History of Economic thought

Lecture Note

Chronology

Aristotle had a static view of the economy. It was based on agriculture.

Scholastic were a group of religious scholars of the middle ages. The leader of the group was St. Thomas Aquinas. They operated when social relationships were not well-defined i.e. there was still a slave-master relationship during this period.

Mercantilists which is divided into two groups: bullionist and mercantilism. They saw trade as the source of the wealth of the nations. This was the period when the foundations of the modern British economy was laid. They saw gold as the main stock of the wealth of the nation. When gold was traded to earn wealth.

Physiocrats which founded by Robert Quesnay. So many people believe he laid the foundation of the modern economy. He was a French man. He lived between 1694-1774. They saw production as a source of growth and was notably production of agriculture and not by the trade as the mercantilists. Brought up competition to eliminate less productive farmers.

Classicalist includes Adam Smith, Karl Marx, David Ricardo. They supported the view that production was the source of wealth but they believed that agriculture was not the only sector that production could occur. This introduced the two sector economy. This era is not a break through era but a systematic era from existing thoughts. This means they were not notably the originators of economic thought but a combination from non-british and British thought. Classicalist were more of a political economy thought. Karl Marx was seen in that group, though he was a little laissez-faire thought.

Neo-Classical which was from the 1860s onwards. Popular names are Jevons, Afred Marshall, J. M. Keynes, Leon Walras (some say he was the father of the modern quantitative microeconomics).

Keynesians school. The distinguishing factor is that the concentrated on macroeconomics whereas the others concentrated on microeconomics.

Neo-Classical Synthesis School. They tried to show that there was no much different between Neo-classicalist and Keynesians; hence trying to bring a linkage. It was founded by Paul Samuelson who was an American.

Monetarist school. The founder was Milton Friedman. Some say that this school emerged from the Neo-Calssicalists. They hold the view that Keynes was different and was wrong.
Noe-Ricardian School. Popular names are Sraffa (Italian) and Joan Robinson (left sided). They brought up the capital theory.

Radical political economic school or the structuralists. They have the extreme left sided view of the economic thought. They see economics thought based on social relationships within the economic society (communist).

New Classical are an extension of the classicalist school. They believed people do not make systematic error.

PRODUCTION

The physiocrats saw agriculture as the main source of wealth and industry, trade and manufacture are the secondary factor. Adam Smith included manufacturing trade and transport. He saw productivity of labour as a production of wealth, hence he drew a distinction between productive and unproductive labour. He defined productive labour as the one that adds value to the object upon which it is bestowed and it is exchange with (paid out of) capital. Unproductive labour is exchange with (PAID FOR OUT OF) revenue. Karl Marx has used arms to further make the distinction between productive and unproductive labour. If arms are used as stock pile, it is a waste, but if sold abroad, the revenue from it could be used to buy something else in which case, it is productive. In other words, the economic functions of the goods determine if it is productive or not.

Adam Smith distinction was based on what determines/stimulates economic growth. If looked at this way, then his interpretation holds sense since capital accumulation is used as a factor of production. Adam Smith was the first to discuss output per capita which is the underlined measure of productivity. He also introduced the division of labour and an element which allows its promoting growth i.e market expansion and capital. He looked at the social structure in he lived which comprises of Landlords, Capitalist and Labourers and their respective income being rents, profit and wages.

Smith argues that labourers in general are productive and as a social entity, that makes production, hence growth possible. He says capitalists are productive in that they provide capital to make growth possible. He was an exponent (promoter) of free trade. He saw landlords as unproductive because they earn where they did not sow. They earn profits merely out of market phenomenon and not their efforts since excess demand over supply creates demand. He believed that capital would be produced more and more. This will initially lead to wage rises and this in turn will lead to pressure on prices and increase in population. And in the end, population exceeding food production. As a consequence, real wages will return to its subsistence level as prices rise coupled with population increase, leading to more labourers. Smith argues that wages drift upward with capital accumulation so he was as optimist. He also argued that competition between capitalists as capital accumulates lead to a fall in profits. He feels that rent rises but will be spent unproductively, so he is pessimistic about the other two groups as a process of growth.
DAVID RICARDO

