5. Say's Law of Markets

Q.1 Explain Say's Law of markets

(A) **Introduction :-** According to Classical economists, the market forces will maintain Full-employment in the long-run. This theory of Full-employment was based on — Say's Law of Market.

(B) **Meaning :-** According to J.B Say - French economist —

"Supply Creates its Own Demand"

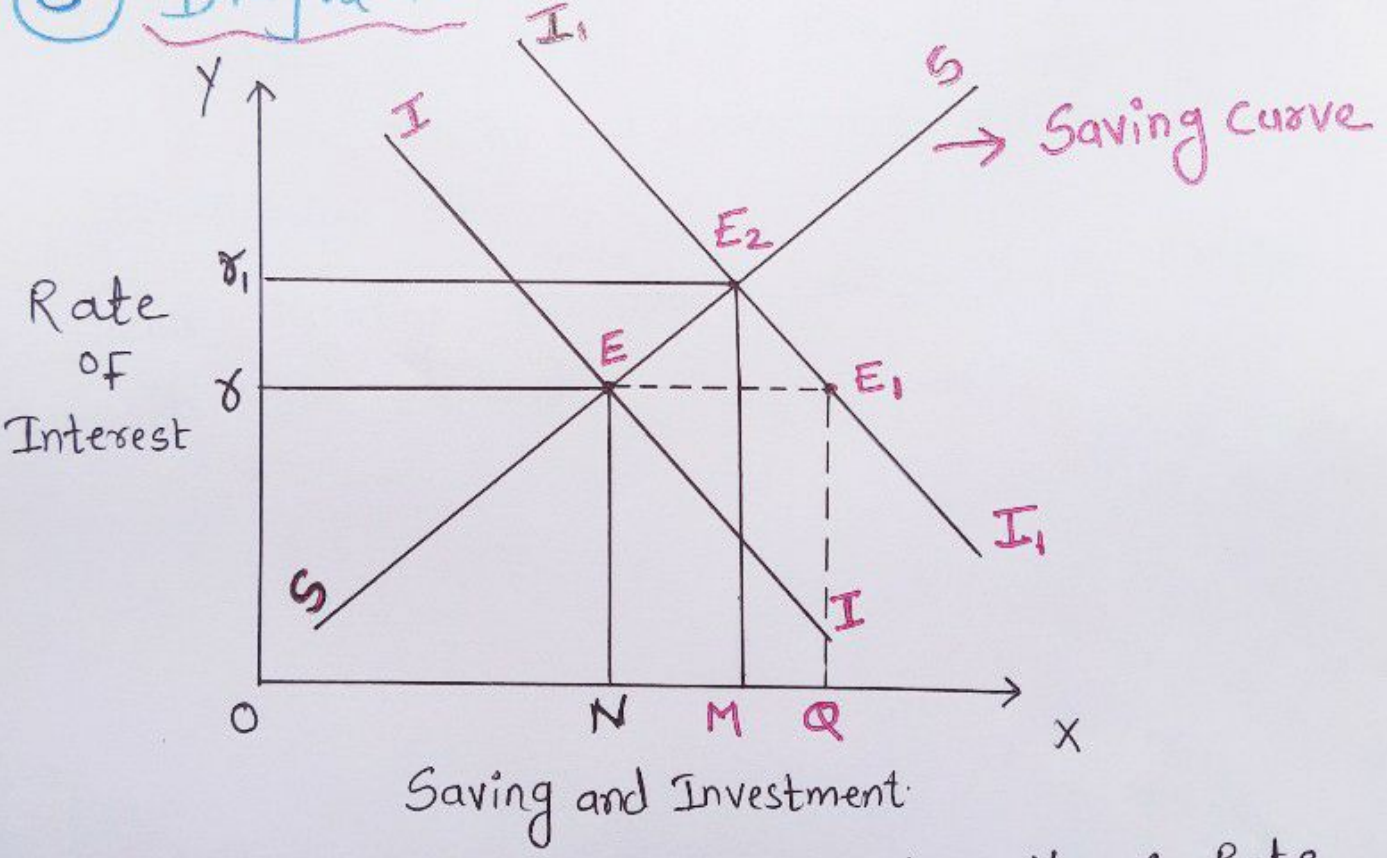
This means that - Production of goods and services will generate enough income and expenditure to demand. There will be no deficiency of Demand In this market there cannot be Over Production or Unemployment - on account of excess supply of goods and services

According to this law the income of Community is spent at such rate that it automatically maintains Full-employment. The income is mostly spent on consumption and rest is saved. The savings are again spent on Capital goods. There is Circular Flow of National Income. Again Aggregate Saving and Aggregate investment are also automatically maintained through the rate of Interest.

