

LESSON 22

THE CONSUMPTION FUNCTION

Learning outcomes

After studying this unit, you should be able to:

- Define consumption function and propensity to consume
- Find the properties or technical attributes of consumption
- Know average propensity to consume and marginal propensity to consume
- Identify the individual motive and the business motives
- Identify the various determinants of consumption function
- Know the measures of propensity to consume

INTRODUCTION:

One of the important tools of the Keynesian economics is ,the consumption function. This chapter deals with the consumption function, its technical attributes, its importance and its subjective and objective determinants along with Keynes's Psychological Law of consumption.

MEANING OF CONSUMPTION FUNCTION

The consumption function or propensity to consume refers to . income consumption relationship. It is a "functional relationship between two aggregates, i.e., total consumption and gross national income." Symbolically, the relationship is represented as $C = f(Y)$, 'where C is consumption, Y is income, and f is the functional relationship. Thus the consumption function indicates a functional relationship between C and Y, where C is dependent and Y is the independent variable, i.e., C is determined by Y.' This relationship is based on the ceteris paribus (other things being equal) assumption, as such only income consumption relationship is considered and all possible influences on consumption are held constant.

In fact, propensity to consume or consumption function is a schedule of the various amounts of consumption expenditure corresponding to different levels of income. A hypothetical consumption schedule is given in Table I.

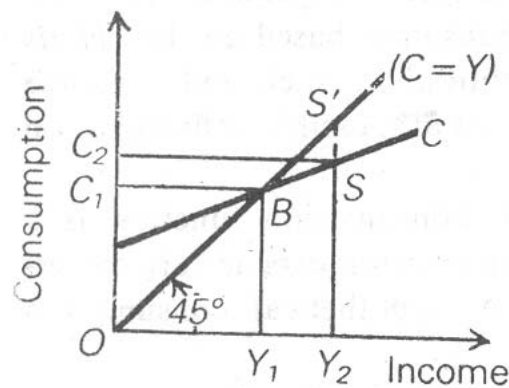
Table I shows that consumption is an increasing function income because consumption, expenditure increases with increase in income. Here it is shown that when income is zero

during the depression, people spend out of their past savings on consumption because they must eat in order to live. When income is generated in the economy to the extent of Rs. 60 crores, it is not sufficient to meet the consumption expenditure of the community so that the consumption expenditure of Rs. 70 crores is still above the income amounting to Rs 60 crores. (Rs. 10 crores are dis-saved). When both consumption expenditure and income equal Rs 120 crores, it is the basic consumption level.

TABLE I : CONSUMPTION SCHEDULE

(Rs. Crores)

Income (Y)	Consumption $C = f(Y)$
0	20
60	70
120	120
180	170
240	220
300	270
360	320



After this, income is shown to increase by 60 crores and consumption by 50 crores. This implies a stable consumption function during the short-run as assumed by Keynes. The above Figure illustrates the consumption function diagrammatically. In the diagram,² income is measured horizontally and consumption is measured vertically. 45° is the unity-line where at all levels income and consumption are equal. The C curve is a linear consumption function based on the assumption that consumption changes by the same amount (Rs 50 crores). Its upward slope to the right indicates that consumption is an increasing function of income. B is the break-even point where $C = Y$ or $OY_1 = OC_1$. When income rises to OY_2 consumption also increases to OC_2 , but the increase in

consumption' is less than the increase in income, $C_1 - C_2 < Y_1 - Y_2$. The portion of income not consumed is saved as shown by the vertical, distance between 45° line and C curve, i.e., SS'. "Thus the consumption function measures not only the amount spent on consumption but also the amount saved. This is because the propensity to save is merely the propensity not to consume. The 45° line may therefore be regarded as a zero-saving line, and the shape and position of the C curve indicate the division of income between consumption and saving".

PROPERTIES OR TECHNICAL ATTRIBUTES OF THE CONSUMPTION FUNCTION

The consumption function has two technical attributes or properties:

(i) the average propensity to consume, and (ii) the marginal propensity to consume.

(1) The Average Propensity to Consume. "The average propensity to consume may be defined as the ratio of consumption expenditure to any particular level of income."⁴ It is found by dividing consumption expenditure by income, or $APC = C/Y$. It is expressed as the percentage or proportion of income consumed. The APC at various Income levels is shown in column 3 of Table II. The APC declines as the income increases because the proportion of income spent on consumption decreases. But reverse is the case with APS (average propensity to save) which increases with increase in income (see column 4). Thus the APC also tells us about the APS, $APS = 1 - APC$.