He was basically concerned with the problem of distribution from the point of view that affects economic growth and production using the same logic as his predecessors that if profit goes to landlords, it will encourage progress. He needed a medium of measurement and since indices were crude, labour was used empirically and as a social substance in production process, it was seen as the only measurement of value. Corn was initially used as a way of pricing and this meant that pricing fluctuates. So Ricardo decided to use gold since it has a stable value. The rate of profit would determine the allocation. Adam Smith introduced the concept of profit, while Ricardo introduced the concept of rate. The idea of rate of profit existing means that capital would move between industries in bid to earn higher profit. He distinguished situations in which increase in labour cost will decline profit and vice-versa. Unless profits can be recouped by price rises, increase in wage would decline profit. He went on to discuss the concept of diminishing returns to agriculture. Ricardo opposed the Corn Laws in contrast to Thomas Malthus. He developed the concept of comparative cost advantage on the assumption of immobility of capital. He developed to go along with it, theory of international payments, specie flow mechanism. He assumed that gold flows out to pay imports leading to import greater than export, fall in quantity of money leads to fall in price, a devaluation situation, export exceeding import due to money flowing back to the country and as money flows back, prices rise.

Ricardo discuss the concept of diminishing returns related to agriculture in a situation where labour and capital are applied to fixed land. If marginal lands are applied to use, it means reduced productivity and the price must be reduced to just cover the cost of production to the most inefficient producer. Though the efficient ones makes surplus profit, but this surplus will be extracted by the landlord from the more efficient landlord and away from profit. A stationary state is arrived at because the surplus merely covers rent and labour cost.

THE GROWTH PROCESS AND VALUATION PROBLEMS AS VIEW BY RICARDO

Ricardo was concerned with how to find a standard value to measure rent, wages and profit. He started off with the quantity of labour as being a standard value. Though Smith started with it too and felt it is applicable to an economy in which labour is the main factor of production. To him, the natural price is made up of wages + profit + rents. Ricardo, however, feels that profits and rents are not measurement of value; rather they are deductions from measurement of labour.

DISTRIBUTION BETWEEN PRICE AND VALUE

Price is a technical term that relates commodities in the market. Price is a numeraire. Value is synonymous with relating price. Value is an objective measure to economic in terms of social resource available. It actually represents the cost for a society to produce something. This is the classical concept: value has been since argued to be a subjective concept of utility and it is coins this basis that price is derive. A distinction is made between value in use which is measures by utility and value in exchange which is measure by prices. Aristotle is the first to make this
distinction. Aquinas defended trade so long as it is fair and he coined the term ‘just price’ (equal exchange). The equality is argue most be related to the labour content, the land content and capital content. Surplus profit was regarded to come form exchange alone.

**ADAM SMITH CONCEPT OF VALUE**

In crude society, value of any commodity it seem to be a function of the quality of labour that went into it. Land belongs to private owners who wanted to reap where they never sow; so does the control of stocks i.e tools of operation (capital). The stream of argument runs up to W=V is wages equals value. The value of a commodity it is command over labour. Jevon held that utility is the basis of value. Marginalism is a function of how much of the good purchaser has already got of it. Disutility is defined as the amount to be paid to induce one to do another hour of piece of jobone does not want to do.

Menger held that the value of any commodity is the opportunity cost which is totally a subjective concept. Alfred Marshall introduced time factor i.e the idea of short, long and very long time. The short period is when production can be increase. The opportunity cost theories assumed fixed production. The classicals emphasized which is subjective. Neo-Classicals emphasized demand which is objective and an intermediate class emphasized a scissors which is cut in between the two.

**KARL MARX VIEW OF PRODUCTION**

Karl Marx came to his idea by rejecting other exciting ideas. He was fascinated by Hegel’s philosophy. Hegel’s idea was that the society was in constant motion. i.e. there is thesis and antithesis formulated into synthesis. This synthesis became the new thesis and the process starts all over. To Hegel, idealism change people; people change society. Marx being an empiricist look up the examination of these ideas. Hegel argues that empirical observation is problematic because observation cannot be linked with ideas. Marx ended up arguing (Hegel upside down) that the society does not move by idealism but by the process through which it makes its living. Marx is thus a materialist. The concept of mode of production explains how the society goes about making its living. There can be a feudal, capitalist, slave, socialist or agriculture mode of production. Marx recognized the existence of both socialist and capitalist modes of production. But the motive force radically different. In the latter, it is profit, while in the former it is humanitarian/welfarism. He feels that ideas are linked with the level of production in the society. Ideas thus take on material force for better or for worse. Marx was concern to analyse the society as he saw it at the time. Essentially as a social revolution. Marx saw the way economics works in the process as fundamental. Marx started by rejecting Ricardo’s labour theory of value for societies alienating human value this concept of alienation runs as a main thread through his ideas.

