

The Classical Theory of Income and Employment

The Classical Postulates

- There is always full employment
- The economy is always in the state of equilibrium
- Money does not matter
- Supply creates its own demand

The Aggregate Production Function

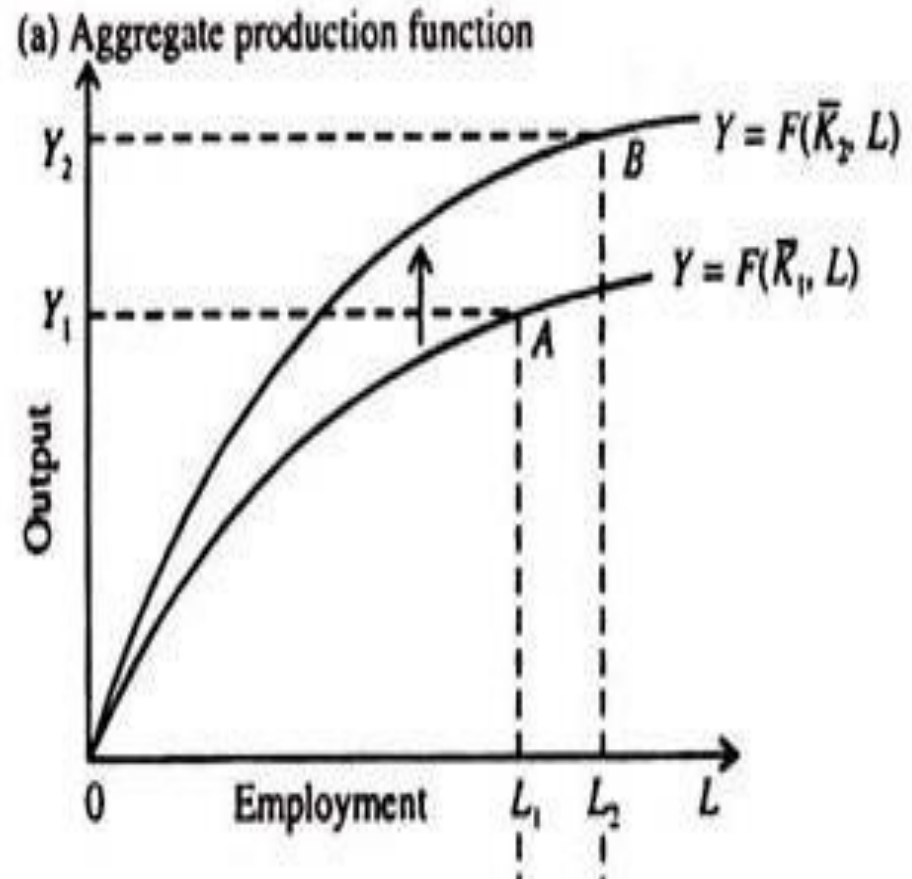
- The national output of a country at any point of time depends on the capital and labor employed

- $Y = f(K, L)$

- $Y =$ Aggregate Real Output

- $K =$ Capital (Fixed)

- $L =$ Labor to produce Y



The Labor Market

- The level of Full employment is determined where labor supply equal labor demand
- The supply of labor is a function of real wages (Wr)
- $LS = f(Wr), \frac{\Delta LS}{\Delta Wr} > 0$

Continued

- Labor demand depends on Marginal revenue productivity of Labor and Real wage

- $Ld = f(Wr, MRP_L)$

- $MRP_L = MPP_L * P$

- $MPP_L = \frac{\Delta Y}{\Delta L}$