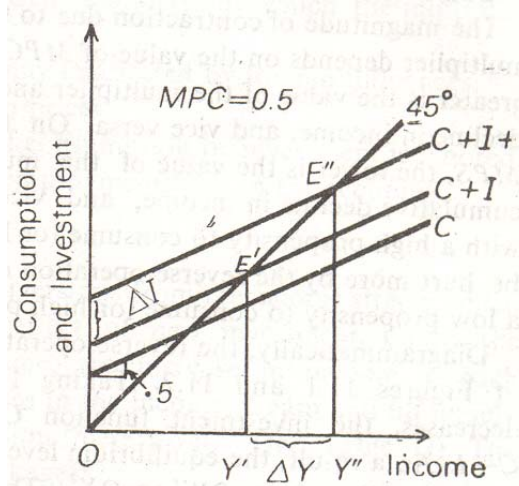
Diagrammatically, the average propensity to consume is any point on the C curve. In Figure 8.2 panel (A), point R measures the APC of the C curve which is OC'/OY' . The flattening of the C curve to the right shows declining APC.

(2) The Marginal Propensity to Consume. "The marginal propensity to consume may be defined as the ratio of the change in consumption to the change in income or as the rate of change in the average propensity to consume as income changes."⁵ It can be found by dividing change in consumption by a change in income, or $MPC = \Delta C / \Delta Y$. The MPC is constant at all levels of income as shown in column 5 of Table II. It is 0.83 or 83 per cent because the ratio of change in consumption to change in income is $\Delta C / \Delta Y = 50/60$. The marginal propensity to save can be derived from the MPC by the formula $1 - MPC$. It is 0.17 in our example (see column 6).

TABLE II

(Rs.
Crores)

(1)	(2)	(3)	(4)	(5)	(6)
Income Y	Consumption (C)	$APC = C/Y$	$APS = S/Y$ (1 – APC)	$MPC = \Delta C / \Delta Y$	$MPS = \Delta S / \Delta Y$ (1 – MPC)
120	120	$120/120=1$ or 100%	0	-	-
180	170	$170/180=0.92$	0.08	$50/60=0.83$	0.17



		or 92%			
240	220	220/240=0.91 or 91%	0.09	50/60=0.83	0.17
300	270	270/300=0.90 or 90%	0.10	50/60=0.83	0.17
360	320	320/360=0.88 or 88%	0.12	50/60=0.83 or 83%	0.17

Diagrammatically, the marginal propensity to consume is measured by the gradient or slope of the C curve. This is shown in figure 8.2 panel (B) by NQ/RQ where NQ is change in consumption (ΔC) and RQ is change in income (ΔY), or $C' C'' / Y' Y''$.

Significance of MPC

The MPC is the rate of change in, the APC. When income increases, the MPC falls but more than the APC. Contrariwise, when income falls, the MPC rises and the APC also rises but at a slower rate than the former. Such changes are only possible during cyclical fluctuations whereas in the short-run there is change in the MPC and $MPC < APC$.

Keynes is concerned primarily with the, M PC, for his analysis pertains, to the short-run while the APC is useful in the long-run analysis. The post Keynesian economists have come to the conclusion that, over the long-run APC and MPC are equal and approximate 0.9. In the Keynesian analysis the M PC is given more prominence. Its value is assumed to be positive and less than unity which means that when income increases the whole of it is not spent on consumption. On the contrary, when income: falls, consumption expenditure does not decline in the same proportion and never becomes zero. The Kynesian hypothesis that the marginal propensity to consume is positive but less than unity $0 < \Delta C / \Delta Y < 1$) is of great analytical and practical significance. Besides telling us that the consumption is an increasing function of income and it increases by less than the increment of income, this hypothesis helps in explaining

- the theoretical possibility of general over production or under employment equilibrium and also
- the relative stability of a highly developed industrial economy. For' it is implied that the gap between income and consumption at all high levels of income is too wide to be easily filled by investment with the possible. consequence that the

economy may fluctuate around an underemployment equilibrium.⁶ Thus the economic significance of "the M PC lies in filling the gap between, income and consumption through planned investment to maintain the desire level of income. Further, its importance lies in the multiplier theory. The higher the MPC, the higher the multiplier and vice versa. The M PC is low in the case of the rich people and high in the case of the poor. This accounts for nigh MPC in 'underdeveloped countries arid low in advanced countries.

