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Psychological Law of Consumption (1935)

Psychological law of consumption also known as Absolute income hypothesis.
Keynes propounded a basic law about the consumption function. This has been described as psychological law of consumption by ***Professor Kurihara.***

According to this law of consumption when the aggregate income increases consumption also increases but rate of increase in consumption will be less than the rate of increase in income. *In other words ; we can say that "* ***There is a direct but non-proportional relationship between income and Consumption."***

Note:
Non proportional relationship shows out of the increment in income if part is saved not consumed that is;

- ***APC <1 and ,***
- ***MPC < 1***

Assumptions :

1. *The MPC will be less than one (MPC< 1) provided the psychological and institutional complex of the society remains constant.*
2. *Normal conditions should continue to prevail in the economy i.e; neither any war should break out nor should occur any revolution, hyper - inflation , or any extra -ordinary event.*
3. *The Keynesian law is that it applies to an advanced capitalist country in which the Government does not interfere in the working of free private Enterprise . In other words, it applies where the Govt. follows a* ***laissez faire policy.***

According to to Keynesian psychological law if Consumption , value of MPC lies between O to 1 .

Keynes did not tell about MPC = 0 and MPC = 1.

Important Point :

- *James Tobin and Arthur Smithies tested this hypothesis (Absolute income hypothesis) in separate studies and came to the conclusion that the short run relation between Consumption and income is non - proportional but the time series data show the long run relationship to be proportional.*

- *Simon Kuznets (the 1971 Nobel Prize Winner in Economics) considered a long period covering 1869 to 1929. His data may be described as the long - run or secular time- series data. This data indicated no long run change in Consumption despite a very large increase in income during the short period. Thus , the long run historical data that generated long run or secular Consumption Function were inconsistent with the Keynesian Consumption Function.*