

Keynes's Psycho-Economic Law, Wages and Consumption

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Received 10.07.2017; Accepted 07.08. 2017

Abstract:

We consider that a milestone of the economic thought is represented in the modern era by John Maynard Keynes. His "revolution" in the theory and practice of Economics has influenced decisively the capitalist economy for four decades of stability and prosperity, until the oil shocks from the 8th decade of the 20th century. Our intention is to link Keynes' Theory of Income with the Happiness Economics in the world of today. to see and understand if the Keynesian theory and practice is still valid, both at macroeconomic level and, mainly, at the individual and household level. A general remark following the day-by-day life, the statistic data regarding the consumption, the economic good sense, is that people spend the money they get, but not all of it. If the particular intention is to get the right position (status), to reach happiness, or stability at the national economy level, it is needed the existence of Savings to ensure future investments and necessary purchases. The answer to the question is positive, both micro and macro level (the latter being an aggregate of the first one), taken into account the specific requirements and conditionalities of the analyzed law.

Keywords: *household, national economy, consumption, savings, future investments, GDP.*

Economic Laws in the literature review

The economic laws express essential, necessary, constant, redundant, objective, conditional, tendentious relations between the various aspects, phenomena and mechanisms of the economic life, involving people consciously participating in economic and social life.

It is necessary to retain the characteristics of the laws in the analyzed field, because the whole amplitude of the subsequent development of the present scientific discourse is based precisely upon the capturing and highlighting of these fundamental attributes of the concept of a law applicable to economic life. This is the concept undergoing the terminological analysis and refinement, a concept that has evolved in the Western literature, to keep it from being confused or associated with the term *lawfulness*. The word comes from the Russian word „zakonomernosti” [10] and it means

either *the ensemble of laws of nature, of society and of thought, or the appropriation of the phenomena of unfolding in compliance with certain (objective) laws* (our emphasize).

It is clear that the utmost interesting thing is to highlight the fact that economic facts and phenomena are not based upon hazard and are not random, but are generated and governed, as are those in nature, of certain ties that possess all the attributes mentioned above: laws, that is. *The laws of the economic field*, as well as those of other natural sciences, point out the ability according to which, as knowledge progress, that *their formulation undergoes changes and that the accuracy of the reflection of related phenomena and processes is constantly improved*.

The laws, with their significance of *general observations, relative truths* that emerged from the real economic and social life and which the *economic science* has synthesized in statements made available to all categories of economic agents, provide the knowledge necessary for all people, indispensable for the conduct of any productive activity, the maintenance of social, political, and economic relations, in accordance with the objective requirements of everyday life, as Blaise Pascal (1623-1662) perceptually highlighted it: *"the people and the scholars create the real world"* [7].

There is a public perception concerning Economics, that it is governed by certain forces similar to the gravity law. Everything is about Income and Expenses. If a glass falls and it breaks, so higher spending than income leads to the bankruptcy situation, thus entailing the destruction of that precise entity. In order to maintain jobs, wellbeing and democracy, a concerted action by the state is required, through the policies it promotes and implements, the potentates of the day and of the corporate system, but also of the ordinary people who are engaged in this system and that it helps to operate and develop [6].

And, in the light of the above, the consumption analysis in today's economy and society perfectly fits; the consumption cannot be the unique "engine" of the economy and the proponent of the GDP growth. It is in constant interaction with the other elements of the economic system without which it can not exist and cannot play the its intended role. [14]. This approach we will take using the methods of analyzing the subject from the specific literature, empiric data from the business and social environment and the induction to see the subject aggregation at the macroeconomic level.

Keynesian thinking

John Maynard Keynes (1883-1946), having great teachers at the Cambridge University, such as Alfred Marshall and A. C. Pigou, dedicated his studies to the pure economy and to understand the mechanisms for the well-functioning of the capitalist economy after the Great Depression 1929-1933. The entire corpus of his theories and concepts about Economics was set out within his masterpiece *"The General Theory of Employment, Interest and Money"* (1936) [4], one of the few fundamental books (works) in the history of Economic Thought.