KEYNES'S PSYCHOLOGICAL LAW OF CONSUMPTION

Keynes propounded: the fundamental psychologically of consumption which forms the basis of the consumption function. He wrote, "The fundamental psychological law upon which we are entitled to depend with great confidence both a prior from our knowledge of human nature and from the detailed facts 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." 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.

Propositions 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. It does not mean that the consumption expenditure falls with the increase in income. 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. This follows from the above proportion because when the whole of increased income is not spent on consumption, the remaining is saved. In this way, 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 10 lead either to fall in consumption or saving than before. This is based on the above propositions because as income increases consumption also increases but by a smaller amount than before which leads to an increase in saving. Thus with increased income both consumption and saving increase.

The three propositions of the law can be explained with the help of the following Table.

TABLE

(Rs Crores)		
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): Income increases by Rs. 60 crores and the increase in consumption is by Rs 50 crores. The consumption expenditure is, however, increasing with increase in income, i.e., 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. to 170, 220, 270, 320 crores, along with increase in saving from Rs to 10, 20, 30 and 40 crores respectively. With increase in income neither consumption nor saving have fallen.

Diagrammatically, the three propositions are explained in Figure 8.3. Here, income is measured horizontally and consumption and saving are measured on the vertical axis. C is the consumption function curve and 45° line represents income.

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

Proposition (2): When income increases to OY_1 and OY_2 , it is 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.

Its Assumptions. Keynes's Law is based on the following assumptions.

(1) It assumes a Constant Psychological and Institutional Complex. This law is based on the assumption that the psychological and institutional complexes influencing consumption expenditure remain constant. Such complexes are income distribution, tastes, habits, social customs, price movements, Population growth, etc. In the short run, they do not change and consumption depends on income alone. The constancy of these complexes is the fundamental cause of the stable consumption functions.

(2) It assumes the Existence of Normal Conditions. The law holds good under normal conditions: If, however, the economy is faced with abnormal and extraordinary circumstances like war, revolution or hyperinflation, the law will not operate. People may spend the whole of increased income on consumption.

(3) It assumes the Existence of a Laissez-faire Capitalist Economy. The law operates in a rich capitalist economy where there is no government intervention. People should be free to spend increased income. In the case of regulation of private enterprise and consumption expenditures by the state, the law breaks down. Thus the law is inoperative in socialist or state controlled and regulated economies.

Professor Kurihara opines that "Keyne's law based on these assumptions may be regarded as a rough approximation to the actual macro-behavior of free consumers in the normal short period."⁷

Implications of Keynes's Law (or Importance of the Consumption function). Keynes's psychological law has important implications which in fact point towards the importance of the consumption functions because the latter is, based on the former. The following are its implications.

(i) Invalidates Say's Law. Say's Law states that supply creates its own demand : "Therefore, there cannot be general overproduction or general unemployment. Keynes's psychological law, invalidates Say's Law because as income increases: consumption also increases but by a smaller amount. In other words, all that is produced (income) is not taken off the market (spent), as income increases. Thus supply fails to create its own demand. Rather it exceeds demand and leads to general over production and glut of commodities in the market. As a result, producers stop production and there is mass unemployment.

(2) Need for State Intervention. As a corollary to the above, the psychological law highlights the need for state intervention. Say's Law is based on the existence of laissez-fair policy and its refutation, implies that the economic system is not self adjusting. So when consumption does not increase by the full increment of income and to sequently there is general overproduction and mass unemployment, the necessity of state intervention arises in the economy, to avert general overproduction and unemployment through public policy.

(3) Crucial Importance of Investment. Keynes's psychological law stresses the vital, point that people fail to spend on consumption the full increment of income. This tendency creates a gap between income and consumption which can only be filled by either increased investment or consumption. If either of them fail to rise, output and employment will inevitably fall. Since the consumption function is stable in the short-run, the gap between income and consumption can only be filled by an increase in investment. Thus the psychological law emphasises the crucial role of investment in Keynes's theory. It is the inadequacy of investment which results in unemployment and logically, the remedy to overcome unemployment is increase in investment.