(2)

According to Classical economists Interest is a reward for Saving. Higher the rate of interest, higher the Saving & Vice Versa. On other side- Lower the rate of interest, higher is the demand for investment & Vice Versa. This is clearly shown with the help of following Diagram:-

(C) Diagram:-



Saving and Investment

1) On x-axis Saving and Investment and on Y-axis Rate of Interest are shown.

2) SS is Saving Curve, Sloping Upward from left to right. It shows Higher the R.O.I, higher the Saving and Vice Versa.

3) II is Investment Curve Sloping Downward from left to right. It shows Inverse relationship between R.O.I and Investment demand.

4) II Curve intersect SS Curve at Point E. Here r is the equilibrium rate where -

Saving = Investment

5) If investment increases, the investment Curve shift to Right Side. $I_1 I_1$. At the interest rate r there is Excess of Investment = EE_1.

6) To maintain equality between Saving and investment, the rate of Interest will rise to r_1

7) Now the Saving and Investment will be in Equilibrium at E_2.

Thus according to Say's Law - Supply Create its own demand.

Q:2 Assumptions of Say's Law of Market

Assumption :-

1. **Perfect Competition :-** Say's assumed that there is Perfect competition in Product market and factor market.

2. **Full Employment of Labour and resources :-** The classical economist assumed the level of Full Employment in the economy. According to them Unemployment is a Temporary Situation and Full Employment Equilibrium is a Normal Situation.

3. **Free Market Economy :-** According Classical economist there is no need of government interference in the economy. Free market automatically bring equilibrium between demand and supply in the economy.

4. **Flexibility of Wages, Prices and Rate of Interest :-** Classical economist assumed that - Wages, Prices and Rate of Interest are Flexible in nature. It help to bring equality between demand and supply of labour, demand and supply of money Saving, Investment etc. This will help to bring Full employment in the economy.

(5) Direct relation between Money wages & Real wages :- (5)

Pigou assumed that Price remain Constant in Product and factor market. So change in Money wages will bring same Change in real wages. So it is shown that Money wages and real wages are directly related.

Q:3 State and Explain Say's Law. On what grounds did Keynes refuse it?

OR Enumerate the Criticisms of Say's Law.

(A) Introduction
(B) Meaning } Same from Q:1

(C) Criticism of Say's Law :-

J.M Keynes has Criticised Say's Law on Following grounds :-

1. Say's Law Unrealistic :- According to Say- 'Supply create its own Demand'. But according to Keynes, supply does not necessarily create its own demand as investment may not be equal to saving. Hence Say's Law is Unrealistic.

2. Under employment Equilibrium :- Keynes rejected the Classical assumption of full employment Equilibrium. According to him, Full-employment is exceptional Case. But Under employment is normal Case.

(eg) Millions of workers are ready to do work at current wage-rate but they do not get Job.

3. Non - Flexibility of Wages :- The Classical economist assumed that wages, Price and rate of interest are Flexible. But Keynes argued that wages are not Flexible. It is very difficult to reduce money wages due to opposition From trade Union. The real wages can be reduced by a

rise in general Price level.

According to Keynes – If money wage rate Could be reduced then it would not increase income and employment. According to Keynes reduction in wages will reduce Agg. Demand, Price, Profits and employment.

4] Role of Money Neglected :- Say's believe that money does not affect the economic activities of markets.
But according to J.M. Keynes People need money for – Transactionary, Precautionary and for Speculative Purposes, Money have a great effect on output, income and employment.

5] Self-Adjucement Not Possible :- According to Say's Law, Full employment is maintained by an automatic and Self-adjucement mechanism in Long-run.
But according to Keynes – It is not automatic and self adjustment Process which reduce the Problems of Poverty, inequality and Unemployment etc. Government intervention is must through – Taxation, Public Expenditure, Public Debt etc.

