Difference between Classical and Neo-Classical Theory:

Classical Theory Definition:

Classical theory basis starts from Adam smith. Adam smith says that in market there is invisible hand which adjust everything. If labor demand is less than wages will become low. and if wages become low then demand of labor increases.

Briefly Overview of Classical Theory:

Adam smith's is usually considered the man to mark the beginning of classical economics. The fundamental message of Adam's Smith on this theory was that the wealth of nations was based not on gold but on trade. When two parties freely agree to exchange things of value because both see a profit in exchange, total wealth increases.

Classical economists observe that markets generally regulate themselves. When buyers are able to choose between various suppliers and companies which do not successfully compete are allowed to fail. Smith warned repeatedly of the dangers of monopoly and stressed the importance of competition.

Classical economic theory assumes that flexible prices both for goods and wages and predicts that supply can creates its own demand.

Neo-Classical Theory Definition:

Neoclassical economics is a broad theory that focuses on supply and demand as the driving forces behind the production, pricing, and consumption of goods and services. It emerged in around 1900 to compete with the earlier theories of classical economics.

Briefly Overview of Neo-Classical Theory:

This approach was developed in the late 19th by Alfred Marshall. Neo-classical theories underline modern day economics, Although Neo-Classical approach is the most widely taught theories of economics. Neo-Classical economists believe that a consumer first concern is to maximize personal satisfaction. Therefore, they make purchasing decisions based on their evaluation of the utility of a product or services.

Classical economists assume that the most important in a product's price is it's cost of production. Neo-Classical economists argue that the consumer's perception of a product's value is the driving factor in its price.

Difference between both theories:

Classical Theory	Neo-Classical Theory
It focuses on the production of goods and services.	It focuses on how individuals operate within the economy and how goods and services are exchanged.
It asks that what an economy grows based on return two factors. For instance: Wages, Rent	How individuals through his choices influence the economy.
It assumes that economy is self-regulating and output is assumed to be distributed among different factors in accordance with the cost by them.	It states prices, output and income are governed in the market through demand and supply by utility maximization.
Concept of utility was absent in theories of labor, growth and value. Equilibrium was a function of wages and interest rate rather than supply and demand.	Equilibrium was a function of supply and demand across all markets, with supply and demand being function of their utility.
Value is considered as cost of producing it. Thus, value is considered as inherent property. Value is cost.	Value is a function of demand and supply. Value is considered as perceived property. Value is utility.
Profit is a payment to a capitalist for performing society's useful function. **Profit** Value = Cost	If supply and demand for a good result in a higher price then cost. Then this will result in profit. **Profit** Earnings - Expenses
Rationality is not emphasized. Profit (value) that accrue to the firms are same as wages that accrue to the workers.	Rationality is emphasized. Individuals agents have rational preferences. Consumer's maximize their utility and firms maximize their profit.
Equilibrium occurs where savings is equal to investment.	Equilibrium occurs where labor demand is equal to labor supply and aggregate demand is equal to aggregate supply.
Classical economic theory assumes that a product's value derives from the cost of materials plus the cost of labor.	Neoclassical economics stipulates that a product or service often has value above and beyond its production costs.