Alienation is defined according to Marx as entrangement from ones product, then been dominated by one's product.
Marx and Hegel use this to explain the society. Marx rejected Ricardo labour theory of value because it leads to alienation of man. He made a distinction between labour power. Labour power in a capitalist system becomes a commodity. Marx means by commodity: a good produce for exchange because it brings social intercourse into being i.e. social unit or social economic.

**Commodity --- money ---- coomodity ---- production function of**

money, the universal value of equivalent is started with to produce a commodity to sell in the market.

\( m \rightarrow c \rightarrow m \)

\( M1>M \) because it embodies profit and leads to production for the sake of production (not for consumption/welfare). The desire to make profit rather than consumption motivates capitalist. Capital considered as a social power, value can therefore be explain in terms of social resources, hence social labour

Structurally capital differs today’s from Marxist 19th century principally because some state production takes place in this present time (most put inside when discussing Marxist view). Labour power must have use value and exchange value.

- Used value is not it being a factor of production as orthoxic but as a social substant of value
- Exchange value is determine by the social resources that go into its production and this variables increase as the system advances.

Values of labour is variable because its intensity can be varied, thereby raising value created capital on the other is fixed because it does not create value. \( C = \text{Capital, } V = \text{Labour value, } K = \text{Labour capital} \)

\( C + V = K \)

Karl Marx describe it as the organic composition of capital

There si technical composition and value composition of capital

In the production process therefore, there are \( C + V + S \) which constitute the value of production – S is the surplus. When Marx talks of exploitation, he refers to \( S/V \) or rate of exploitation. He is not saying though that the workers are exploited because they do not earn the value of his wage, but rather because he does not control the surplus value he has created/ in other word a class socially controls the surplus and thus the society.

Surplus value is the excess over the socially necessary labour for the cause of production. Wages are paid at value. For the law of value Marx paid a simplified assumption of equal value exchange. There is no unequal exchange i.e. exploitation takes place without individual labour
being pay less than their value. But Ricardina version of socialism states that individual was cheated because he paid less than his value.

\[ S' = \text{rate of exploitation (S/V)} \]
\[ P' = \text{rate of profit (S/K) or (s/c+v)} \]
\[ P = \text{Price of production (C+V+P')} \]
\[ Q = \text{output} \]

The organic composition of capital will determine the rate of profit.

In the long run, to Marx, there was the tendency for the rate of profit to decline. Concentration of capital takes place and then begins to grow in size i.e. through internal expansion. Then centralization of capital takes over.

**KARL MARX ON VALUE AND EXPLOITATION**

Marx sees the theory of value as accounting for exploitation. The workers value is his cost in terms of labour. The employer makes him produce more value than he costs, leaving the workers with subsistence wage. Nonetheless, Marx defends capitalism. The capitalist first recruit workers by destroying peasants. The wage level will be set at the prevailing standard of living. The worker produces surplus value which the capitalist uses to employ new workers. Real wages will rise as enough capital has been accumulated and the labour pool drying out. Marx thus paints capitalism as a necessary stage in economic development that enables the productive power of labour to be improved. Marxist today will not like to subscribe to the view that capitalism betters or improves workers standard of living.

**VALUE IN MARX AND RICARDO’S THEORY**

Value is:

1. The quantity of labour power directly or indirectly embodied in a commodity
2. The power a commodity has in exchange for others

Ricardo used 1 to solve the problem of treating heterogenous collection of objects as if they are homogenous good. In his model, prices of production more or less correspond to values or else his theory of rate of profit is undermined. To him, the quality of labour embodied is not the cause of value. Marx on his own part used 2 for his own analysis. The capitalist mode of production is the cause of values, although values can exist in other modes. It is in the capitalist mode of production that used values become an ‘immense accumulation of commodities’. Value to Marx necessarily reflects predominance of a given set of social relations to production. Forst, the productivity of capital. Second, the existence of free labour force. Third, all other social relations
that make possible the exploitation of labour power in order to develop the mechanism that allows the generation of surplus value in production process.

CIRCULATION

Circulation here relate to exchange in economy i.e. \( M \rightarrow C \rightarrow M' \) as opposed to the siege economy i.e. \( C \rightarrow M \rightarrow C' \).

An economy that initiates exchange value is capitalism. The level of economy activity, the amount of exchange taking place in the economy and the rate of economic wellbeing within the economy i.e. to some extent, Keynesian economists.