6. Interest is not a Equilibrium factor :-
Say's believe that equality between Saving and Investment is brought about by changes in rate of Interest.
But according to J.M. Keynes – Equality between

Saving and Investments is brought about by changes in Income.

According to Keynes- Saving and Investment are Undertaken by two sets of People. They cannot be brought to equality level on basis of Rate of Interest. The important determinant of Saving is Income. The Important determinant of Investment is Rate of Interest and MEC. Therefore According to Keynes - Saving and Investment can be brought to Ecquilibrium level on basis of Income rather than Rate of Interest.

7. Artificial Obstacles :- The theory of Say's Law is based on Perfect Competition where many Problems of market and Government do not found. But the world is full of many artificial Problems like- Minimum wage Rate, Industrial monopoly, Trade Union etc. It have great impact on income, Price, wages & Interest rate etc.

8. Over Production is Possible :-

Say's Law states that - Supply create its own demand and there cannot be general Over Production. According to Keynes, all incomes accruing to Factors of Production is not spent but some part of it is saved which is invested. Therefore Saving and Investment are not always equal. There is problem of over Production and Unemployment.

(9) Demand Creates its own Supply :-

Say's Law states that- "Supply Creates its Own Demand" Therefore there cannot be general overproduction and mass Unemployment.

But according to Keynes- "Demand creates its own supply" Unemployment is the result from deficiency of Effective demand.

(10) State Intervention :- Say's Law is based on Laissez-Faire Policy i.e Non intervention of Government But according to Keynes government play an active role for growth and development of country.

According to Keynes- State intervention is necessary for adjusting supply and demand within the economy through Fiscal and Monetary measures.

Q.4 What are the Features of Say's Law of Market?

A] Introduction & B] Meaning } Same from Q:1

C] Features OF Say's Law OF Markets :-

1. General Over Production is not Possible :-

Say's Law states that " Supply creates its own demand " This means that Production of goods and services will generate enough income and expenditure to demand. There will be no deficiency OF demand. In such situation there Cannot be Over Production because supply of goods will not exceed demand as a whole.

2. Production Creates Market for Goods :-

Producers Produce goods with the help of four factors of Production. Producer Pay wages to Labourers For Producing income. Same income is used for Purchasing goods and services. Thus Supply create its own demand.

3. Saving and Investment Equality :-

According to classical economist, People do not spend all income on Consumption, but some part is Saved which is automatically invested For further Production. Thus Saving and Investments are equally maintained to avoid general Over Production.

4) **Barter System as its Basis :-** Say's Law mostly work in Barter economy. In this economy People Produce goods either to consume or to exchange with other Peoples. If there was shortage of Certain goods, then it is considered as Temporary phenomenon.

5) **Rate OF Interest :-** Say's Law of markets explain that Rate of Interest is the determinant Factor in maintaining the equality between saving and Investment. If at any time- investment exceeds Saving, then Rate of interest will Rise. If Savings are exceeds investment, then Rate of Interest will Fall.

(6) **Labour Market :-** Say's Law of markets assumed Full employment as normal Feature of an economy. By giving minimum wages to labourers, more labourers can be employed. In this way there will be more demand for labour, so there will be no Unemployed in economy

Q:5 Explain the Implications of Say's Law.

Implications of Say's Law

1. **No General Unemployment and Overproduction :-**

Say's Law state that – "supply create its own demand" It means Production of goods and services will generate enough income and expenditure to demand. Under free economic condition Labour is automatically employed in Labour market.

Thus there is no General Unemployment and Over production of goods and services

2. **Automatic Adjucement :-** According to Say's there is automatic adjucement in the economy whatever is produced is consumed in economy Supply will always equal to demand. Hence there is no necessity of government to intervene in business matters.

3) **Flexible Rate of Interest :-** Say's Law of market explain that Rate of Interest is the important determinant in maintaining the equality between saving and Investment. In this market rate of Interest is Flexible which bring equality between Savings and investment.

