CONCEPT: THE CONSUMPTION FUNCTION

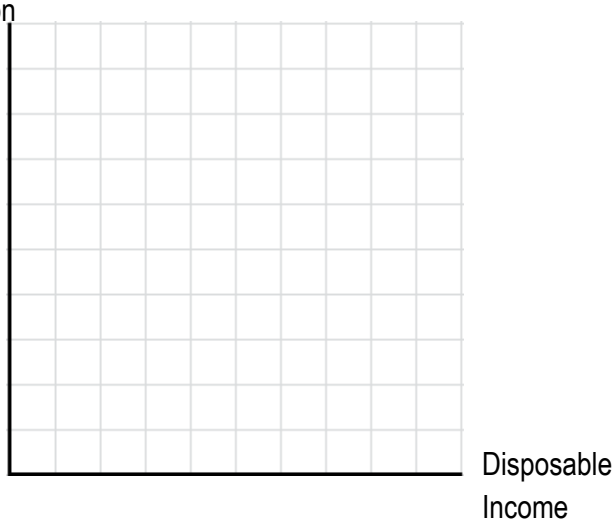
- The ***consumption function*** relates the amount of *household spending* to the level of _____ income
  - □ The consumption function is also referred to as the ***consumption schedule***
  - □ ***Disposable Income*** is the amount of income left after paying taxes
    - > Disposable income is either used for _____ or _____

$$Disposable\ Income = National\ Income - Net\ Taxes$$

POP QUIZ: You work in a candy factory that has been making tons of sweet, sweet profit. For all your hard work and dedication, you receive a bonus of $10,000 and an annual raise of 20% of your current salary. Due to this:

a) You are likely to increase your total consumption
b) You are likely to decrease your total consumption
c) Your total consumption will stay the same

Consumption Function



- ***Marginal Propensity to Consume (MPC)*** – the amount that consumption changes when disposable income changes
  - □ MPC is the _____ of the consumption function

$$MPC = \frac{\Delta\ Consumption}{\Delta\ Disposable\ Income}$$

- ***Marginal Propensity to Save (MPS)*** – the amount that household saving changes when disposable income changes

$$MPS = \frac{\Delta\ Savings}{\Delta\ Disposable\ Income}$$

● Disposable income is either used for _____ or _____

□ Any increase in disposable income will either be _____ or _____

$$Disposable\ Income = Consumption + Savings$$

$$1 = MPC + MPS$$

● Sometimes, the consumption function is represented algebraically using the formula for a line:

$$Consumption\ (C) = mx + b$$

C = Consumption

m = _____ = _____

x = _____ = _____

b = _____ = the amount of consumption when disposable income equals _____

$$C = (MPC * Yd) + b$$

PRACTICE: Calculate the Marginal Propensity to Consume and the Marginal Propensity to Save using the following table:

Disposable Income	Consumption	Savings	MPC	MPS
$18,000	$16,000			
$20,000	$17,200			
$22,000	$18,400			
$24,000	$19,600			
$26,000	$20,800			

PRACTICE: If the Keynesian consumption function is C = 10 + 0.8 Yd then, if disposable income is $1000, what is amount of total consumption?

a) $0.80
b) $800
c) $810
d) $0.81
e) Cannot be determined

PRACTICE: If the Keynesian consumption function is C = 10 + 0.8 Yd then, when disposable income is $1000, what is the marginal propensity to consume?

a) 0.8
b) 800
c) 810
d) 0.81
e) Cannot be determined

PRACTICE: An increase in the marginal propensity to consume will:

a) Lead to the consumption function becoming steeper
b) Shift the consumption function upwards
c) Shift the consumption function downwards
d) Not affect the consumption function