(4) Existence of Underemployment Equilibrium. Keynes's notion of underemployment equilibrium is also, based on the psychological law of consumption. The point of effective demand which determines the equilibrium level of employment is not of full employment but of full underemployment because consumers do not spend the full increment of their income on consumption and there remains a deficiency in aggregate demand, Full employment equilibrium level can, however, be reached if the state increases investment to match the gap between income and consumption.

(5) Declining Tendency of the Marginal Efficiency of Capital. The psychological law also points towards the tendency of declining marginal efficiency of capital in a laissez-faire economy. When income increases and consumption does not increase to the same extent, there is a fall in demand for consumer goods. This results in a glut of commodities in the market. The producers will reduce production which will, in turn, bring a decline in the demand for capital goods and hence in the expected rate of profit and business expectations. It implies a decline in the marginal efficiency of capital. It is not possible to arrest this process of declining tendency of marginal efficiency of capital unless the propensity to consume rises, but such a possibility can exist only in the long run when the psychological law of consumption does not hold good.

(6) Danger of Permanent Over-saving or Under-investment Gap; Keynes's psychological law points out that there is always a danger of an over-saving or under-investment gap appearing in the capitalist economy because as people become rich the gap between income and consumption widens. This long-run tendency of increase in saving and fall in investment is characterised as secular stagnation. When people are rich, their propensity to consume is low and they save more. This implies low demand which leads to a decline in investment. Thus the tendency is for secular stagnation in the economy.

(7) Unique Nature of Income Propagation, The fact that the entire increased income is not spent on consumption explains the multiplier theory. The multiplier theory or the process of income propagation tells that when an initial injection of investment is made in the economy, it leads to smaller successive increments of income. This is due to the fact that people do not spend their full increment of income on consumption. In fact, the value of multiplier is derived from the marginal propensity to consume, i.e., $\text{Multiplier} = 1 / 1 - \text{MPC}$. The higher the MPC, the higher the value of the multiplier, and vice versa.

(8) Explanation of the Turning Points of the business Cycles. This law explains the turning points of a business cycle. Before the economy reaches the full employment level, the downturn starts because people fail to spend the full increment of their income on consumption. This leads to a fall in demand, overproduction, unemployment and a decline in the marginal efficiency of capital. Figure 8.4 panel (A) shows this downturn movement. When income increases above the breakeven point by $Y'Y''$, consumption expenditure increases by a smaller amount $C'C''$, $C'C'' < Y'Y''$. Before the economy reaches the full-employment income level Y_f , the downturn will start because the gap between the 45° line and C curve continues to widen.

Conversely, the upturn in the economy starts before it reaches the stage of complete depression because when income falls, consumption also falls but by less than the fall in income. People continue to buy consumer goods even when their income falls. So when the excess stock of commodities is exhausted in the community during a depression, the existence of consumer expenditure on goods leads to revival. This is best explained with the help of Figure 8.4 panel (B) where below the breakeven point B, the C curve is above the 45° income line. The fact that the consumption function curve C is above the income line shows that revival will start before income falls to zero. This is because the fall in consumption $C'C''$ is less than the fall in income $Y'Y''$.

DETERMINANTS OF THE CONSUMPTION FUNCTION

Keynes mentions two principal factors which influence the consumption' function and determine its slope and position. They are -(i) the subjective factors, and (ii) the objective factors.

The subjective factors are endogenous or internal to the economic system. They include psychological characteristics of human nature, social practices and institutions and social arrangements. They are unlikely to undergo a material change over a short period of time except in abnormal or revolutionary circumstances.⁹ They, therefore, determine the slope and position of the C curve which is fairly stable in the short-run.

The objective factors are exogenous or external to the economic system. They may, therefore, undergo rapid changes and may cause marked shifts in the consumption function (i.e., the C curve).