4) More Production :- Say's Law assumed Full-employment of resources. It will help to Produce more Output

5) Passive Role of Money :- Say's believe that money does not affect the economic activities of markets. Money is used only as a medium of exchange to facilitate transactions

6) Pigovian Formulation :- According to Pigou's View, wage-Rate will help to bring more employment of Labour. Even Flexibility of interest Rate will bring equilibrium between—

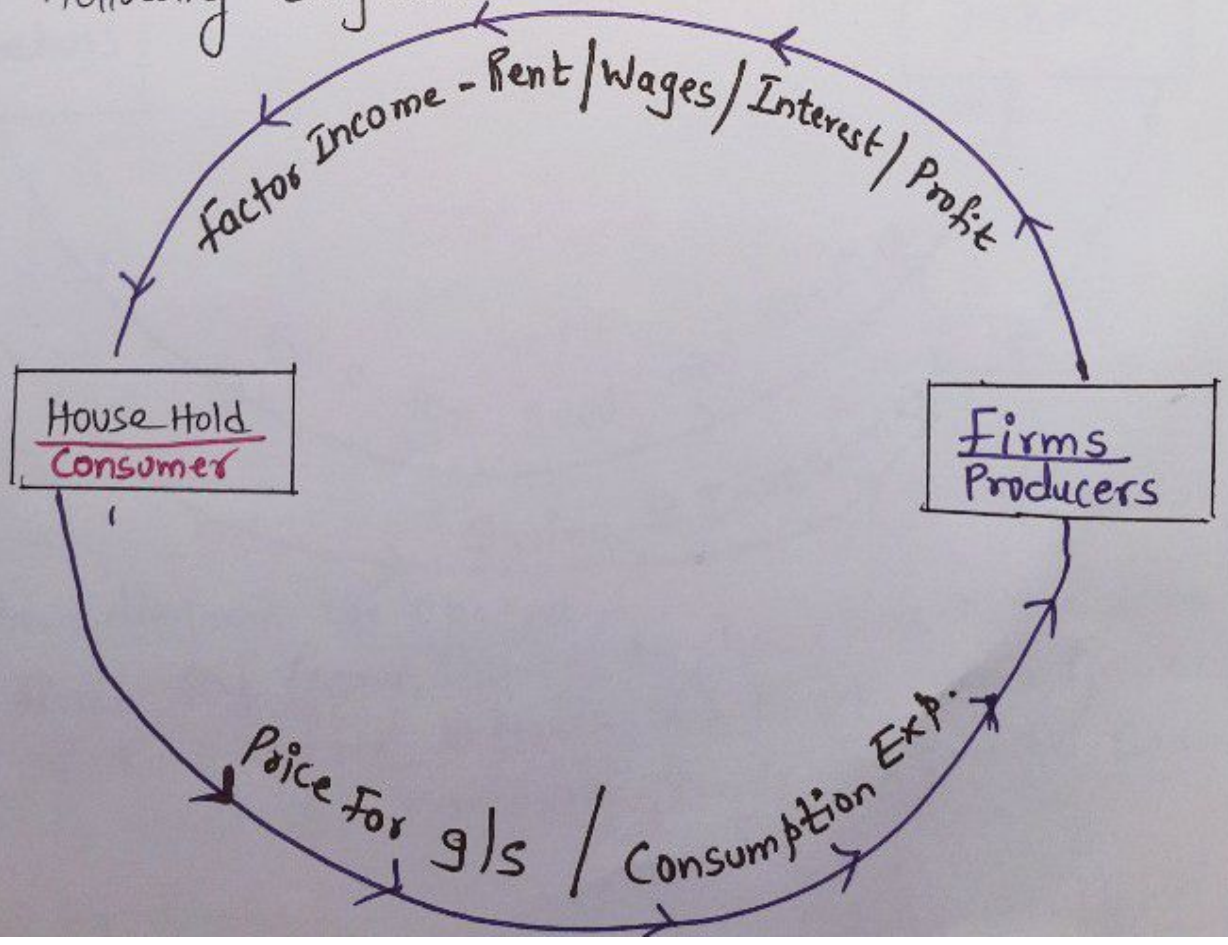
Saving = Investment

Q.6 Explain Say's Law in a Money Economy?

(A) **Introduction :-** The Original form of Say's Law is applicable to Baster economy. In Baster economy People produce goods either for themselves or for exchange with other People. Classical economists believe that Say's Law is equally applicable in money economy.

