D2 Macroeconomics

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

## Say's Law of Market -

Say's Law of Market belived 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

Production of goods worth Rs 10 crore → creation of income by way of wages, rent, interest etc to the tune of 10 crores

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Supply of goods worth Rs 10 crore → Income of Rs 10 crore becomes the source of demand for goods worth 10 crore

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 dislocating the existing ones.

Implication's 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 $\boxed{S = I}$

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.