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Demand function with constant income elasticity

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Consider the following maximization problem:

$$\max_{\{h,c\}} u(h, c) \quad \text{s.t.} \quad rh + pc = y$$

where h and c are goods (housing and non-housing consumption), $u(\cdot, \cdot)$ is a standard utility function, r and p are prices of h and p in dollars, and y is income in dollars.

The FOCs of this problem yield the following optimality condition

$$\frac{u_h(h, c)}{u_c(h, c)} = \frac{r}{p} \quad (1)$$

where u_x represents the partial derivative of the utility function with respect to x . We represent this condition as

$$c = f(h, r, p)$$

where $f(\cdot, r, p)$ gives the value of c for each h such that equation (1) holds.

Replacing in the budget constraint of the problem we have

$$rh + pf(h, r, p) = y. \quad (2)$$

A constant income elasticity function would be defined as $\tilde{h} = g(r, p)y^\xi$ where $\xi \equiv \frac{d \ln \tilde{h}}{d \ln y}$ is the elasticity. Can we obtain this function form in this problem?

Fully differentiating (2) with respect to $\ln h$ and $\ln y$ yields

$$rhd \ln(h) + pf_h h d \ln(h) = y d \ln(y)$$

$$hd \ln(h) (r + pf_h) = y d \ln(y) \implies \frac{d \ln(h)}{d \ln(y)} = \frac{y}{h} \frac{1}{(r + pf_h)}$$

and using the budget constraint

$$\frac{d \ln(h)}{d \ln(y)} = \frac{r + p(c/h)}{r + pf_h}.$$

Thus, for the income elasticity to be constant we require a condition on the MRS, namely that

$$\frac{c}{h} = \frac{dc}{dh}$$

for any y and fixed r and p .