(B) **Say's Law in a Money Economy :-**

According to Classical economist money is neutral and it does not affect the real Process of Production and distribution. They assumed that income received by household is spent on Consumption Expenditure. It is clearly shown in following diagram :-

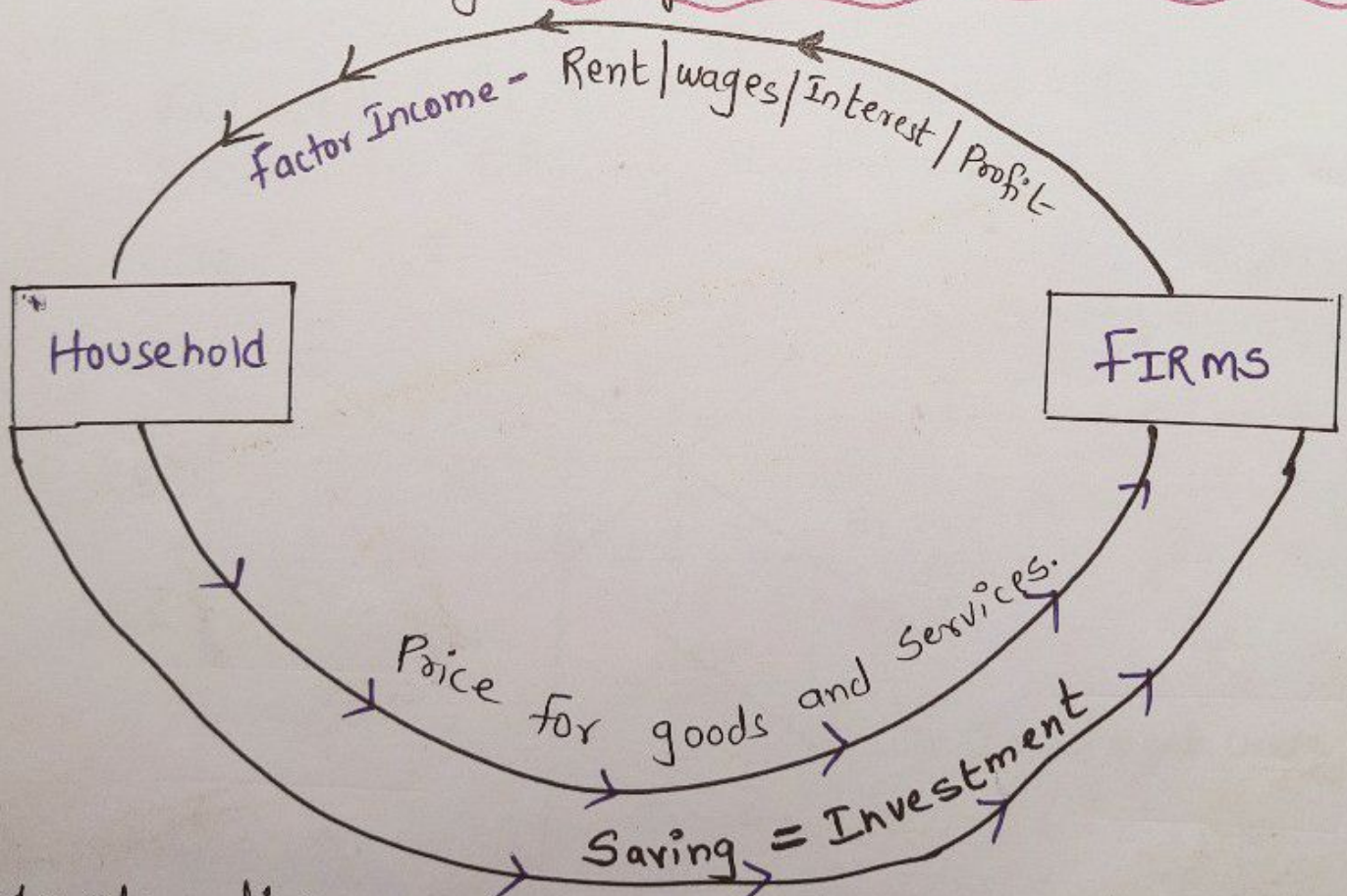


In above figure we observe —

1] Firms use factors of production (Inputs) given by Households. In return Firms Pay - Rent, wages, Interest and Profit to Households.

2] Household spend same income for purchasing various goods and services. It shows the ~~Circl~~ Circular Flow of goods and services between Households and Firms.

3] There is no saving and Hoarding of money. In this way supply creates its own demand.



