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LESSON – 3
THEORIES OF
EMPLOYMENT
& INCOME

INTRODUCTION

- THE MAIN ECONOMIC PROBLEM FACED BY ALL COUNTRY IS UNEMPLOYMENT.
- CLASSICAL ECONOMIST – J.B.SAY
- MODERN ECONOMIST – J.M.KEYNES

MEANING OF FULL EMPLOYMENT

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• **FULL EMPLOYMENT MEANS THAT PERSONS WHO ARE WILLING TO WORK MUST HAVE EMPLOYMENT OR A JOB.**

. **KEYNES DEFINES FULL EMPLOYMENT AS THE ABSENCES OF INVOLUNTARY UNEMPLOYMENT.**

UNEMPLOYMENT AND ITS TYPES

. Unemployment is problem faced when there are people, who are willing to work and able to work but **cannot find suitable jobs**

- 1. CYCLICAL UNEMPLOYMENT**
- 2. SEASONAL UNEMPLOYMENT**
- 3. FRICTIONAL UNEMPLOYMENT**
- 4. EDUCATED UNEMPLOYMENT**
- 5. TECHNICAL UNEMPLOYMENT**
- 6. STRUCTURAL UNEMPLOYMENT**
- 7. DISGUISED UNEMPLOYMENT**

CYCLICAL UNEMPLOYMENT

- This unemployment exists during the downturn phase of **trade cycle** in the economy.
- Cyclical unemployment **can be cured by public investment or expansionary monetary policy.**

SEASONAL UNEMPLOYMENT

- . This type of unemployment occurs during **certain seasons** of the year.**

Eg. Agriculture

FRICITIONAL UNEMPLOYMENT (TEMPORARY UNEMPLOYMENT)

**. FRICITIONAL UNEMPLOYMENT ARISES DUE TO
IMBALANCE BETWEEN SUPPLY OF LABOUR AND
DEMAND FOR LABOUR. THIS IS BECAUSE OF IMMOBILITY
OF LABOUR, LACK OF NECESSARY SKILLS, BREAK
DOWN OF MACHINERY, SHORTAGE OF RAW MATERIALS ETC.
THE PERSONS WHO LOSE JOBS AND IN SEARCH OF JOBS
ARE ALSO INCLUDED UNDER FRICITIONAL UNEMPLOYMENT.**

EDUCATED UNEMPLOYMENT

. WHEN QUALIFICATION **DOES NOT MATCH** THE JOB

EDUCATED UNEMPLOYMENT OCCURS.

- * FAULTY EDUCATION SYSTEM,
- LACK OF EMPLOYABLE SKILLS,
- MASS STUDENT TURNOUT
- PREFERENCE FOR WHITE COLLAR JOBS

HIGHLY RESPONSIBLE FOR EDUCATED UNEMPLOYMENT IN INDIA.

TECHNICAL UNEMPLOYMENT

- . Now a days, **invention and innovations** lead to the adoption of new techniques there by the existing workers are retrenched. **labour saving devices are responsible for technological unemployment.**

STRUCTURAL UNEMPLOYMENT

- . Structural unemployment is due to **drastic change in the structure** of the **society**.
- . This unemployment results from massive and deep rooted changes in economic structure.

DISGUISED UNEMPLOYMENT

- . Disguised unemployment occurs when **more people are there than what is actually required.**
- . In this situation, marginal productivity of labour is **zero or less or negative.**

CLASSICAL THEORY OF UNEMPLOYMENT

Introduction :

. Classical theory was developed by **David Ricardo, J.S.Mill, J.B.Say and A.C.Pigou.**

. Classical economists assumed:

*Full employment without inflation.

*Wages and prices of goods were flexible.

*Competitive market existed in the economy(laissez – faire

JEAN BAPTIST SAY

- **SAY'S
LAW OF
MARKET**



SAY'S LAW OF MARKET

. Says's law of market is the core of the classical theory of employment. J.B.say was a French economists and an industrialist.

. According to J.B.say:

“Supply creates its own demand”. Hence there cannot be general over production or the problem unemployment in the economy.

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In short, this classical theory explains that

**“ a person receives his income from
production which is spent on the purchase
of goods and services produced by others.**

For the economy as a whole, therefore,

total production equal total income.”

ASSUMPTIONS OF THE SAY'S LAW OF MARKET

1. **No single buyer or seller** of commodity or an input **can affect price.**
2. **Full employment.**
3. There will be a **perfect competition** in labour and product market.
4. There is **wage – price flexibility.**
5. **Money acts** only **as a medium** of exchange.
6. **Long – run** analysis.

