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FOR:

SYBCOM

BUSINESS ECONOMICS

THE CLASSICAL THEORY OF EMPLOYMENT

- The classical theory of employment refers to the theory and ideas about determinants of employment and income propounded by the classical writers like Adam Smith, Ricardo, and Mill etc.
- The classical economist took for granted the existence of full employment. In other words they assumed that the economy achieves equilibrium at the full employment level only.

ASSUMPTIONS –

- There is no deficiency in demand as supply creates its own demand.
- The unemployment generated in different sectors was automatically wiped off by the self-adjusting price mechanism.

SAYS LAW AS AN EXPLANATION OF FULL EMPLOYMENT –

- The famous Nineteenth century French economist Jean Baptiste Say expressed the Law of Market in his book “Treatise on Political Economy ”in 1803.
- J. B. Say asserted that ‘Supply creates its own demand ’. The production of output in itself generates purchasing power equal to the value of that output. It is argued that Production increases not only the supply of goods but also creates the demand to purchase these goods ’.

THE ASSUMPTIONS OF SAYS LAW OF MARKET –

- There is optimum allocation of resources
- Commodity prices and factor prices are determined in perfect equilibrium of their demand and supply
- There is perfect competition in the market
- There is free enterprise economy
- There is no government intervention in the economic field
- The size of market has no limits
- All savings are automatically invested and equality between the savings and investment is brought about by changes in the rate of interest

- According to Says Law as every additional supply creates an additional demand there can be no general overproduction. Any expansion in the output would create an equivalent expansion in income and in spending.
- In symbolic,
- $\Delta O = \Delta Y = \Delta E$

- The total demand can be divided into - a} the demand for consumers goods
- B} the demand for capital goods.
- Similarly, supply also can be divided into similar two categories. The supply of capital goods is the investment while the demand for capital goods is generated out of the savings. The function of equating saving to investment is done by the rate of interest when savings of the people increases the rate of interest declines.

- Thus the rate of interest is responsible for making demand and supply equal to each other. Thus the total demand is always equal to total supply.
- If free interplay of the market forces is allowed unemployment will be done away with automatically. If there is unemployment the wage rates will go down this will reduce the cost of production which will reduce the price of different commodities. This will bring about an additional demand for the commodities and the increased demand will push up production. This increase in production will provide employment to the unemployed labour force. In this way if the wage rates are elastic unemployment will be automatically removed.

CONCLUSION:

- In brief this law states that **supply creates its own demand.** From this it has been concluded that in a free economy there is always a tendency towards the full employment.

KEYNESIAN CRITICISM OF THE CLASSICAL THEORY –

- Unrealistic Assumption of full employment equilibrium –

Keynes considered the fundamental classical assumption of full employment equilibrium condition as unrealistic.

- Undue Importance to the long period –

Keynes opposed the classical insistence on long term equilibrium.

- There is no automatic self-adjustment in the economy –

Keynes totally disagreed with the Says Law and stressed the possibility of supply exceeding demand causing disequilibrium in the economy

- Attack on wage cut policy –

Keynes observed that a general wage cut would reduce the purchasing power in the hands of workers which means a cut in their consumption. A decline in aggregate effective demand will obviously lead to decrease in the level of employment.

- Keynes attack on Interest rate –

Keynes also attacked the classical theory in regard to saving and investment. He objected to the classical idea of saving and investment equilibrium through flexible rates of interest. According to him saving and investment equilibrium are obtained through changes in income rather than interest rate.

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THANK YOU