What determines the level of economic activity and well being in an economy?

The mercantilist writers were the first to write on this. Their notion of what constitute economic wealth is tied up with circulation. For them, exchange is the source of wealth (in order words, trade). A country is held rich by the process of foreign exchange. Misseldom (1620) and Malynes argued that all state policies must be directed towards restricting foreign exchange. So they argued against money flowing out (discouraging international trade). The Mercantilists however e.g Mourn (1664) argued that the end result of a country’s activity should be the country becoming nice creditor with respect to the rest of the world. Thence, this repayment should be put into circulation (reinvestments in an international sense) to end what now becomes BOP surplus. The Mercantilist saw the elements of unfair exchange in entrepot trading because the unsuspecting partner is exploited. Money totally depends on exchange William Petty (in 17th century) argued that it is possible for a country to have so much money or not at all. That money is not tied to exchange, but more on circulation only as a means to allowing goods and services to circulate. Meaning that there could be much money, but not wealth. These may construe the basis of the quantity theory of money. David Hume argued that it might possibly be beneficial as a consequence of encouraging investment, demand for services and goods if there are some resources unemployed.

Richard Cantillon writing in 1755 had a concept of today’s quantity of money. He develop the concept of a circular flow of money, where he had:
Cantillon argued that there would need to be a money supply equal to 50% of transactions so that the circulation flows. The rate which money circulates also matters. He assumes a maximizing level of resources utilization.

**PHYSIOCRACY**

This was a school pre-Adam Smith and their focus was agriculture. Period was between 1760 and 1777. The philosophy of this school was based on two traditions.

1. Liberal traditions i.e. unrestricted laissez-faire. Like Adam Smith’s work was in reaction to British Mercantilism, so was physiocrats in reaction to French Mercantilism.
2. Natural right to private property: they introduced the generation of happiness or welfare as the objective of economic activity.

The concept of welfare has its origin from the Physiocrats.

The most distinguishing feature of their analysis was to develop cantillon’s theory i.e. labour and land as the source of wealth. They introduced the concept of ‘Produit net’ which today is referred to as ‘net product’. The Physiocrats were not analysis surplus in terms of value as Adam Smith and subsequent economists did. For example, in their analysis, corn as a seed is planted and reproduces seed. In other words, they analysed it in terms of physical productivity. This led to their distinction between agricultural (productive) and manufacturing (sterile) sector.

According to them, manufacturing merely transform what already existed and not creating new value of products.

The leader of the Physiocrats is Francois Quesnay. He came to economics out of his social involvement he undertook. He observed a mild difference in results from capitalized and less-capitalised farm production. He therefore concluded that capital was imperative in agriculture productivity. Quesnay wrote his famous book ‘the nature of capital’ which is closely linked with his idea/analysis of circulation. He believes someone provides the capital. He broke the society into three classes.
1. The owners class that are landlord, the church and the state
2. The sterile class are manufacturers
3. The productive class are the agriculture sector

In his famous economic model, The Tableau Economique, presents how input from the agriculture sector act as input in the manufacturing sector and the surplus from agriculture is used to buy goods from the manufacturing, which serves as their income. This process continues as long as there is economic activity.

**The Tableau Economique**

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<th>Productive</th>
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- This analysis assumed existence of food agriculture capital of 10,000
- Analysis is also referred to as state of bliss
- It is one of the earliest models in economics as we know it today
- Quesnay used this model to analyse and prove that there will be a decline in the productive capacity of the economy if there is a shift in people spending less on agriculture
- This viewpoint is crucial because it contradicts what later analyst such as Adam Smith see as self-regulating

Three things handed down from this analyses from the Physiocrats:

1. Model building on the part of physiocrats to abstract the complexity of the economy
2. Division of time into periods. The Tableau breaks up economic activities into time periods, starting with 5000 and onwards
3. Represents attempt to quantify i.e. figure were used. The analysis showed the important of pattern of expenditure

THE FRENCH CLASS

They took up this up and defended that there was no problem emanating from pattern of expenditure but unfortunately, they did not analyse it further.

Jean Baptiste Say, whose work later became known as ‘Say’s Law’ was prominent among those who opposed the agricultural viewpoint. Adam Smith also took this up and all sectors were held to be productive. The question is ‘what determines the level of economic activity?’

