SAY'S LAW: WERE (ARE) THE CRITICS RIGHT?*

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INTRODUCTION

This paper examines what economists call "Say's Law" from its inception in 1803 to the present time. While the logic behind J.B. Say's contention that what one demands is predicated upon what one supplies seems simple and irrefutable, it has divided economic thinkers for nearly two centuries. A large body of literature — from the Mercantilists who preceded Say (and whose works he sought to refute) to modern-day "Supply-Siders," who managed to dominate a U.S. Presidential election — has been written on this "law."

Because the number of important critics and supporters is large, and the space allotted to this paper so small, I shall limit the scope of this essay. A large portion is allocated to examining and explaining the "law" itself. Although "Say's Law" seems to be self-explanatory, judging from the differences in interpretation that have followed since 1803, it seems that before looking at the critics, one must first know what was being criticized.

Because of limitations on length, I cite only British critics and supporters for the 19th Century and J.M. Keynes in the 20th Century. I omit the works of Sismondi and Marx, despite their importance. In addition to those limitations, I also admit that the length (and time) constraints will not allow me to examine in detail many of the criticisms that a more thorough work would require. I also add our own observations and criticisms.

I ask: Is the Say's Law that is often criticized in the economic literature really what Say wrote? If not, what mistakes did the critics make. This paper tries to answer those questions.

In 1803, Economist Jean Baptiste Say of France published his principal work, *Traite' d'Economie Politique*, a book which Say hoped would make him the greatest of economic thinkers.

While many economic historians still praise *Traite'*, Say is remembered mostly for Book I, Chapter XV, "Of the Demand or Market for Products," in which what economists call "Say's Law" is explained. That this law has been debated in academic and government circles would be an understatement. Indeed, much of the economic discussion of the 1980 U.S. Presidential campaign between Jimmy Carter and Ronald Reagan centered upon a resurrection of Say's Law. Say's legacy is long, but not entirely for the reasons for which he had hoped.

In modern macroeconomics, Say's Law — if taught at all — is taught as a fallacy of classical economics, to be regarded in the same manner as the Labor Theory of Value and the wages-fund. The law was "discredited," as Socialist Michael Harrington wrote, by "the Great Depression." (Harrington 1981). John Maynard Keynes attacked the "law" in his own 1937 historical work, *The General Theory*, and most of the academic world applauded. Wrote Paul M Sweezy (1947) about Say's Law, "Historians fifty years from now may record that Keynes' greatest achievement was the liberation of Anglo-American economics from a tyrannical dogma . . . ." Schiller (1997) declares that Say's Law was brought into disrepute *prima facae* by the very appearance of business cycles that critics insist that Say's Law affirmed could never happen.

Indeed, Say's Law had stirred some controversy a century earlier. Thomas Malthus challenged it in 1820 with a piece that was quickly answered by David Ricardo. However, Sowell (1985) writes that the most virulent attack came from Karl Marx, who declared Say's Law to be "preposterous," "childish babble," "pitiful claptrap," "a paltry evasion," and Say, himself, to be "dull," "inane," "miserable," "thoughtless," and a "humbug." Despite Marx's citicisms, however, most economists of that century were convinced by Say's logic and generally accepted the Frenchman's doctrine.

Like most doctrines that have such a lightning-rod effect, there is much to Say's Law that is misunderstood. This is not to say that opponents of Say's Law oppose it simply because they misunderstand it and, therefore, only need to become educated about it. Indeed, many seem to oppose it *because* they understand it, or at least understand its implications. Sweezy (1947) noted that "the Keynesian attacks (on Classical Economics) . . . all fall to the ground if the validity of Say's Law is assumed." One can be assured that had economic policymakers in the United States and England held to the postulates of what Say wrote in his chapter XV, that government policies might well have followed different paths than they have since the early 1930s.

The obvious question, then, is: What is Say's Law? The popular answer, or at least the version of the law with which most commentators are familiar, is that "supply creates its own demand." In other words, demand in the marketplace is derived from that which has been produced. Writes Benjamin Anderson (1949), "The prevailing view among economists, . . . has long been that purchasing power grows out of production. The great producing countries are the great consuming countries."

To simply say that "supply creates its own demand" however, is to inadequately state the law and to undermine the context in which Say wrote it; to suggest this law is Say's only legacy would also be doing Say and his writings a great disservice. Say might not have reached his goal of becoming the world's greatest economist, but he was a powerful economic thinker and the direction of classical economic thought was due in large part to this Frenchman.