IMPLICATIONS OF SAY'S LAW

1. There is **no possibility for over production** or unemployment.
2. If there **exist unutilized resources** in the economy, **it is profitable** to employ them up to the point of full employment.
3. **No need for government intervention.**
4. **Interest flexibility** brings about **equality** between **saving and investment.**
5. **Money performs only the medium** of exchange. People will **not hold idle money.**

CRITICISMS OF SAY'S LAW

1. According to Keynes, **supply does not create its demand**. It is not applicable where demand does not increase as much as production increases.
2. **Automatic adjustment process will not remove unemployment.**

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3. Money is not neutral. Individuals

hold money for contingencies while
businessmen keep cash reserve for
future activities.

**4. Say's law is based on the proposition that supply
creates its own demand and there is
no over production.**

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5. KEYNES REGARDS FULL EMPLOYMENT AS A SPECIAL CASE BECAUSE THERE IS UNDER – EMPLOYMENT IN CAPITAL LIST ECONOMIES.

6. THE NEED FOR STATE INTERVENTION ARISES IN THE CASE OF GENERAL OVER PRODUCTION AND MASS UNEMPLOYMENT.

KEYNES'S THEORY OF EMPLOYMENT AND INCOME

- . According to Keynes, the factors of production such as capital goods, supply of labour, technology and efficiency of labour remain **unchanged** while determining the level of employment.

EFFECTIVE DEMAND

- **Effective demand denotes money actually spent by the people on products of industry.** The money which entrepreneurs receive is paid in the form of rent, wages, interest and profit. Therefore effective demand equals national income.

$$ED = NY$$

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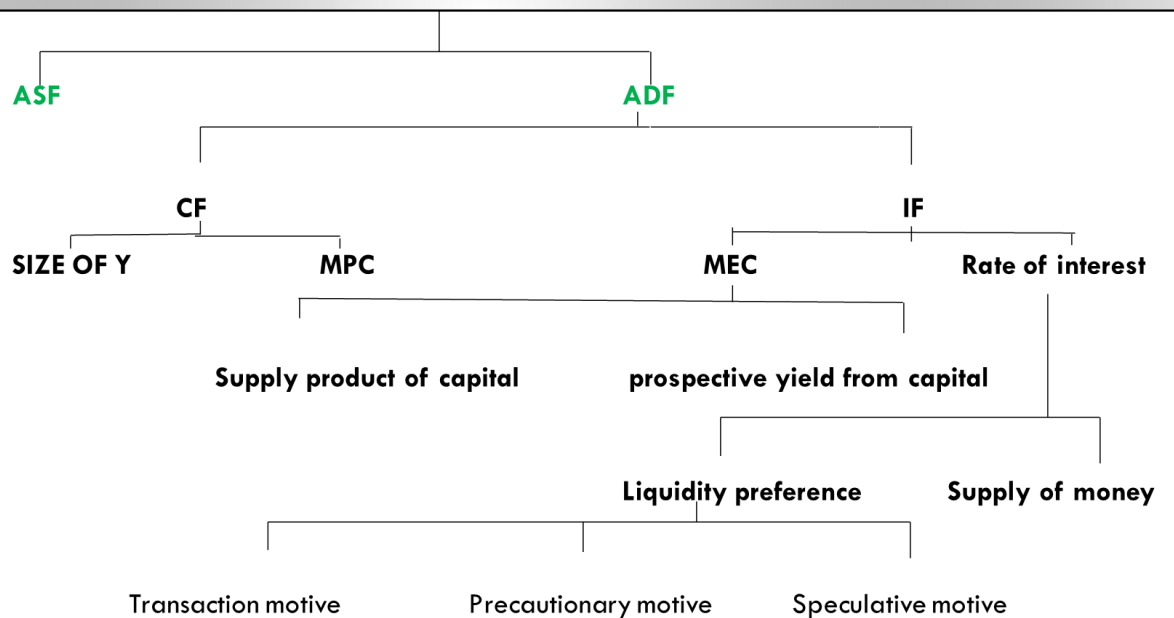


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. According to the Keynes theory of employment, “Effective demand signifies the **money spent on consumption** of goods and services and **on investment**. The total expenditure is equal to the national income, which is equivalent to the national output”. The relationship between employment and output of an economy the forces of aggregate supply and aggregate demand.

