

D2 Macroeconomics

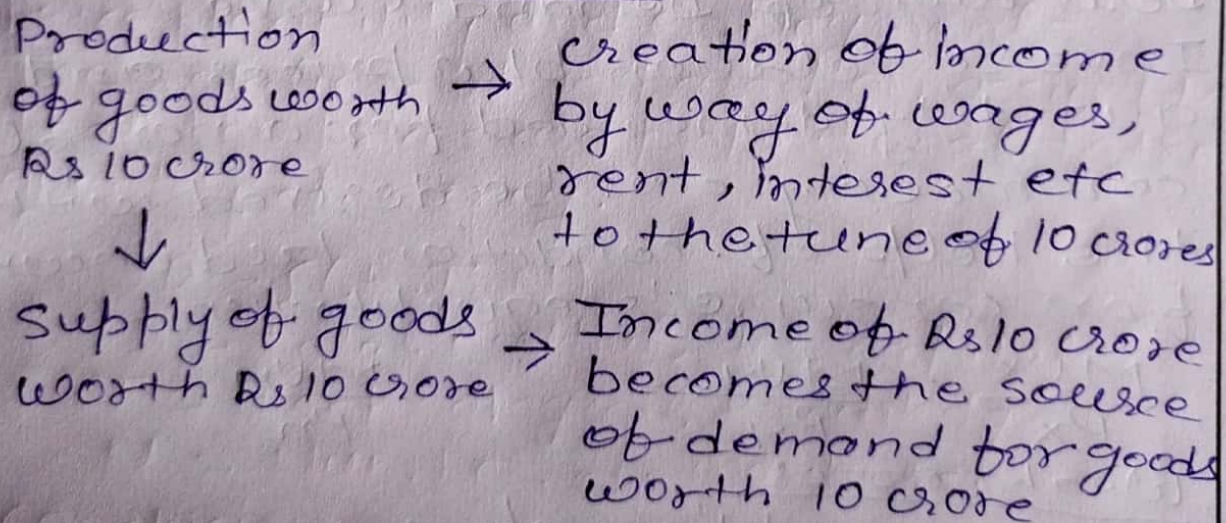
Topic - Say's law of Markets
and classical theory of employment

Say's Law of Market -

Say's Law of Market believed to be given by J.B Say, a French economist of the 19th century. According to this law, supply creates its own demand

In other words, production and supply of a product creates an equivalent demand for the product, so there can never be a problem of over production.

chart



Therefore, every supply creates its own demand. Here there will be neither over production nor deficiency of demand. J.B say concluded that aggregate demand is equal to aggregate supply.

Assumption of Say's law

- i) whatever income the economy generates is instantaneously spent either on consumption or on capital goods.
- ii) There is perfect competition in product, factor and money market
- iii) There is no govt interference in the functioning of economy
- iv) Economy is closed
- v) New entrants have easy access into the markets without distorting the existing ones.

Implications of Say's law

- i) The economy is a two sector economy.
- ii) As long as there exist unemployed resources in the economy, it is profitable to employ them.
- iii) savings are only a form of investment
- iv) The mechanism of wage flexibility brings about full employment.

Say's law and classical theory -
it is propounded by Ricardo & Adam Smith.

classical theory of employment rules out the possibility of deficient demand and hence involuntary unemployment. This theory believes in full employment or near full employment.

According to this theory, the income which is not spent on consumer goods and thus saved will be automatically invested.

Here $S = I$

Classical economists thought that if price mechanism in a capitalist economy is allowed to work freely without any interference by the government, then there is always a tendency of full employment in it. Therefore, whenever there is tendency of or lapses of full employment, then these are removed automatically by working of free price mechanism.

Price flexibility and employment -

The relationship is based on assumption that the prices are proportional to the quantity of money.

$$Q = f(K, T, N)$$

Q = Total output, K = Capital

T = Technological knowledge

N = Number of workers.

Conclusion -

We have discussed above classical theory of employment. From this, it has been concluded that in a free enterprise capitalist economy there is always a tendency towards full employment.