4th Sem(M)

Keynes's psychological Law of Consumption.

Keynes propounded the fundamental psychological law of consumption which forms the basis of the consumption function. The law implies that there is a tendency on the part of the people to spend on consumption less than the full increment of income.

proposition of the Law:- This law has three related propositions:-

(1) When income increases, consumption expenditure also increases but by a smaller amount. The reason is that as income increases, our wants are satisfied side by side, so that the need to spend more on consumer goods diminishes. In fact, the consumption expenditure increases with increase in income but less than proportionately.

(2) The increased income will be divided in some proportion between consumption expenditure and saving. When the whole of increased income is not spent on consumption, the remaining is saved, i.e consumption and saving move together.

(3) Increase in income always leads to an increase in both consumption and saving. This means that increased income is unlikely to lead either to fall in consumption or saving than before. Thus with increased income both consumption and saving increase.

(2)

The three propositions of the law can be explained with the help of the following table-1:-

Income (Y)	Consumption (C)	Savings (S = Y-C)
0	20	-20
60	70	-10
120	120	0
180	170	10
240	220	20
300	270	30
360	320	40

proposition (1):- The table (1) shows that income increases by Rs. 60 crores and the increase in consumption is by Rs. 50 crores. The consumption expenditure increasing with increase in income i.e by Rs 170, 220, 270 and 320 crores against Rs. 180, 240, 300 and 360 crores respectively.

proposition (2):- The increased income of Rs. 60 crores in each case is divided in some proportion between consumption and saving (i.e Rs 50 crores and Rs 10 crores).

proposition (3):- As income increases from Rs. 120 to 180, 240, 300 and 360 crores, consumption also increases from Rs. 120, 170, 220, 270, 320 crores

along with increase in Saving from Rs. 0, to 10, 20, 30 and 40 crores respectively. With increase in income neither consumption nor Saving have fallen.

Diagramatically, the three propositions are explained in fig-(1).

Income is measured horizontally and consumption and Savings are measured on the vertical axis. C is the consumption function curve and 45° line represents income.

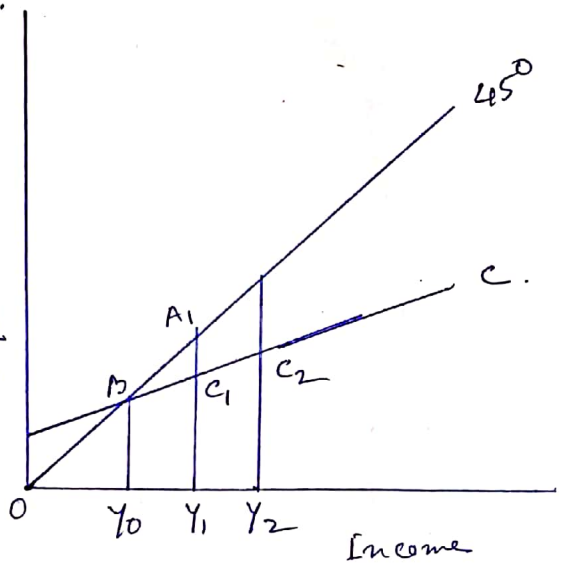

fig-(1)

proposition (1):- when income increases from OY_0 to OY_1, consumption also increases BY_0 to C_1Y_1 but the increase in consumption is less than the increase in income i.e $C_1Y_1 < A_1Y_1$ by A_1C_1.

proposition (2):- when income increases to OY_1 and OY_2, it divided in some proportion between consumption C_1Y_1 and C_2Y_2 and Saving A_1C_1 and A_2C_2 respectively.

proposition (3):- increases in income to OY_1 and OY_2 lead to increased consumption $C_2Y_2 > C_1Y_1$ and increased Saving $A_2C_2 > A_1C_1$ than before. It is clear from the widening area below the C curve and the Saving gap between 45° line and the C curve.