

Cooleconomics.com
Principles of Economics

Study Question – Consumption

An economy has consumption function $C = 200 + .6(Y-T)$. Household taxes are 200. Transfer payments are 300.

- a) Graph the consumption function
- b) Calculate consumption, personal savings, and disposable income if national income is 5000.
- c) How much will consumption and savings **change** if income changes by \$500?

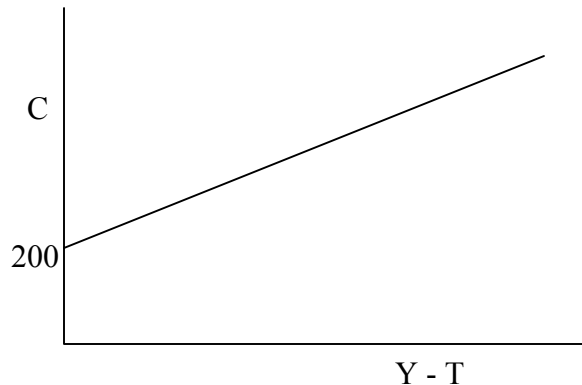
Answers to Study Questions – Consumption

An economy has consumption function $C = 200 + .6(Y-T)$. Household taxes are 200. Transfer payments are 300.

- Graph the consumption function
- Calculate consumption, personal savings, and disposable income if national income is 5000.
- How much will consumption and savings **change** if income changes by \$500?

Answers: (These use the simplifying assumptions of our models)

a)



b) $C = 200 + .6(5000 - 200 + 300) = 3260$

$$\text{disposable personal income} = 5000 - 200 + 300 = 5100$$

$$\text{personal savings} = \text{disposable personal income} - \text{consumption} = 5100 - 3260 = 1840$$

c) The MPC is .6, meaning that consumers spend 60 cents of every dollar of extra income (saving the other 40 cents).

$$\text{So consumption rises by } .60 \times 500 = 300$$

$$\text{And savings rises by } .40 \times 500 = 200$$

(This assumes no changes in household taxes or transfer payments.)