Being that capital accumulation is a function of savings, the idea of giving encouragement to spending on agriculture products came under attack by Adam Smith. Smith argued that saving does not pose any problem since this is later spent via investment and further consumption. This idea of savings = investment was not attached until Keynes. Smith felt that savings and investment go together. He argued that as a result of capital accumulation, there would be increase in competition between capitals and the rate of profit would decline as a result. He felt that there is demand for capital because there is demand for output which capital is used to create. This led to Say’s position that ‘supply creates its own demand’ (Say’s Law 1803). That is the fact that there is high level of output that give rise to high level of economic activity not because people have more money.

In the 1814 edition of his book, he proposed that if production is mainly for needs, production will be of barter type. This means that Say’s Law is a contradiction of what the Physiocrats felt was the problem, namely expenditure. Say’s law implies that output will take care of its demand. There are ways of interpreting Say’s Law. One way is to see savings as not evil but a desiring phenomenon. One important question is ‘in what sense can sense be made out of Say’s Law?’ three terms were used to answer this. They are:

1. **Walras’ Law:** there are a range of commodities in existence of which money is one. Then supply could be said to create demand. Since people who do not demand other goods will demand money, it implies that money is wanted for its own sake.

2. **Say’s Identity:** it is a Ricardian preposition. It adopts a different view in that it does not include money as a commodity but something close to a barter economy in which money is more of a veil. In such case, it is convenience that has encouraged the good being traded for money i.e. for a good to transform itself to another good.

3. **Say’s Equality:** it is most complicated and modern. Suppose there is as excess demand for a commodity, prices will be raised and the value of money holding of individual will increase. This is known as the real balance effect. Individuals could want to build up their balances and will as such reduce their demand for commodities. The reverse process will work in the opposite case. This view allows for the existence of self-regulating effect.
In summary, the problem with use of Say’s Law is this difference in interpretation.

DEBATE BETWEEN DAVID RICARDO AND THOMAS MALTHUS

The debate is important because it led to the development of macroeconomics. The debate started in the theory of profit what will cause the rate of profit to fall. To Ricardo, it was the increase difficulties in the production of food and increase cost of food production. To Malthus, while agreeing with increase cost, added that the relationship between consumption demand and accumulation must be understood. Ricardo, using the second interpretation argued that accumulation can go on indefinitely. For Malthus, he argued that such possibility of generating demand must be interpreted into willingness of the people to actually consume. The argument therefore is as to what consumption does as accumulation takes place. Malthus means that we cannot guarantee. He argued that consumption can be pushed too far because as it presses further, consumption demand will fall short.

He more or less implied somewhat what we now call ‘demand management’ due to what he calls lack of effective demand. Effective demand is that – not only that demand exists – but that demand at pre-existing rate of profit. Ricardo argued that producers should accept a lower rate of profit. Malthus argued rigidly on saving aspect. Since to him, it is the capitalist who invest out of his savings. He ignored demand relating aspect of investment.

In Ricardo’s view, decline would associate with the supply side. But Malthus, while agreeing also added demand side effect. Karl Marx positions with respect to this question and thereby his relationship with his predecessors. He referred to Say’s Law as a ‘children babble’ which is self-explanatory. That is because it fails to take into account of capitalism as a historic organization. Marx rejects the view that money is merely a veil. In such case, it is a barter economy which may be a confusing way to analyzing two different systems.

In a barter economy, it is C ---- C i.e. commodity for/to commodity. Whereas in capitalism, it is C --- M ---- C form of exchange. In capitalism, it is M --- C --- M' --- C'. in this case, the role of money is more important than as postulated by Say’s Law.

The second stage of the exchange in pre-capitalism. Marx argued it is not likely to take place in capitalism i.e. M --- C..

He therefore concludes that there is an inherent tendency of profit to fall in the long-run. This he still argues is not associated with tendency of deficient demand, but that if the organic composition of capital rises faster than the rate of surplus value does. Marx shows this by breaking the system into two department. This leads to saying that there is no possibility in principle of there been a deficient demand. He however argues that there is some aspect of the laws that could be accommodated. Surplus value is only a factor determine the rate of profit. It is the changer in the rate of profit that is associated with prices i.e. the relationship between rate of profit and capital accumulation i.e. the imbalance between production
relative to consumption. Marx does not believe in Say’s Law. He saw crisis independently of the type of breakdown. Marx argued under (consumption) the problem according to Marx lies in the specific nature of capitalism i.e. capitalism has been not economic crisis as a whole. He did not develop a full explanation of this though. Marx reason for crisis are mainly two:

Firstly, Factor in production of surplue value itself which have the tendency of reducing rate of profit itself. The process of accumulat
ing capital has a long run tendency of rate of profit to fall accumulation is a self-contradictory process. The survival of a block of capital requires the competition of others. Therefore a tendency for C/V to expand more rapidly than S/V. C/V = organic composition of capital, S/V = rate of exploitation. As a labour unit has more capital/constant capital associated with it, the organic composition of capital (C/V) rises. S/V would have gone up as well but the rate of profit = S/C + V.

