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# TOPIC :- CLASSICAL THEORY OF INCOME AND EMPLOYMENT

The descriptions of classical theory of income and employment is essential because some of the aspects of classical theory are more relevant to the conditions prevailing in the developing countries and this theory highlights those factors which govern income and employment in those countries. While the Keynesian theory emphasises the role of effective demand in the determination of income and employment, classical economists believed that in a free market economy there was always a tendency towards the establishment of full employment of labour and there was sufficient demand for the output produced.

Classical theory of income and employment is based on the following concepts:—

(1) Say's Law :—

The classical theory propounded by Ricardo and Adam Smith shows that the levels of income and employment are governed by fixed capital stock on the one hand and wage goods fund on the other. The classical theory believes in full employment or near full employment prevailing in the economy. This concept of classical theory regarding the existence of full employment in economy is based on Say's Law given by French economist Prof. J. B. Say. According to Prof. Say, "Supply creates its own demand." This denotes that every increase in production made possible by the increase in the productive capacity or the stock of fixed capital will be sold in the market and there will be no problem of lack of demand. So classical economists rule out the possibility of over production; there being no problem in selling the output Produced. According to Say's Law, greater Production automatically leads to a greater money income which creates the market for the greater flow of goods Produced. Thus deficiency in demand being no Problem, the Process of capital accumulation and expansion of Productive capacity will continue till all People are employed and there is no reason why the Productive capacity created remains unutilised or under-utilised. According to this theory, the income which is not spent on consumer goods and thus saved will becomes investment expenditure. Therefore, investment equals saving. Thus, the leakage caused by the saving in the income flow is made up by the investment expenditure. In this way, a given Productive capacity continues to be fully utilised and no Problem of deficiency of demand arises.

(2) Wage-Price Flexibility and Full Employment:

The classical economists also Proved the validity of the assumption of full employment with an other

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fundamental logic. According to them, the amount of production which the business firms can supply does not depend only on aggregate demand or expenditure but also on the prices of products. The deficiency in aggregate expenditure would be made up by changes in price level. When due to increase in savings of the people the expenditure of the people declines, it will then affects the prices of products. As a result of fall in aggregate expenditure or demand the prices of product, would decline and at reduced prices their quantity demanded will increase and as a result the quantity produced of goods will be sold out at lower prices. In this way, they expressed the view that inspite of decline in aggregate expenditure caused by the increase in savings the real output, income and employment will not fall provided the fall in prices of products is proportionate to the decline in aggregate expenditure