In above diagram we observe —

1. Firms Pay factor income to household in the form of Rent, wages, Interest and Profit. Same Income is used for purchasing goods and services produced by Firms.

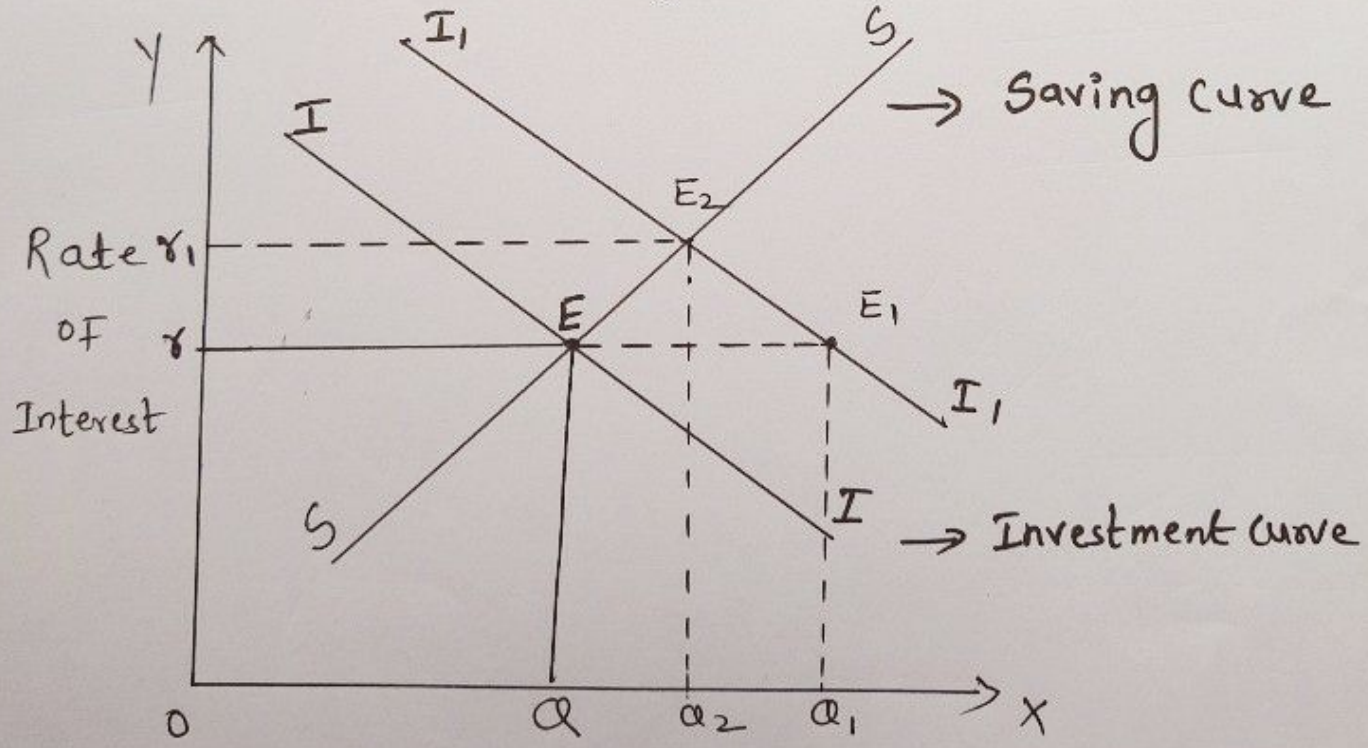
2] If household do not spend entire income on consumption expenditure, then they save some Part of Income.

3] Saving is injected towards Firms through Investment by financial market.

4) According to classical Economists—
Interest is reward for Investment, so High R.O.I, higher will be Saving.

5] On the other side— Higher R.O.I, less will be demand for investment and Vice Versa.

6) Thus— Saving will rise and Investment will Fall till both become equal. It is shown in Following diagram :—



Saving and Investment

1) SS is Saving curve and II is the Investment Curve.
2) E is the Point of Equilibrium where SS = II
Here γ is the rate of Interest

3] If Investment increase, Investment Curve will shift to right side = I, I_1

4] At R.O.I – γ, EE_1 is the Excess investment demand which give rise to R.O.I at γ_1.