$$ED = Y = C + I = \text{Output} = \text{Employment}$$

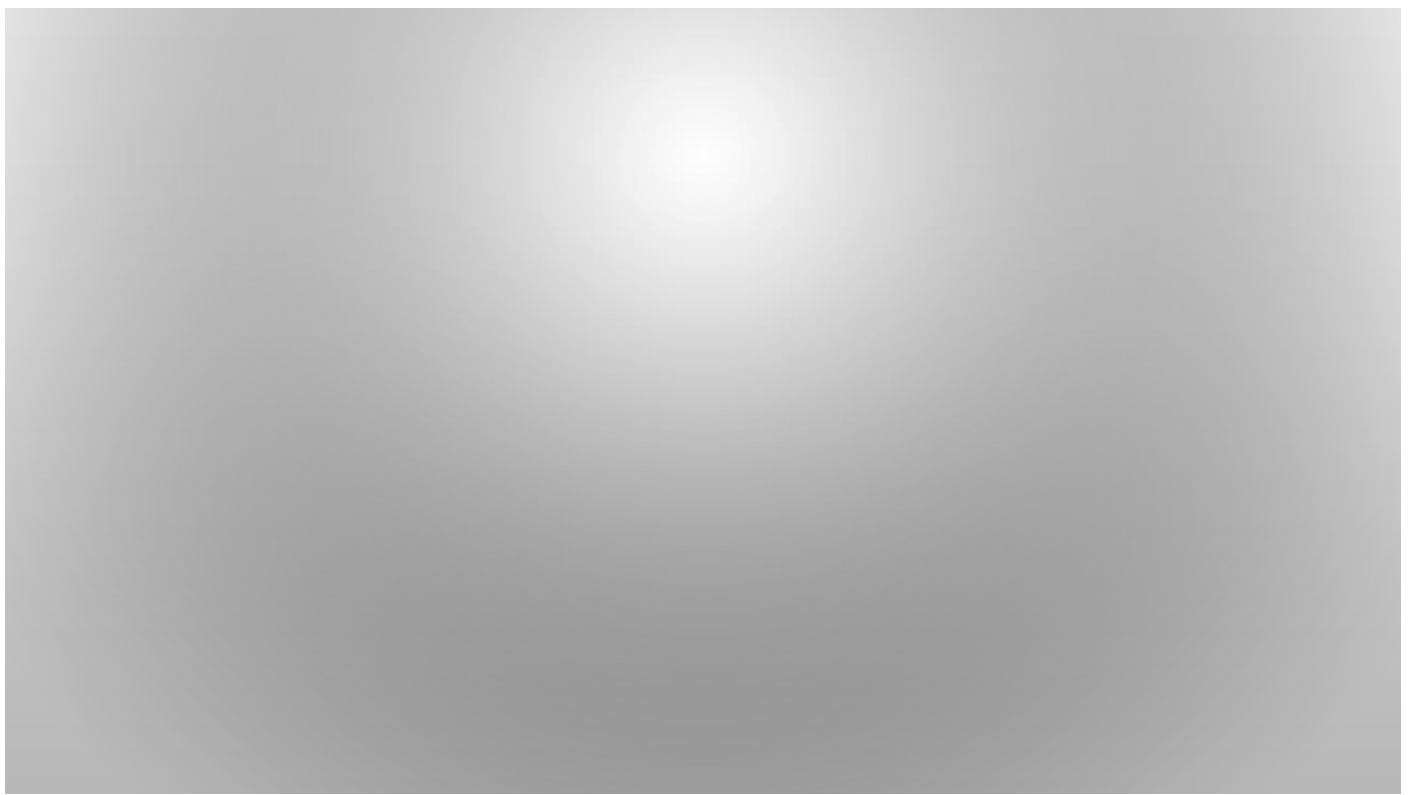
$$ED = O/P = Y = \text{EMPLOYMENT} = (C + I)$$



AGGREGATE DEMAND FUNCTION(ADF)

The aggregate demand is the **amount of money which entrepreneurs expect to get by selling the output produced by the number of labourers employed.**

Therefore, it is the expected income or revenue from the sale of output at different levels of employment.



**AGGREGATE DEMAND –
COMPONENTS (4) :**

- * **Consumption demand**
- * **Investment demand**
- * **Government expenditure**
- * **Net export (export – import)**

DESIRED DEMAND

Desired demand in the economy is the sum total of :

- * Desired private consumption expenditure (C)
- * Desired investment expenditure (I)
- * Desired government spending (G)
- * Desired net exports (X - M)

. Thus, the desired spending is called aggregate spending.

