

MACRO ECONOMICS

PAPER2

B.A PART 2

TOPIC :- CLASSICAL THEORY OF EMPLOYMENT

The Classical Theory of Employment: Assumption and Criticisms:-

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 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.

It’s Assumptions:

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

1. There is the existence of full employment without inflation.
2. There is a laissez-faire capitalist economy without government interference.
3. It is a closed economy without foreign trade.
4. There is perfect competition in labour and product markets.
5. Labour is homogeneous.
6. Total output of the economy is divided between consumption and investment expenditures.
7. The quantity of money is given and money is only the medium of exchange.
8. Wages and prices are perfectly flexible.

9. There is perfect information on the part of all market participants.
10. Money wages and real wages are directly related and proportional.
11. Savings are automatically invested and equality between the two is brought about by the rate of interest
12. Capital stock and technical knowledge are given.
13. The law of diminishing returns operates in production.
14. It assumes long run.

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