Subjective Factors in the Consumption Function. Keynes's subjective factors basically underlie and determine the form (i.e., slope and position) of the consumption function. As already noted above, the subjective factors are the psychological characteristics of human nature, social practices and institutions, especially the behavior patterns of business concerns with respect to wage and dividend payments and retained earnings, and social arrangements affecting the distribution of income.¹⁰

Individual Motives. First, there are, eight motives "which lead individuals to refrain from spending out of their incomes." They.-are

- (i) the desire to build reserves for unforeseen contingencies;
- (ii) the desire to provide for anticipated future needs, i.e., old age, sickness, etc.,
- (iii) the desire to enjoy an enlarged future income by way of interest and appreciation;
- (iv) the desire to enjoy a gradually increasing expenditure in order to improve the standard of living;
- (v) the desire to enjoy a sense of independence and power to do things;
- (vi) the desire to secure a "masse de manoeuvre" to carry out speculative or business projects;
- (vii) the desire to bequeath a fortune;
- (viii) the desire to satisfy a pure merely instinct.

Business Motives. The subjective factors are also influenced by the behavior of business corporations and governments. Keynes lists four motives for accumulation on their part:

- (i) Enterprise, the desire to do big things and to expand;
- (ii) Liquidity, the desire to meet emergencies and difficulties successfully;
- (iii) Income raise, the desire to secure large income and to show successful management;
- (iv) Financial prudence, the desire to provide adequate financial resources against depreciation and obsolescence, and to discharge debt.

These factors remain constant during the short-run and keep the consumption function stable.

Objective Factors. The objective factors which undergo rapid changes and cause. Marked shifts in the consumption function are considered on p. 109. First we take up the objective factors given by Keynes.

(1) **Change in the Wage Level.** If the wage rate rises, the consumption function shifts upward. The workers having a high propensity to consume spend more out of their increased income and this tends to shift the C curve upward. If, however, the rise in the wage rate is accompanied by a more than proportionate rise in the price level, the real wage rate will fall and it will tend to shift the C curve downward, A cut in the wage rate will also reduce the consumption function of the community due to a fall in income, employment and output. This will shift the curve downward.

(2) **Windfall Gains or Losses.** Unexpected changes in the stock market leading to gains or losses tend to shift the consumption function upward or downward. For instance, the phenomenal/windfall gains due to the stock market boom in the American economy after, 1925 led to a rise in the consumption spending of the stock-holders by roughly in proportion to the increased income and as a result the consumption function shifted upward. Similarly, unexpected losses in the stock market lead to the downward shifting of the C curve.

(3) **Changes in the Fiscal Policy.** Changes in fiscal policy in the form of taxation and public expenditure affect the consumption function. Heavy commodity taxation adversely affect the consumption function' by reducing the disposable income of the people. This, is what actually happened during the Second World War when the consumption function shifted downward due to heavy indirect taxation, rationing and price controls, On the other hand, the policy of progressive taxation along with that of public expenditure on welfare programmes tends to shift the consumption function upward by altering the distribution of income.

(4) **Change in Expectations.** Change in future expectations also affect the, propensity to consume. If a war is expected in the near future, people start hoarding durable and semi-durable, commodities in anticipation of future scarcity and rising prices. As a result, people buy much in ,excess of their current needs and the consumption function shifts upward. On the contrary, if it is expected: that prices are likely to -fall in the future, people would buy only those things which are very essential. It will lead to a fall in consumption demand and' to a downward shift of the consumption function.

(5) **Change in the Rate of Interest.** Substantial changes in the market rate of interest may influence the consumption function indirectly. There are several ways in which the rate of interest may affect the consumption function. A rise in rate of interest will lead to a fall in the price of bonds, thereby tending to discourage the propensity to consume of the bond-holders. It may also have the effect of substituting one type of assets for another. People may be encouraged to save rather than invest in bonds. In case they are buying durable

consumer goods like refrigerators, scooters, etc. on hire-purchase system they will tend to postpone their purchases when the rate interest rises. They will have to pay more in installments and thus their consumption function will shift downward. Keynes' wrote, 'Over a, long period substantial changes in the rate of interest probably tend to modify social habits considerably.'

Besides, these five factors; Keynes also listed changes in accounting practice with respect to depreciation. This factor has been rejected by Hansen who opines that "it is not a factor which can be thought to change violently in the short-run and it was a mistake for Keynes to include it here." However, we add some of the other objective factors listed by Keynes's followers."