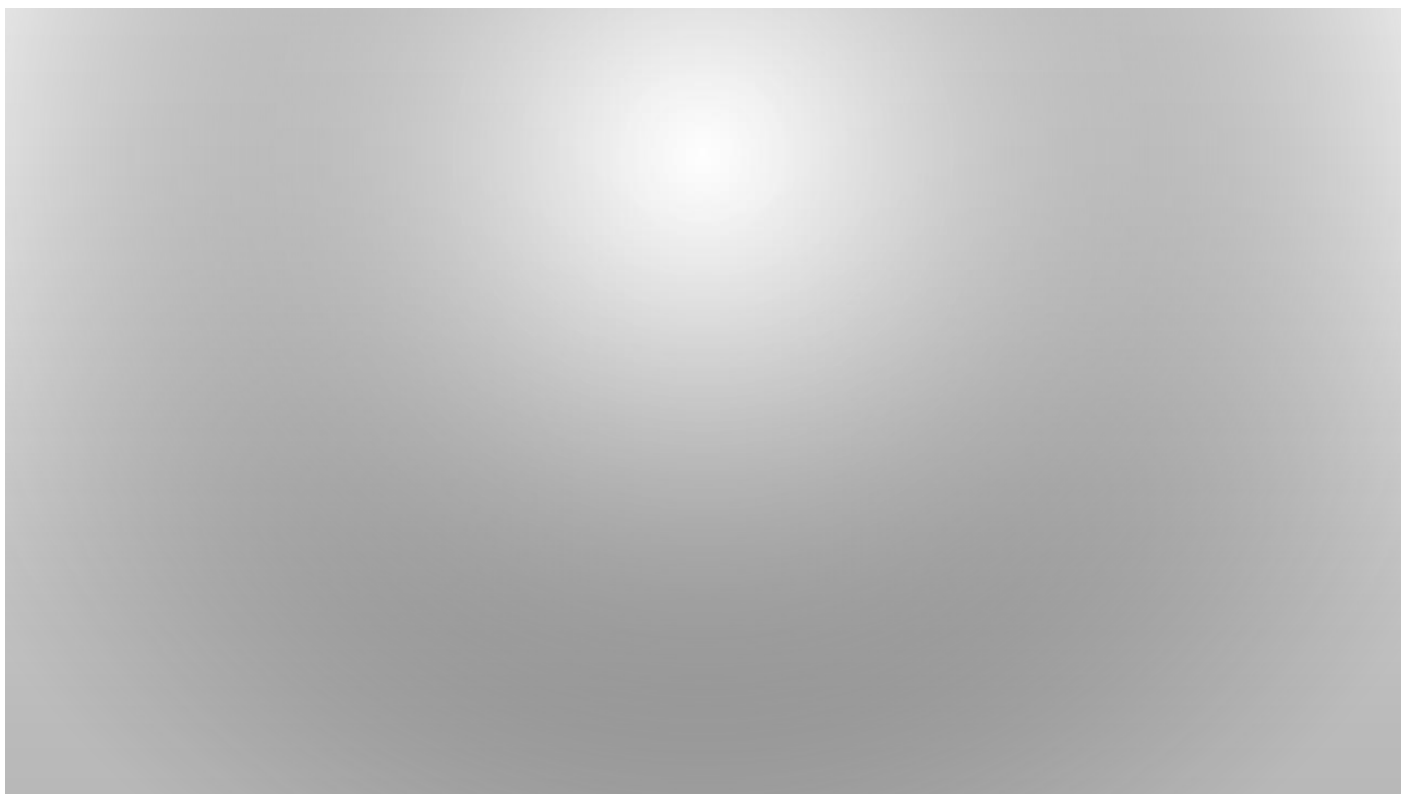
$$AD = C + I + G + (X - M)$$

AGGREGATE SUPPLY FUNCTION (ASF)

Aggregate supply refers of the **value of total output** of goods and services produced in an economy in a year.

In other words :

Aggregate supply is equal to the value of national product, i.e ., national income.



AGGREGATE SUPPLY – COMPONENTS (4)

- * **AGGREGATE CONSUMPTION EXPENDITURE (C)**
- * **AGGREGATE PRIVATE SAVINGS (S)**
- * **NET TAX PAYMENTS (T)**
- * **PERSONAL TRANSFER PAYMENTS TO THE
FOREIGNERS (RF)**