5) Now we get New Equilibrium – E_2.
Here – $SS = I, I_1$ at higher R.O.I – γ_1.

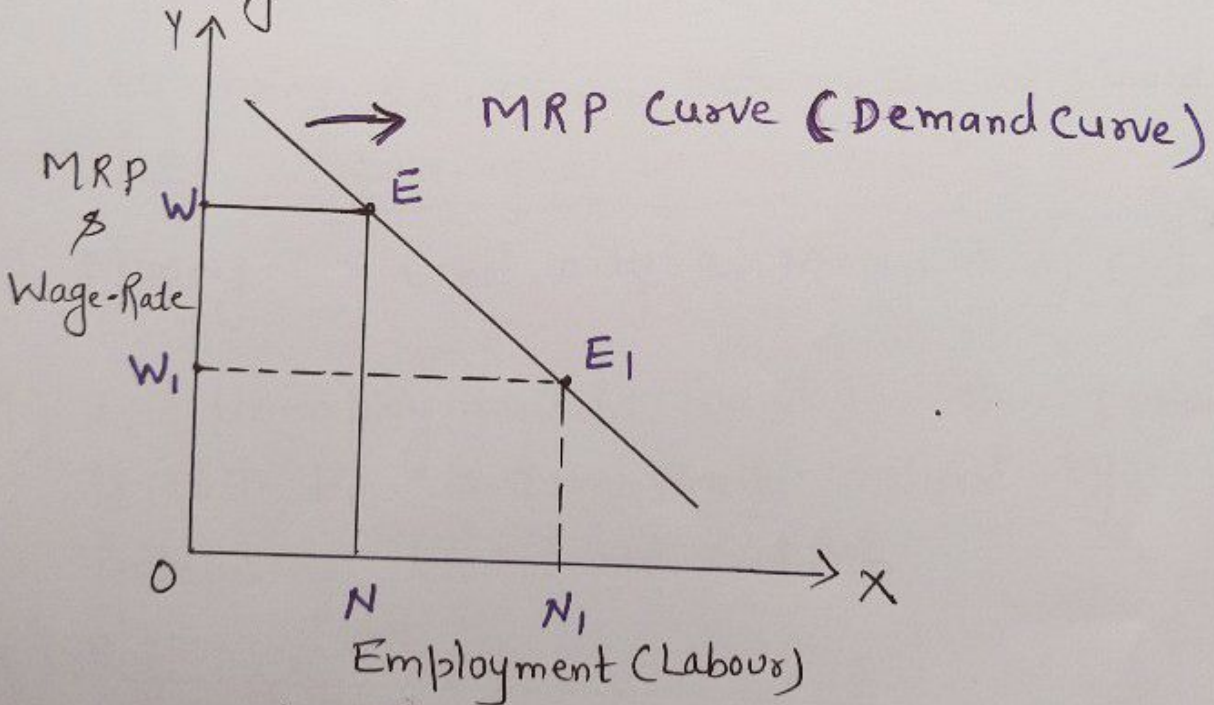
Thus Say's Law framed in barter economy can be also used in Money Economy.

Q.7 Explain Pigou's Version of Say's Law?

Pigou's Version of Says Law :—

Pigou's developed Say's Law in terms of - Labour Market. According to Pigou, free-competition will Provide Full-employment in the labour market The flexibility of Prices and wage-rate will help to remove Unemployment.

According to Pigou- Unemployment is arise for Temporary short Period. During this Period wage-rate will start falling till Unemployed labour are employed. It is clearly shown in Following diagram —



In above diagram —

1) MRP is Marginal Revenue Product Curve which is sloping downward from left to right.
2) When ON Labours are employed at OW wages, we get Equilibrium at E level.

3) If Wage-Rate reduce From OW to OW_1, then we can employ more labours from ON to ON we get New Equilibrium at E_1 level.

* IMPLICATIONS OF SAY's LAW

i) There is automatic adjucement in the economy. SS = DD (Supply = Demand)

ii) General Unemployment and Over Production of goods is not possible.

iii) Wage-Rate Flexibility will help to bring employment of labour.

iV) The Flexibility of Interest rate will help to bring equilibrum between Saving & Investment. i.e Saving = Investment

V) Money is Used only as Medium of Exchange

Vi) If Unemployment is Found For short Period, it will be automatically Solved by increasing demand and output.