Marx argues that the tendency for the C/V to rise more rapidly than S/V.

Secondly, the basic underline cost of crisis is over acmmualtion of capital. Once the prices as started, the other follows such as crisis of demand. But this demand problem is not the real cause of the crisis but a response/ consequence as a result of earlier crisis. This causes capital to be redrawn from the system. Because there is possibility of realizing capital. Opportunity for stronger capital to purchase weaker ones at prices which are lower than their genuine value arise. This is part of their recovery process. In Monetary economics, having made a sale, the producer is not compel to spend the money. He could hold on to it for a while. Hence the criticism of ‘immediacy’ in Say’s Law at a stage when product can be sold at their real value. Those who bought however, will later found it profitable. This is bcause those bought at a physical value, the real value appreciate later. Thus restoring the rate of surplus value. Finacila crisis exacerbate the initial crisis. Expansion of money supply to pick up production itself create financial crisis. There are non Marx theory that held to explain crisis in terms of the expansion and contraction of the monetary system. To Marx, this was secondary. Money as a means of storing value exacerbate the crisis. Once crisis has developed, there would be tendency to hound money. The immediacy of Say’s Law is not realized. The under consumption tendency may manifest itself once recession comes in. But it is a cause of the crisis. Against the background of falling rate of profit, restoration of capitalism is made more difficult. There follows a continuous increase in length of the crisis. This may in the long run leads to some political reaction (misery, violence) that result which will eventually leads to the destruction of capitalism. [prediction of Marx/Marxian]

NEO-CLASSICALS ON CIRCULATION

Neo-classicals economics marginal utility of Jevon, Walral and Alfred Marshall are all in the Neo-classicals and they are associated with Microeconomics. Neo-classicals concerns radically changing method of thinking and tackling problems. Involves use of objective theory of value
which was classical and this was blended into the subjective consideration in the Neo framework. This can be seen to mean the change in the emphasis. Conditions that determine the capacity over time of economic growth concern the classicals. Even Marx make capitalism the objective of growth. For the Neo-c there were not concern for the growth or long run trend of the economic but with the short time trend they were concern with the question ‘what determine the way in giving stock of resources is allocated?’. In other words and static model they started the narrowing down of the scope of economic analysis. Circulation and economic crisis analysis is really outside of the analytical framework of the noe.C. There was a break in the methodology. They accepted the tendency similar to Say’s Law i.e. a tendency towards full employment if the market system works properly. The Neo rely more on the quantity theory of money. When there is disequilibrium between supply and demand ‘real balance effect’ will restore the equilibrium. This is term direct mechanism. The indirect mechanism is associated with the rate of interest and the rate of return on capital there is excess supply on commodity. This imply an excess demand for money. Interest rate will increase. This increase relative to rate of profit will discourage further investment, there will then be a reduction in the supply of goods and services until it comes in line with demand. This analysis bores down to the fact that there can not be a long run disequilibrium and hence crisis. The only situation unemployment exist to the Neo, are when prices and wages are inflexible. They saw labour as a commodity and can therefore be analyse as any other commodity market. They used the marshallian cross of the demand and supply of goods market to analyse the labour market.

Demand and supply schedule

Marginal productivity of labour will determine its demand since the employer pays the worker the value which he the employer will maximize his profit with. According to them, if the government will bring the wage level to W, there would be full employment. Partial analysis is the term that has be used to describe the analysis in the Keynesian framework. But the fact that marginal productivie theory is incorporated by the classical it in that demand for labour is a derived one. Keynes said the consequence of cutting eages is to cut output of labour because income is cut. Consequently, demand for labour will shrink and this will lead to another equilibrium, though there is still excess supply of labour. This is what Keynes referred to as under employment equilibrium. Keynes submission therefore is that, contrary to the Neo position, unemployment cannot be solve by cutting wages. He went on to analyse in attempt to show what could be done to restore full employment with variables in the economy, notably investment and consumption.