CONSUMPTION FUNCTION

The consumption function or propensity to consume refers to income consumption relationship.
The consumption function relates the amount of consumption to the level of income or in other words we can say that "consumption is a function of income."
Consumption Function should be carefully distinguished from the amount of consumption as by consumption function we mean the whole schedule which shows consumption at various levels of income, whereas the amount of consumption means the amount consumed at a specific level of income.
Keynes was the first who evolved the concept of consumption function. He also revealed an important fact regarding the schedule of consumption function is that when the income rises then consumption also rises but not as much as the income, the reason for rising of consumption less than income is that a part of the increement in income is saved.
Now, we consider a hypothetical schedule of consumption function.
Consumption demand depends mainly on income and propensity to consume.
Propensity to consume on other hand depends on various factors such as price level, interest rate, stock of wealth & several other factors, but since Keynes was concerned mainly with short run consumption function so he

assumed price level, interest rate etc to be constant in his theory. Thus in the short run Keynesian consumption function considers consumption only as a function of current income.

Thus $C = f(Y)$ —— ①

C = Consumption
Y = Income and
f is the functional relationship.

Here in eq^n ① C is a dependent variable and Y is an independent variable, i.e C is determined by Y. In specific way, Keynesian consumption function can be also written as;

$$C = a + bY$$

where a & b are constants
Here a is the intercept term of the consumption function & b stands for slope of consumption function & therefore represents MPC
& Y represents the level of current income.

Now, let us consider a hypothetical schedule of consumption function;

Income (Y) Rs. in crores	Consumption (C) Rs. in cr.
0	75
1000	750
1100	825
1200	900
1300	975
1400	1050
1500	1125
1600	1200

Now when we consider the above drawn schedule of consumption function we see that when income is zero during depression then people spend out their past savings say Rs 25 on consumption because they must eat in order to live.

Now, when an income of Rs1000 cr. is generated in the economy then the consumption is equal to Rs750 cr. Again now when Income increases from Rs1000 cr to Rs 1100 cr then the amount of consumption rises from Rs750 cr to Rs 825 cr. Thus with the increase in income by Rs100 crs., the consumption rises by Rs75 cr. and the remaining Rs25 cr. is saved.

Similarly, when income rises from Rs1100 cr. to Rs 1200 cr then the amount of consumption increases from Rs 825 cr to Rs 900 cr. Here also as a result of increase in income by Rs100 cr the amount of consumption rises by Rs75 cr. & the remaining Rs 25 cr. is being saved. The same theory applies to further increase in income & consumption.

So, the above schedule reveals an important fact that when income rises consumption also rises but not as much as rise in income because a part of increment in income is saved.

We can also illustrate the keynesian consumption function diagrammatically.

~~Considerg~~ Consider fig.(1) drawn below. In the fig. NI is measured along x-axis and the amount of consumption or consumption expenditure is being measured along the Y-axis.

In the fig. a line making 45° ~~line~~ angle with X-axis (OZ)

has been drawn. As line OZ makes 45° angle with X-axis so every point on it is equidistant from both the axes. ~~Thus on the line OZ income & consumption are equal.~~

Now in the fig. Keynesian consumption function curve is being depicted by CC'.

From fig. we could see that consumption function curve CC' deviates from the 45° line OZ. If CC' would have coincided with 45° line OZ then it would have implied that the amount of consumption is equal to income at every level of income which in actual practice is not so because consumption increases less than income. So CC' curve deviates from 45° line OZ, and at lower level of income CC' curve lies above OZ line, which signifies that at lower level of income consumption is greater than income. This is so because at lower level of income, a nation may draw its accumulated savings to maintain its consumption standard.

Now as income increases consumption also increases & at income level OY_0, consumption is equal to income i.e point B is the break-even point where C = Y.

Now, beyond the level of income OY_0, consumption increases with increase in income but less than the increase in income & hence therefore CC' curve lies below the line OZ beyond Y_0.

From the fig. we also see that the beyond the level of income OY_0, the gap between consumption & income widens. The difference between consumption & income represents saving. So in the fig. the portion of the incom

which is saved is shown by the gap between the 45° line OZ and the consumption function curve CC'. Therefore through fig. we see that with the increase in income, saving gap also widens.

Thus the consumption function measures not only the amount spent on consumption but also the amount saved.