(6) Financial Policies of Corporations, Financial policies of corporations with regard to income retention, dividend payments and reinvestments tend to affect the consumption function in several ways. If corporations keep more money in the form of reserves, dividend payments to shareholders will be less, this will have the effect of reducing the income of the shareholders and the consumption function will shift downward. Moreover "a lag between corporate profits and dividend payments tends to slow/up the 'multiplier' process of consumption responding and income propagation For excessive corporate savings, however prudent from the standpoint of individual corporations, not only reduce consumption expenditures but may also make it 'almost hopeless to find still more new investment,' as Keynes put it."¹²

(7) Holding of Liquid Assets. The amount of liquid assets in the form of cash balances, savings and government bonds in the hands, of consumers also influence the consumption function. If, people, hold larger liquid assets they will have a tendency to spend more out of their current income and the propensity, to, consume will move upward, and vice versa. Pigou was of the view that with a cut in money wage, prices fall and the real value of such assets increases. This tends to shift the consumption function upward. This is called the "Pigou Effect." But it is not necessary for the Pigou effect to take place, via money wage-cut. An increase in the real value of such accumulated savings takes place directly through a fall in prices and a decrease in their value through price inflation. In the former case, asset holders tend to spend more on consumption and in the latter case less on consumption, If, however, the low income groups hold such liquid assets, the tendency would be for the consumption function to shift upward because their propensity to consume is high.

(8) The Distribution of Income, The distribution of income in the community, also determines the shape of the consumption function. ,If there are large disparities in income distribution between the rich, and 'the poor, the consumption function is low because the rich have a low propensity to consume and the poor with a very low income; . are unable to spend more on consumption. If through progressive taxation and other fiscal measures, the inequalities of income and wealth are reduced, the consumption function will shift upward because with the increase in the income of the poor their consumption expenditure will increase more than the reduction in the expenditure of the rich. "Moreover, If the distribution of income is significantly altered for political or

humanitarian reasons, consumer habits themselves may undergo such changes as to cause the position or shape of the entire consumption function to vary perceptibly."¹³

(9) Attitude toward Saving. The consumption function is also influenced by people's attitude toward saving. If they value future consumption more than present consumption, they will tend to save more and the consumption function will shift downward. This tendency may be reinforced by the state through compulsory life insurance, provident fund and other social insurance schemes to keep the consumption function low. In a high-saving economy, the consumption function is low.

(10) Duesenberry Hypothesis. James Duesenberry has propounded a relative income hypothesis affecting the consumption function. The first part of this hypothesis relates to the demonstration effect. 'There is a tendency in human beings not only to keep up with the Joneses but also to surpass the Joneses, that is, the tendency is to strive constantly toward a higher consumption level and to emulate the consumption patterns of one's rich neighbors and even to surpass them. Thus consumption preferences are interdependent. The second, part is the 'past peak of income' hypothesis which explains the short-run fluctuations in consumption. Once the community reaches a particular income level and standard of living, it is reluctant to come down to a lower level of consumption during a recession. Consumption is sustained by the reduction in current saving and vice versa. So there is no shift in the consumption function during the short-run. There is simply an upward downward movement on the same consumption function when income rises or falls during the short-run.'

We may conclude with Professor Hansen "that except for quite abnormal or revolutionary changes in certain "objective factors--expectations caused by unusual events such as wars, earthquakes, strikes, revolutions etc., major changes in the tax structure, quite exceptional windfall losses or gains-apart from such drastic changes, shifts in the 'propensity to consume out of a given income' are not likely to be" of more than secondary importance."¹⁴

MEASURES TO RAISE THE PROPENSITY TO CONSUME

The propensity to consume remains stable, during the short-run due to the existence of certain psychological and institutional factors in the society. But "employment can only increase *pari passu* with an increase in investment; unless, indeed, there is a change in the propensity to consume," as pointed out by Keynes. Therefore, it is significant to study the measures which tend to raise the propensity to consume

- (1) **Income Redistribution.** Redistribution of income' in favour of the poor tends to raise the propensity to consume because the marginal propensity to consume of the low income groups is high in comparison to the rich. Therefore, the propensity to consume can be raised by transferring income, and wealth from the rich to the poor. This can be done by the state through its taxation and public spending Policies. By imposing progressive taxes on incomes, expenditures, estates, capital gains: etc., the state is able to mobilise larger revenues for providing more facilities to the poor. But care should be taken that Such taxation should not,

adversely affect investment Secondly. the state can increase the income, of the poor through judicious public expenditure programme. By starting public works, it is in apposition to increase income by providing larger employment opportunities to the unemployed . The provision for free education, free mid-day- meals, free health services, low-rent housing indirectly ,helps in increasing the income of the workers and tends to raise their Consumption expenditure. Such social expenditures by the state also increase the efficiency of the workers which, in turn leads to a rise in their wages.

