JAYOTI VIDYAPEETH WOMEN'S UNIVERSITY, JAIPUR

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Faculty of Education and Methodology

Faculty Name- JV'n Dr. Md Meraj Alam

Program- BA B.Ed 3rd Semester

Course- Macroeconomics

Digital session name - Consumption Function

Introduction:

Given the aggregate supply, the level of income or employment is determined by the level of aggregate demand; the greater the aggregate demand, the greater the level of income and employment and vice versa.

Keynes was not interested in the factors determining the aggregate supply since he was concerned with the short run and the existing productive capacity. We will also not explain in detail the factors which determine the aggregate supply and will confine ourselves to explaining the determinants of aggregate demand.

Aggregate demand consists of two parts—consumption demand and investment demand. In this article we will explain the consumption demand and the factors on which it depends and how it changes over a period of time. Consumption demand depends upon the level of income and the propensity to consume. We shall explain below the meaning of the consumption function and the factors on which it depends.

The Concept of Consumption Function:

As the demand for a good depends upon its price, similarly consumption of a community depends upon the level of income. In other words, consumption is a function of income. The consumption function relates the amount of consumption to the level of income. When the income of a community rises, consumption also rises.

How much consumption rises in response to a given increase in income depends upon the marginal propensity to consume. It should be borne in mind that the consumption function is the whole schedule which describes the amounts of consumption at various levels of income.

Consumption demand depends on income and propensity to consume. Propensity to consume depends on various factors such as price level, interest rate, stock of wealth and several subjective factors. Since Keynes was concerned with short-run consumption function he assumed price level, interest rate, stock of wealth etc. constant in his theory of consumption. Thus with these factors being assumed constant in the short run, Keynesian consumption function considers consumption as a function of income. Thus

$$C= f(Y)$$

In a specific form, Keynesian function can be written as:

$$C = a + f(Y)$$

Where a and b are constants. While a is intercept term of the consumption function, b stands for the slope of the consumption function and therefore represents marginal propensity to consume.

Keynesian consumption function has been depicted by CC' curve in Fig. 6.1 in which along the X-axis national income is measured and along the Y-axis the amount of consumption is measured. In this figure, a line OZ making 45° angle with the X-axis, has been drawn. Because line OZ makes 45° angle with the X-axis every point on it is equidistant from both the X-axis and Y-axis.

Therefore, if consumption function curve coincides with 45° line OZ it would imply that the amount of consumption is equal to the income at every level of income. In this case, with the increase in income, consumption would also increase by the same amount.

As has been said above, in actual practice consumption increases less than the increase in income. Therefore, in actual practice the curve depicting the consumption function will deviate from the 45° line. If we represent the above consumption schedule by a curve, we would get the propensity to consume curve such as CC in Fig.

It is evident from this figure that the consumption function curve CC' deviates from the 45° line OZ. At lower levels of income, the consumption function curve CC lies above the OZ line, signifying that at these lower levels of income consumption is greater than the income.

It is so because at lower levels of income, a nation may draw upon its accumulated savings to maintain its consumption standard or it may borrow from others. As income increases, consumption also increases and at the income level OY_0, consumption is equal to income.

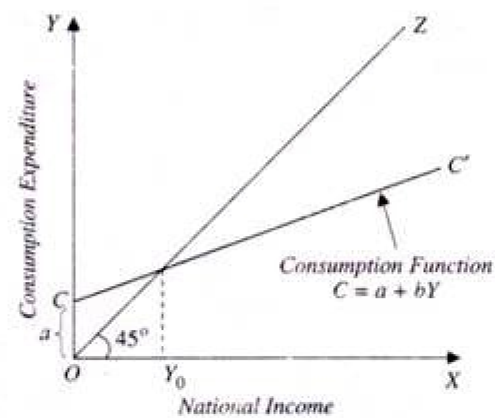

Fig. 6.1. *Keynesian Linear Consumption Function*

Source: Internet

Beyond this, with the increase in income, consumption increases but less than the increase in income and therefore, consumption function curve CC lies below the 45° line OZ beyond Y_0. An important point to be noted here is that beyond the level of income OY_0, the gap between consumption and income is widening. The difference between consumption and income represents savings. Therefore, with the increase in income, saving gap also widens and as we shall see later, this has a significant implication in macroeconomics.