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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 ececonomy.

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.

Continue……………..

E-content 2

New economic policy

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INDIAN ECONOMY

Chapter 7 - Economic Reforms Since 1991 And Its Feature

Question 1(A):

Fill in the blanks with the appropriate option from the bracket.

1. India has adopted a __________ policy of economic development since 1991.
(liberal, restrictive, strict, normal)

2. At present there are only ________ industries under compulsory licensing.
(6, 10, 4, 12)

3. Due to globalisation, agricultural export___________
(increases, decreases, constant, zero)

ANSWER:

1. India has adopted a ***liberal*** policy of economic development since 1991.
Explanation-
Before 1991, economic activities in India were subject to various controls and regulations by the government. The majority of the industries were under the government control while the private sector played only a secondary role. However, such a policy led to several problems in the form of stagnation, imbalance, etc. In wake of this since 1991, India moved towards a liberal policy of economic development.

2. At present there are only ***6*** industries under compulsory licensing.
Explanation-
Currently, there are only 6 strategic industries that are under compulsory licensing due to social and security reasons. These include alcohol, cigarette, industrial explosives and pharmaceutical industries.

3. Due to globalisation, agricultural export ***increases***.
Explanation-
With globalisation, Indian farmers gained access to the global markets. This helped farmers increase their business network, which led to an increase volume of agricultural exports from India.

Question 1(B):

Match the pair

Group A	Group B
1. SEBI	a) Public sector
2. Liberalisation	b) Profit motive
3. BHEL	c) Removing restrictions
4. Privatisation	d) 1988

ANSWER:

The items in the two columns can be correctly matched as follows.

Group A	Group B
1. SEBI	a) 1988
2. Liberalisation	b) Removing restrictions
3. BHEL	c) Public sector
4. Privatisation	d) Profit motive

1. SEBI - 1988
Explanation-
SEBI was established in the year 1988 (made a statutory body in 1992) with

the objective of regulating the functioning of stock exchanges and mutual funds.

2. Liberalisation - Removing restrictions
Explanation-
Liberalisation implies the removal of trade restrictions and licensing system that obstruct economic growth and development. India adopted the liberalisation policy in 1991.

3. BHEL - Public sector
Explanation-
Bharat Heavy Electrical Limited (BHEL) is a public-sector enterprise. It is one of the industries that were given Navaratna status under the privatisation policy adopted by government.

4. Privatisation - Profit motive
Explanation-
Privatisation implies reducing the role of the public sector and increasing the role of the private sector in the economy. With greater role of the private sector , profit became an important motive of the economic activities.

Question 1(C):

State whether the following statements are true or false.

1. Economic reforms were introduced when Dr. Manmohan Singh was the finance minister.

2. *Laissez- faire* policy advocates minimum state intervention in a market economy.

3. The share of the manufacturing sector in GDP has decreased recently.

ANSWER:

1. This statement is true.
Explanation-
Economic reforms were introduced in India in 1991 under the guidance of the then Finance Minister Dr. Manmohan Singh and the late Prime Minister Shri Narasimha Rao.

2. This statement is true.
Explanation-
The term *laissez-faire* was introduced by the renowned economist Adam Smith in 1776. A *laissez-faire* economy is one in which there is minimum intervention of the government in the market.

3. This statement is true.
Explanation-
An analysis of the post reform period indicates that the annual average growth rate of the industrial sector has decreased. During the post reform period the annual average growth rate was 6.2% as against 7.6% in the pre-reform period.

Question 2(A):

Define or explain the concepts.

1. Industrial sector

2. F.D.I

3. FEMA

ANSWER:

1. The industrial sector, also known as the secondary sector, is responsible for manufacturing finished goods in an economy. It includes manufacturing, processing and construction activities related to metal working and smelting, automobiles, textiles, chemicals, electrical and electronic goods.

2. FDI or Foreign Direct Investment refers to direct investment in the business of a domestic country by a foreign business. It is either done by buying the domestic business by the foreign company or by extending the operations of a business in other countries. As a part of the liberalisation policy, India laid high emphasis on encouraging FDI.

3. The Foreign Exchange Management Act (FEMA) was enacted by the Indian government to allow free movement of goods and services from and to other countries. This Act provides Indian companies access to global markets and allows them to avail loans in foreign currencies.