(2) Increased Wages. If wages are raised, they will have direct effect in shifting the consumption function upward. But a policy high wages adversely affects the level of employment in the economy

for it is not possible to raise the marginal revenue productivity of labor in the short-run. If wages are raised in such a situation, costs will rise-in the absence of increase in the marginal revenue productivity of labor and the economy is likely to experience unemployment .Therefore, the long-run wage' policy should be such that wages increase pari passu with increase in labor productivity. This will tend to raise the level of consumption in the economy.

(3) Social Security Measures. 'Social security measures tend to raise the consumption function in 'the long-run. Provision for unemployment relief, medical, facilities, old age pension, etc. remove future uncertainties and the tendency to save is reduced on ,the part of the people, The state should; therefore, provide Larger social security measures to raise the propensity to consume of the people. Unemployment relief and old age pensions tend to maintain a high consumption expenditure even during 'a depression and thus help bring revival in the economy. So social security measures tend to raise the consumption function both in periods of prosperity and depression.

(4) Credit Facilities. Cheap and easy credit facilities help in shifting the consumption function upward. When 'loans are easily and cheaply available to the people, they' buy more durable consumer goods like scooters, televisions, refrigerators etc. This tends to raise the propensity to consume. To purchase, these things on installment basis or on hire-purchase system produces the same effect thus credit facilities in various ways, help raise the propensity 'to consume "of durable consumer goods,

(5) Advertisement. Advertisement is one of the most significant ways to raise the propensity to consume in modern times ;'Advertisement and propaganda through the various media of radio, television _ cinema, newspaper, etc. make the consumers familiar with the uses of products. The consumers are attracted toward them and they tend to buy them; this raises-their propensity to consume.

(6) Development of the Means of Transport. Well developed means of transport also tend to shift the consumption function upward. The movement of goods from .the manufacturing centers to the different parts of the country becomes easy. The size of the market expands. The prices may also fall due to the reduction of transport cost Things are

available to the people in their 'respective towns. All this as the tendency to raise the consumption function.

(7)Unbanisation. As a corollary to the above, 'urbanisation \i\helps raise the propensity's consume. When urbanization takes place, people move from the rural to the urban areas. They are enamored by new articles and influenced by the demonstration effect. This tends to shift the consumption function upward. Thus the state should follow, the, policy of deliberate urbanisation for the purpose of raising the consumption function.

Questions for self assessment:

1. Define consumption function and propensity to consume?

2. What are the various properties or attributes of consumption function?

3. What are the various determinants of consumption?

POINTS TO PONDER:

The Consumption Function

MEANING OF CONSUMPTION FUNCTION

The consumption function or propensity to consume refers to Income consumption relationship.

It is a "functional relationship between two aggregates, i.e., total consumption and gross national income."

Symbolic representation of consumption function

Symbolically, the relationship is represented as $C = f(Y)$, 'where C is consumption, Y is income, and f is the functional relationship.

Individual motives

There are eight individual motives:

- (i) the desire to build reserves for unforeseen contingencies;
- (ii) the desire to provide for anticipated future needs, i.e., old age, sickness, etc.,
- (iii) the desire to enjoy an enlarged future income by way of interest and appreciation;
- (iv) the desire to enjoy a gradually increasing expenditure in order to improve the standard of living; (v) the desire to enjoy a sense of independence and power to do things;
- (vi) the desire to secure a "marge de manœuvre" to carry out speculative or business projects;
- (vii) the desire to bequeath a fortune;
- (viii) the desire to satisfy a pure merely instinct.

Business motives

- i) Enterprise, the desire to do big things and to expand;
- (ii) Liquidity, the desire to meet emergencies and difficulties successfully;
- (iii) Income raise, the desire to secure large income and to show successful management;
- (iv) Financial prudence, the desire to provide adequate financial resources against depreciation and obsolescence, and to discharge debt.-

MEASURES TO RAISE THE PROPENSITY TO CONSUME

- Income Redistribution
- Increased Wages
- Social Security Measures
- Credit Facilities
- Advertisement
- Development of the Means of Transport
- Urbanization
