Chapter 9

THE PROPENSITY TO CONSUME: II. THE SUBJECTIVE FACTORS

I

There remains the second category of factors which affect the amount of consumption out of a given income —namely, those subjective and social incentives which determine how much is spent, given the aggregate of income in terms of wage-units and given the relevant objective factors which we have already discussed. Since, however, the analysis of these factors raises no point of novelty, it may be sufficient if we give a catalogue of the more important, without enlarging on them at any length.

There are, in general, eight main motives or objects of a subjective character which lead individuals to refrain from spending out of their incomes:

(i) To build up a reserve against unforeseen contingencies;

(ii) To provide for an anticipated future relation between the income and the needs of the individual or his family different from that which exists in the present, as, for example, in relation to old age, family education, or the maintenance of dependents;

(iii) To enjoy interest and appreciation, i.e. because a larger real consumption at a later date is preferred to a smaller immediate consumption;

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(iv) To enjoy a gradually increasing expenditure, since it gratifies a common instinct to look forward to a gradually improving standard of life rather than the contrary, even though the capacity for enjoyment may be diminishing;

(v) To enjoy a sense of independence and the power to do things, though without a clear idea or definite intention of specific action;

(vi) To secure a *masse de manœuvre* to carry out speculative or business projects;

(vii) To bequeath a fortune;

(viii) To satisfy pure miserliness, i.e. unreasonable but insistent inhibitions against acts of expenditure as such.

These eight motives might be called the motives of Precaution, Foresight, Calculation, Improvement, Independence, Enterprise, Pride and Avarice; and we could also draw up a corresponding list of motives to consumption such as Enjoyment, Shortsightedness, Generosity, Miscalculation, Ostentation and Extravagance.

Apart from the savings accumulated by individuals, there is also the large amount of income, varying perhaps from one-third to two-thirds of the total accumulation in a modern industrial community such as Great Britain or the United States, which is withheld by central and local government, by institutions and by business corporations—for motives largely analogous to, but not identical with, those actuating individuals, and mainly the four following:

(i) The motive of enterprise—to secure resources to carry out further capital investment without incurring debt or raising further capital on the market;

(ii) The motive of liquidity—to secure liquid resources to meet emergencies, difficulties and depressions;

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(iii) The motive of improvement—to secure a gradually increasing income, which, incidentally, will protect the management from criticism, since increasing income due to accumulation is seldom distinguished from increasing income due to efficiency;

(iv) The motive of financial prudence and the anxiety to be 'on the right side' by making a financial provision in excess of user and supplementary cost, so as to discharge debt and write off the cost of assets ahead of, rather than behind, the actual rate of wastage and obsolescence, the strength of this motive mainly depending on the quantity and character of the capital equipment and the rate of technical change.

Corresponding to these motives which favour the withholding of a part of income from consumption, there are also operative at times motives which lead to an excess of consumption over income. Several of the motives towards positive saving catalogued above as affecting individuals have their intended counterpart in negative saving at a later date, as, for example, with saving to provide for family needs or old age. Unemployment relief financed by borrowing is best regarded as negative saving.

Now the strength of all these motives will vary enormously according to the institutions and organisation of the economic society which we presume, according to habits formed by race, education, convention, religion and current morals, according to present hopes and past experience, according to the scale and technique of capital equipment, and according to the prevailing distribution of wealth and the established standards of life. In the argument of this book, however, we shall not concern ourselves, except in occasional digressions, with the results of far-reaching social changes or with the slow effects of secular progress. We shall, that is to say, take as given the main background of subjective

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motives to saving and to consumption respectively. In so far as the distribution of wealth is determined by the more or less permanent social structure of the community, this also can be reckoned a factor, subject only to slow change and over a long period, which we can take as given in our present context.

II

Since, therefore, the main background of subjective and social incentives changes slowly, whilst the short-period influence of changes in the rate of interest and the other objective factors is often of secondary importance, we are left with the conclusion that short-period changes in consumption largely depend on changes in the rate at which income (measured in wage-units) is being earned and not on changes in the propensity to consume out of a given income.

We must, however, guard against a misunderstanding. The above means that the influence of moderate changes in the rate of interest on the *propensity* to consume is usually small. It does not mean that changes in the rate of interest have only a small influence on the amounts *actually* saved and consumed. Quite the contrary. The influence of changes in the rate of interest on the amount actually saved is of paramount importance, but is *in the opposite direction* to that usually supposed. For even if the attraction of the larger future income to be earned from a higher rate of interest has the effect of diminishing the propensity to consume, nevertheless we can be certain that a rise in the rate of interest will have the effect of reducing the amount actually saved. For aggregate saving is governed by aggregate investment; a rise in the rate of interest (unless it is offset by a corresponding change in the demand-schedule for investment) will diminish investment; hence a rise in the rate of interest must have the effect of reducing incomes to a level at which saving is decreased in the

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same measure as investment. Since incomes will decrease by a greater absolute amount than investment, it is, indeed, true that, when the rate of interest rises, the rate of consumption will decrease. But this does not mean that there will be a wider margin for saving. On the contrary, saving and spending will *both* decrease.

Thus, even if it is the case that a rise in the rate of interest would cause the community to save more *out of a given income*, we can be quite sure that a rise in the rate of interest (assuming no favourable change in the demand-schedule for investment) will decrease the actual aggregate of savings. The same line of argument can even tell us by how much a rise in the rate of interest will, *cet. par.*, decrease incomes. For incomes will have to fall (or be redistributed) by just that amount which is required, with the existing propensity to consume, to decrease savings by the same amount by which the rise in the rate of interest will, with the existing marginal efficiency of capital, decrease investment. A detailed examination of this aspect will occupy our next chapter.

The rise in the rate of interest might induce us to save more, *if* our incomes were unchanged. But if the higher rate of interest retards investment, our incomes will not, and cannot, be unchanged. They must necessarily fall, until the declining capacity to save has sufficiently offset the stimulus to save given by the higher rate of interest. The more virtuous we are, the more determinedly thrifty, the more obstinately orthodox in our national and personal finance, the more our incomes will have to fall when interest rises relatively to the marginal efficiency of capital. Obstinacy can bring only a penalty and no reward. For the result is inevitable.

Thus, after all, the actual rates of aggregate saving and spending do not depend on Precaution, Foresight, Calculation, Improvement, Independence, Enterprise, Pride or Avarice. Virtue and vice play no part. It all

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depends on how far the rate of interest is favourable to investment, after taking account of the marginal efficiency of capital.[1] No, this is an overstatement. If the rate of interest were so governed as to maintain continuous full employment, virtue would resume her sway;—the rate of capital accumulation would depend on the weakness of the propensity to consume. Thus, once again, the tribute that classical economists pay to her is due to their concealed assumption that the rate of interest always is so governed.

[1] In some passages of this section we have tacitly anticipated ideas which will be introduced in Book IV.