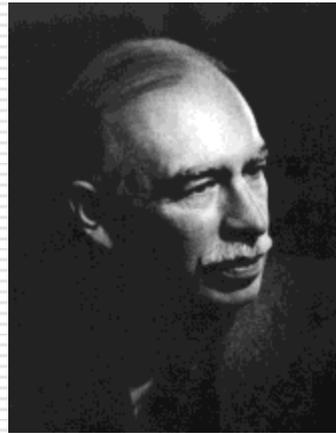# *Keynes Psychological Law of Consumption*

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introduction

During 1930s a serious and deep rooted depression, popularly known as world wide depression occurred. for instance, unemployment in US rose from 3.2% in 1929 to 25.2% in 1933. The GNP fall by 30% and could not be recovered until 1939. In U.K. also the level of unemployment remained around 11% through out decade of depression. This caused lot of sufferings to the society and therefore give rise to a debate amongst economists. British economist J.M. Keynes was a notable participant in the debate during The course of which he developed his Revolutionary Theory of Macro Economics.

One of the important tools of the Keynesian economics is the consumption function Consumption is a function of income. Study of consumption function then relates to Mutual relation between aggregate consumption, expenditure and National income.

$$C = f(y)$$

Keynes propounded the fundamental psychological law of consumption from the basis of the consumption function.

Acc. To Keynes, " The fundamental psychological law upon which we are entitled to depend with great confidence both from our knowledge of human nature and from the detailed fact of experience, is that men are disposed as a rule and on the average to increase their consumption as their income increases but not by as much as the Increase in their income."

This law implies that marginal propensity to consume is always positive but less than Unity.

Assumptions

1. No change in psychological and institutional complex.

2. Normal Conditions.

3. Prosperous capitalist economy based on laissez-faire.
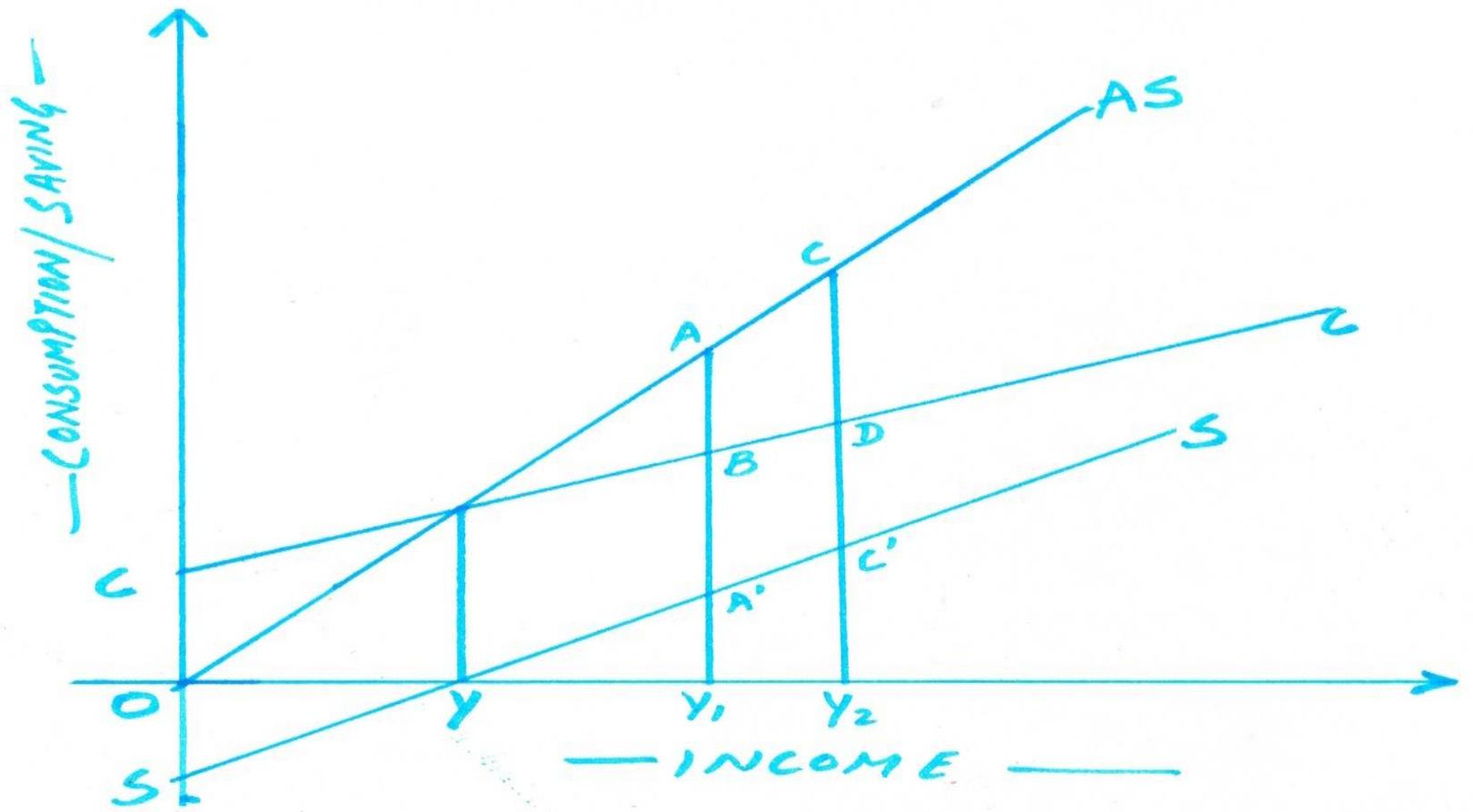
Explanation

Psychological Law of Consumption

Income (Y) (Rs. Crore)	Consumption (C) (Rs. Crore)	Saving (S) (Rs. Crore)
0	50	-50
50	75	-25
100	100	0
150	125	25
200	150	50
250	175	75
300	200	100
350	225	125

$$Y = C + S$$
$$C = Y - S$$

Proposition of the Law

1. When income increase consumption expenditure also increase but by a smaller amount.
2. Increased income is divided between consumption expenditure and saving in Same proportion.
3. An increase in aggregate income is unlikely to lead either to less consumption or less saving than before.

Implications or Importance of this law

1. Refutation of Say's law
2. Strategic importance of investment
3. Need for state intervention
4. Possibility of general over production & unemployment
5. Decline in Marginal Efficiency of capital
6. Under employment equilibrium

7.Secular stagnation

8.Unique process of income generation

9.Over saving gap

10.Inducement to investment

11. Explanation of trade cycles

conclusion

"Keynes consumption function is an epoch making tool in economic analysis." A.L.Hansen

This consumption function is important tool in policy making because it explains why saving increase more than consumption, people save more for their future. Their psychology push them to consume less and save more.

Recommended books and important questions

1. State and explain Keynes psychological law of consumption along with its importance in the determination of income and employment in the economy.

2. Explain Keynes psychological law of consumption with its implications.

Books

J.M. Keynes*, General theory of employment,interest and money,1936*