Among the strengths (real *cornerstones*) of the Keynesian theory set out in the above-mentioned work, there is also the enunciation of the *Basic Psychological Law on Income and Consumption*. J.M. Keynes rejects the explanation of the Classic French thinker Jean-Baptiste Say who states that automatically the savings are included in a new economic process, i.e. savings become investments. BUT, in keynesian assumption, part of the earnings of employees and entrepreneurs *are not reintroduced into economic flows through the financial market as well as that of goods and services*. There is a phenomenon of (money) hoarding, i.e. the process of keeping the monetary values at their holders, without introducing them and putting them on the market, that is without investing them. Even if these savings are considered to be safe, however, the activity of firms (enterprises) suffers, lacking these monetary resources necessary for the good development of production, which leads to the *stabilization of the economic system at a level of the output inferior to that of the full use of the available resources* [7].

The solution that Keynes anticipates to get out of the crisis was that of the incitement of the public power *of the global demand for goods and services*. In other words, the demand for all goods and services to be replaced by the public investments or consumption, both firms and public authorities [1].

For the present paper, we are interested in the *Keynesian Income Theory*, theory which, in its essence, states that the current real income (the disposable one) is the most important determinant in the act of consumption on short run.

At this point, we have to add a newer theoretical development of the relationship between income and consumption, as *the Paradox of Happiness*. This one was drawn by another Englishman researcher, Richard Easterlin, in the early 70' of the last century. Here, we may find out a mixture of psychological human features, mainly, and economic considerations. In its essence, this theoretical product affirms that happiness level has a positive relationship with current income, but a negative one with the aspirations about future income (future status). In Easterlin' vision, *the level of happiness, of the wellbeing, satisfaction/pleasure of life, is somewhat constant, while disposable income rises* [8].

At the world (macro) level, we are in the presence of *The World Happiness Report* which presents on top of the countries for 2016 Norway, while for 2015 the happiest country was Denmark. This Report (and countries' ranking) is based on indicators, such as GDP/capita (the only tangible which gives substance to our problem and analysis), and then generosity, trust, hope for healthy life, freedom to make changes in the life. Overall, the Nordic countries are considered the happiest countries in the world, with no or very low level of corruption, high standards of life, developed and stables economies....

The Keynesian Fundamental Psycho-Economic Law

John Maynard Keynes, in his masterpiece work of 1936 and other analysts in the Keynesian work [2] have analyzed the consumption behavior of community/people, starting from subjective elements and based on human psychology. The knowledge of human nature and also the knowledge of men and women habits are determinant in understanding the disposition of people to increase their consumption, *on an average*, but not as much as the increase in their income.

And thus, we arrive to the highlighting of Keynes' conception, materialized in *the Fundamental Psychological Law*:

Usually and on average, as income increases, consumption increases too, but not by as much as the increase in income.

Mathematically, the above sentence is written as follows:

$$\Delta Y > \Delta C$$

i.e. the growth margin of disposable income is higher than the growth margin of consumption (spendings)

Following the sense at the end of previous sub-chapter, the Fundamental Psycho-Economic Law is based on *the disposable income*, according to the equation:

$$Y = C + S \quad \text{where} \quad \begin{array}{l} \text{C-Consumption} \\ \text{S-Savings} \end{array}$$

As we see, from a subjective, a psychological point of view, J. M. Keynes considered as a basic theoretical demarche the reason of *increasing the gap between income and consumption, as income increases*, theoretical construction that will finally lead the author at stipulation of *the existence of a balance of capitalist economy at a level of under-utilization of workforce*.

Based on what Lord Keynes is telling us in Book III, we face the reality that, *on short run*, we face to the people's habits, consumption behavior, and it takes time to catch up with their income increase. The same thing it is happening at the national income level, when this one increases,

only a smaller porportion of it will be spent, the most part will be saved for development and future projects. Of course, nowadays, the situation is quite different, in the sense that a larger part is consumed, but important is to remain an important part for investments (this aspects prove the managerial capacity of the modern State) [11].

