JAYOTI VIDYAPEETH WOMEN'S UNIVERSITY, JAIPUR

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Faculty of Education and Methodology

Faculty Name- JV'n Dr. Md Meraj Alam

Program- BA B.Ed 3rd Semester

Course- Macroeconomics

Digital session name – Classical Theory of Employment

Introduction:

John Maynard Keynes in his General Theory of Employment, Interest and Money published in 1936, made a frontal attack on the classical postulates. He developed a new economics which brought about a revolution in economic thought and policy.

The General Theory was written against the background of classical thought. By the "classicists" Keynes meant "the followers of Ricardo, those, that is to say, who adopted and perfected the theory of Ricardian economics." They included, in particular, J.S. Mill, Marshall and Pigou.

Keynes repudiated traditional and orthodox economics which had been built up over a century and which dominated economic thought and policy before and during the Great Depression. Since the Keynesian Economics is based on the criticism of classical economics, it is necessary to know the latter as embodied in the theory of employment.

The Classical theory of Employment.

The classical economists believed in the existence of full employment in the economy. To them, full employment was a normal situation and any deviation from this regarded as something abnormal. According to Pigou, the tendency of the economic system is to automatically provide full employment in the labour market when the demand and supply of labour are equal.

Unemployment results from the rigidity in the wage structure and interference in the working of free market system in the form of trade union legislation, minimum wage legislation etc. Full employment exists "when everybody who at the running rate of wages wishes to be employed."

Those who are not prepared to work at the existing wage rate are not unemployed because they are voluntarily unemployed. Thus full employment is a situation where there is no possibility of involuntary unemployment in the sense that people are prepared to work at the current wage rate but they do not find work.

The basis of the classical theory is Say's Law of Markets which was carried forward by classical economists like Marshall and Pigou. They explained the determination of output and employment divided into individual markets for labour, goods and money. Each market involves a built-in equilibrium mechanism to ensure full employment in the economy.

Assumptions

The classical theory of output and employment is based on the following assumptions:

- There is the existence of full employment without inflation.
- There is a laissez-faire capitalist economy without government interference.
- It is a closed economy without foreign trade.
- There is perfect competition in labour and product markets.
- Labour is homogeneous.
- Total output of the economy is divided between consumption and investment expenditures.
- The quantity of money is given and money is only the medium of exchange.
- Wages and prices are perfectly flexible.
- There is perfect information on the part of all market participants.
- Money wages and real wages are directly related and proportional.
- Savings are automatically invested and equality between the two is brought about by the rate of interest
- Capital stock and technical knowledge are given.

- The law of diminishing returns operates in production.
- It assumes long run.

Explanations of the theory

The determination of output and employment in the classical theory occurs in labour, goods and money markets in the economy.

Say’s Law of Markets:

Say’s law of markets is the core of the classical theory of employment. An early 19th century French Economist, J.B. Say, enunciated the proposition that “supply creates its own demand.” Therefore, there cannot be general overproduction and the problem of unemployment in the economy.

If there is general overproduction in the economy, then some labourers may be asked to leave their jobs. The problem of unemployment arises in the economy in the short run. In the long run, the economy will automatically tend toward full employment when the demand and supply of goods become equal.

When a producer produces goods and pays wages to workers, the workers, in turn, buy those goods in the market. Thus the very act of supplying (producing) goods implies a demand for them. It is in this way that supply creates its own demand.

Determination of Output and Employment:

In the classical theory, output and employment are determined by the production function and the demand for labour and the supply of labour in the economy. Given the capital stock, technical knowledge and other factors, a precise relation exists between total output and amount of employment, i.e., number of workers. This is shown in the form of the following production function: Q=f (K, T, N)

where total output (Q) is a function (f) of capital stock (K), technical knowledge (T), and the number of workers (N)

Given K and T, the production function becomes Q = f (AO which shows that output is a function of the number of workers. Output is an increasing function of the number of workers, output increases as the employment of labour rises. But after a point when more workers are employed, diminishing marginal returns to labour start.

This is shown in Fig. 1 where the curve Q = f (N) is the production function and the total output OQ_1 corresponds to the full employment level N_F. But when more workers N_fN_2 are employed beyond the full employment level of output OQ_1, the increase in output Q_1Q_2 is less than the increase in employment N_1N_2.

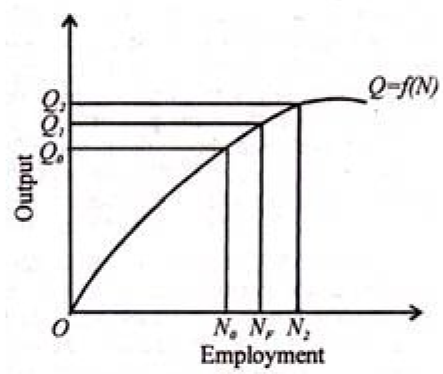

Fig. 1

Source: Internet