Keynes Pyschological law of consumption:

It states that consumption expenditure increases with every increase in income but less than proportionately.

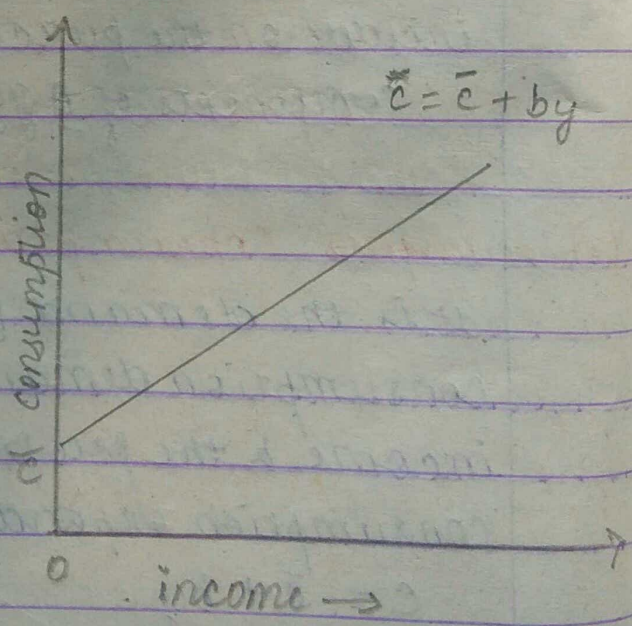
$$Y = C + S$$

S → save

Features of consumption expenditure:

1. It increases with increase in income
2. Consumption expenditure cannot be zero even when income is zero

	Income	Consumption
	0	50
	50	75
Break → Y=C component	100	100
Saving = 0	150	125
	200	150



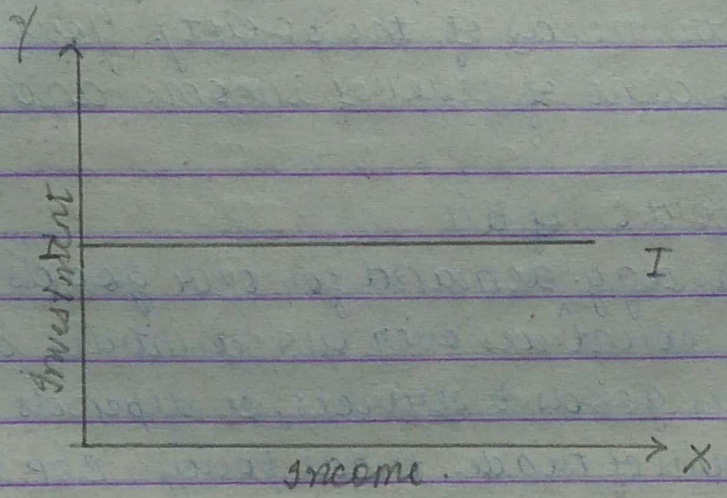
(22) Investment Demand

It is the total expenditure incurred by the producers on the purchase of capital goods. Investment demand is of two types:

(a) Autonomous Investment

(b) Induced Investment

Autonomous Investment : It is the investment which is independent of level of income and profitability. Autonomous investment remains constant at all levels of income.



Induced Investment : It is the investment made by private sector with the objective of earning profit. Induced Investment has a direct relation with the level in an economy. Induced Investment depends on 2 factors (1) Rate of Interest

(22) Marginal efficiency of Investment (MEI)

There is an inverse relationship between rate of interest and induced investment.

Marginal efficiency of capital refers to the expected profitability of new investment.

MEC > ROI (gain)
MEC = ROI
MEC < ROI (loss)

(ROI = Rate of Interest)

Govt Demand :

It is the total expenditure incurred by the government on the purchase of goods & services to fulfill the needs of the society. Govt demand is independent of level of income and a profit motive.

Net Export : of all

It is the agg. demand for our goods and services by foreign countries over our countries demand for foreign countries goods & services. It depends on exchange rate, terms of trade, trade policy, BOP position etc.

AD = C + I

In a closed economy net export is absent and govt. demand is divided into consumption demand and investment demand. so for simplicity Keynes took only 2 components of agg. demand and they are consumption & investment demand.

Income	Consumption (C)	Investment (I)	AD = C + I
100	120	40	160
200	200	40	240
300	280	40	320
400	360	40	400
500	440	40	480
600	520	40	560

$AD = \bar{C} + by + I$

$= \bar{A} + by \quad (\bar{C} + I = \bar{A})$

$\bar{A}$ = autonomous component (when income = 0)