At the microeconomic level (individuals, households) and, even, at the macroeconomic level (where we are dealing with aggregate measures), the expenditures on consumption to purchase goods and services such as food, clothing, shelter, fuel, energy etc...is the largest part of general expenditures or aggregate expenditure. Therefore, it appears a difference between earnings (income) and what is not consumed, difference calld savings (S).

Furthermore, according to Keynes' theory, in this situation it intervenes *the Consumption function*, under the form:

$$C = f(Y)$$

i.e. the consumption is directly linked to the income, it is proportional with the disposable income.

Hence, the importance of existence of savings, or (money) hoarding, in order to ensure the stability of households or national economies, capable in such manner to make further investments and spendings. A particular situation is that of zero income, case in which we are talking about *autonomous consumption*. This one is independent of the level of the disposable income. It is the amount of consumption which occurs even the income level is zero and agents and households will dissave to satisfy the basic needs for living [9].

In the present study, we are dealing with the term *consumer spending* which represents what households/individuals buy to fulfill everyday needs. This consumption includes goods and services and *exactly the goods or services* bought regularly to satisfy, primarily, the first and second level (physiological and safety needs) or basic stage of Maslow Hierarchy of Needs [5] give substance to the **C term** included in the above mentioned formula.

The realities of today, our valures [13] example some Central and Eastern economies, show that a raise of income, especially in the budgetary sector [15], leads to an almost simultaneously increase in the consumption goods and tariffs of services. Therefore, the level of consumption remains aprox. the same and the household or individual do not feel the respective income growth. And this

aspect sustains what Keynes said, that *when income increases, only a smaller (reduced) proportion of it is consumed.*

As a conclusion, based on John Maynard Keynes' words: *Consumption is the sole end and object of all activity.* And it is a dilemma of what we are spending for things today, for satisfying pleasures or being in trend, that is to live the moment, or to wait spending money for things in the future (how long is this future and decisions must be taken under risk and uncertainty).

At the macro level, regarding the figures provided by World Bank for 2016, we can see the proportion of consumption of households in the GDP [12]. For example, Croatia 58.3 %, Germany 53.6 %, Iceland 49.0 %, Rep. of Moldova 86.7 %, Norway 45.2 %, Romania 61.8 %, United State with no data for 2016!, European Union 56.3 %. If we to deepen the analysis (but it is no such case here), we will see that the large proportion of the expenditures are for basic goods (food, water, shelter..) and, also, for the developing countries or less developed ones, important is the quality of the products and services (a higher quality implies higher prices, hence a larger proportion of expenditures).

Conclusions and Discussions

This complex law, psychological and subjective on one hand and economic on the other, must be analyzed as being of macroeconomic nature, operating at the national (or regional) level, rather than individuals. And all this discussion is due to the already mathematic formula of the *marginal propensity*, in which

$$\Delta C + \Delta S = 1$$

i.e. when national income rises 1 monetary unit (\$, £, €) part of it goes for consumption and part for savings.

The statement was called "psychological" linked to the behavior of people and its goals for wellbeing, prosperity and happiness. Happiness which, as we saw, could become the support and "propeller" for increasing productivity and economic better results.

One more thing, not without significance: people are in a good mood, if they have in pockets enough money for safety and stability.

Another big result is that of the existence of money hoarding, either in banks, or in households. More, it exists legislative gaps in some Central and Eastern countries in the respect of dignitaries' declarations of wealth and where the cash is not stipulated within household. It is held to future spendings, being observed that higher income earners keep the spendings approximately the same and put the extra income (in fact that ΔY) in investments (either for their pleasure, or to be like

others of the same category (appropriation phenomenon). The consumption musn't be the main factor of GDP growth (like in countries as Romania), but it is in direct proportion with the salaries, which are needed to be at a higher or equal level as in the previous period. Experiments in fiscal legislation which lead to a lower level of salaries and possible deterioration of the standard of living, as also in Romania, are not required and are not in the benefit of employees and entities.

Overall speaking, the answer to the question is positive, due to the specific conditionalities existing in the statement, such as, *usually, on average* and targeting the consumption of goods and services forming the basic level of the Maslow Pyramid of Needs. The following purchasing goods, durable and luxurious, fall under incidence of other economic instruments, such as Engel's Law.

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