

# PRINCIPLES OF ECONOMICS

Lecture 40 CONSUMPTION

November, 2015



# TOPIS OF DISCUSSION

## 1. Consumption

- Meaning
- Consumption Function
- Constituents
  - Average Propensity to Consume (APC)
  - Marginal Propensity to Consume (MPC)

# CONSUMPTION- KEYNES'S CONJECTURES

➤  $Y = C + I$

➤ Consumption is determined by current income

$$C = f(Y)$$

Keynesian concept of consumption function stems from the fundamental psychological law of consumption.

**Psychological Law of Consumption:** When the total income of a community increases, the consumption expenditure of the community will also increase, but less than proportionately

# APC & MPC

- Marginal propensity to consume- rate of change in consumption due to change in income
- $MPC = \Delta C / \Delta Y$  is between zero and one ( $0 < c < 1$ )
- Average propensity to consume is the absolute level of expenditure
- $APC = C / Y$  falls as income rises
- Average propensity to save (APS) =  $1 - APC$
- Marginal propensity to save (MPS) =  $1 - MPC$

# DETERMINANTS OF CONSUMPTION FUNCTION

## • OBJECTIVE FACTORS

- Change in wages/salaries and income
- Distribution of income
- Windfall gains or losses
- Changes in fiscal policy
- Change in expectations/inflation
- Change in rate of interest
- Financial policies of the corporations
- Holdings of liquid assets
- Attitude towards savings

## SUBJECTIVE FACTORS

- Security Motive
- Desire for Improvement
- Financial Economies (Prudences)
- Demonstration effect
- Desire to maintain the accustomed standard of living

**THANK YOU 😊**