$$\text{AGGREGATE SUPPLY} = C + S + T + RF$$

EQUILIBRIUM BETWEEN ADF & ASF

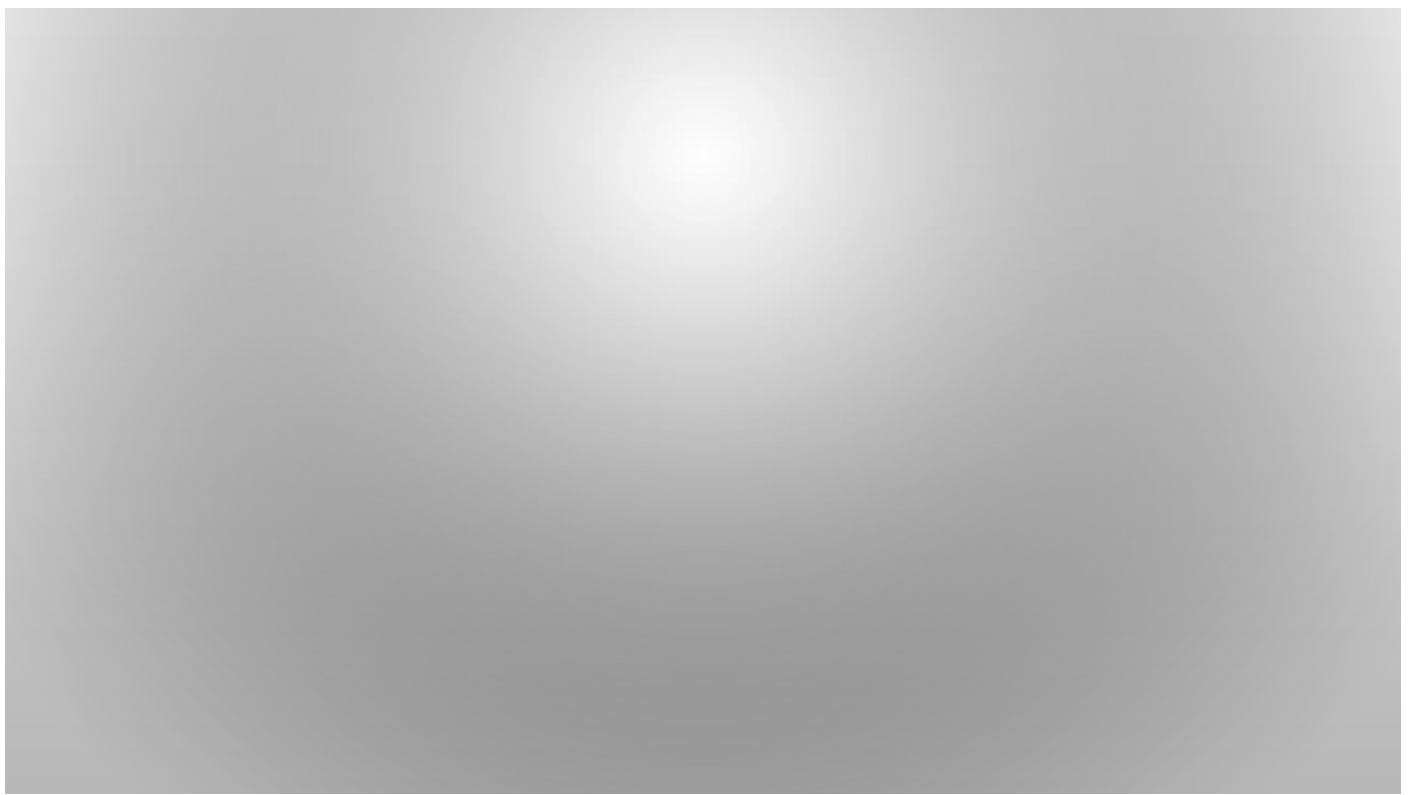
All the decisions concerning consumption expenditure are taken by the individual households, while the business firms take decisions concerning investment. It is also assumed that **consumption function is linear** and **planned investment is autonomous.**

TWO APPROACHES

There are two approaches to determination of the equilibrium level of income in Keynesian theory.

these are :

- * Aggregate demand – Aggregate supply approach**
- * Saving – Investment approach**



COMPARISON

KEYNESIANISM

- 1) Short – run equilibrium.
- 2) Saving is a vice.
- 3) The function of money is a medium of exchange on one side and a store of value on the other side.
- 4) Macro approach to national problems.
- 5) State intervention is advocated.

CLASSICISM

- 1) Long – run equilibrium.
- 2) Saving is a social virtue.
- 3) The function of money is to act as a medium of exchange.
- 4) Micro foundation to macro problems.
- 5) Laissez – fair policy is advocated.

COMPARISON

KEYNESIANISM

- 6) Applicable to all situations.
- 7) Budgeting should be adjusted to the requirements of economy.
- 8) Rate of interest is determined by the demand and supply of money.
- 9) Rate of interest is a flow.
- 10) Demand creates its own supply.

CLASSICISM

- 6) Applicable only to the full employment
- 7) Balanced budget.
- 8) Rate of interest is determined by saving and investment.
- 9) Rate of interest is stock.
- 10) Supply creates its own demand.



THANK YOU