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B.A.Part -1
Paper-2
Topic :- **Psychological law of consumption**
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Keynes' law is limited by the following assumptions:

1. Constancy of Psychological and Institutional Factors:

Propensity to consume will remain stable owing to the constancy of the existing psychological and institutional complexities influencing consumption expenditure.

2. Normal Economic Conditions:

General economic conditions are normal and there are no abnormal and extraordinary circumstances such as war, revolution, inflation, etc.

3. Laissez-faire Policy:

It is assumed that there exists a free capitalist economy, in which there is no government restriction on consumption when income increases.

Implications of the Psychological Law of Consumption:

A more detailed analysis of Keynes' law shows that it has the following important implications:

1. Highlighting the crucial importance of investment in an economy:

A vital point in the law is the tendency of people not to spend on consumption the full amount of an increase in their income. There is thus a "gap" between aggregate income and aggregate consumption.

Assuming the consumption function to be stable during a short-run period, the "gap" will widen with an increase in income. This gives rise to the problem of investment. Investment should be increased to fill the gap between income and consumption. Keynes, therefore, stresses that investment is the crucial and initiating determinant of levels of income and employment.

2. Refuting Says law of Market

It refutes Say's Law of market by indicating the demand deficiency and possibility of over-production.

3. Explanation to the Business Cycle:

An explanation of the turning points of a business cycle is also provided by this law. The upper turning point from a boom is caused by a collapse of the marginal efficiency of capital owing to the fact that consumption expenditure does not keep pace with increase in income during the prosperity phase.

Similarly, the law explains the revival of the marginal efficiency of capital and the turning point of recovery from a depression, on the basis of the fact that when income is reduced consumption expenditure does not decrease in the same proportion.