Dependent Utility Function

Examples: Illness, Death

Utility in one state is, given the same income, different from utility in the other state.

$$u_2(w) = \alpha + \beta u_1(w)$$

1 2 possibilities

1) $\alpha \neq 0, \beta = 0$

only total utility is different, not marginal utility

no change for optimal allocations

equalizing marginal utility still implies equalizing wealth in the states

2) $\beta \neq 0$

marginal utility different

changes optimality of wealth allocation

equalizing marginal utility does not imply equalizing wealth in the states