SAY AND HIS LAW

J.B. Say (1767-1832) was a man of many talents and accomplishments. Bell (1953) writes that Say learned his business trade in England and France, where he became both a soldier and statesman, serving in the French Tribunate in 1799. After Napoleon dismissed him from that position, he became the proprietor of a cotton spinning mill, which is where he worked when his *Traite'* was published.

A disciple of Adam Smith, Say did much to publicize the Scotsman's work on the European continent, although *Wealth of Nations* was translated into French when Say was only 12 years old. Like Smith, Say sought to discredit doctrines of mercantilism (or, for the French, Colbertism) and replace them with more liberal thought. Say was fortunate enough to see his book go through five printings during his lifetime. *Traite'* was so popular in the United States that the English translation served as a standard text of economic in American colleges and universities for much of the Nineteenth Century.

Say believed, as do many of his modern compatriots, that the economist was performing science, and that his (or her) work should be done in a positive vein. The economist, he noted, is a "passive spectator" who should not give advice. He believed, as did Smith, that "natural law" governed economic behavior, which made it orderly, predictable, and universal. It was in that spirit that he developed what became Say's Law.

Contrary to popular teaching in macroeconomics, Say never wrote that recessions or periods of resource unemployment could not happen. In fact, he had observed such periods as a businessman and wrote Chapter XV to address that problem, or at least to address what he believed was *not* the cause of the problem:

> It is common to hear adventurers in the different channels of industry assert that their difficulty lies not in the production, but in the disposal of commodities; that products would always be abundant, if there were but a ready demand, or market for them. *When the demand for their commodities is slow, difficult, and productive of little advantage, they pronounce money to be scarce; the grand object of their desire is a consumption brisk enough to quicken sales and keep up prices* (italics mine)

In presenting Say's Law, Henry Hazlitt (1959) wrote, "Whenever business was bad, the average merchant had two explanations at hand: the evil was caused by a scarcity of money and by general overproduction. Adam Smith, in a famous passage in *The Wealth of Nations*, exploded the first of these myths. Say devoted himself to a refutation of the second." In other words, Say was not attempting to create a doctrine which said that business downturns or recessions were impossible, but rather tried to explain why he believed that recessions (Say did not use that term) were not caused by a general overproduction of goods. In fact, any unbiased reader can see that Say was actually describing what one might call recession conditions.

Sowell (1994) writes that in the Classical system, Say's Law "involved six major propositions." Sowell writes:

1. "The total factor payments received for producing a given volume (or value) of output are necessarily sufficient to purchase that volume (or value) of output."
2. "There is no loss of purchasing power anywhere in the economy." (In other words, no Keynesian "leakages.") "People save only to the extent of their desire to invest and do not hold money beyond their transactions need during the current period."
3. "Investment is only an internal transfer, not a net reduction, of aggregate demand."

4. "In real terms, supply equals demand *ex ante,* since each individual produces only because of, and to the extent of, his demand for other goods."
5. "A higher rate of savings will cause a higher rate of subsequent growth in aggregate output."
6. "Disequilibrium in the economy can exist only because the internal proportions of output differ from consumer's preferred mix – *not* because output is excessive in the aggregate."

As Sowell points out, even the critics held to the first three propositions. It was the last three that created the controversy. (It should also be noted that the last proposition helps form the basis for the Austrian Business Cycle Theory as outlined by Ludwig von Mises, F.A. Hayek, and Murray N. Rothbard.)

As might be expected the real source of the conflict between supporters of Say's Law and its opponents came with the controversy over whether or not gluts – unsold inventories – were *proportional* or *general.* Proponents of Say's Law believed the former, while Malthus and others held to the latter, which falls under the aegis of theories of underconsumption.

UNDERCONSUMPTION THEORIES

Before proceeding further with an analysis of Say's Law, I will first briefly explain overproduction or underconsumption theories of recession. (The theories will be further illuminated as the paper discusses those who disagreed with Say.) Say's critics invariably come from this loosely connected group, which that Malthus, Karl Rodbertus, Thorstein Veblen, and Keynes, although underconsumption theories did not begin with them. (Karl Marx was in a different category.) In his well-known *Mercantilism*, Eli Hecksher (1935) notes that the idea abounded during the Sixteenth and Seventeenth centuries when many held a "deep-rooted belief in the utility of luxury and the evil of thrift."

What later economists would term the “paradox of thrift” – that while saving may be good for individuals, it is bad for the community at large – had been part of the intellectual landscape for many years.

> Thrift, in fact, was regarded as the cause of unemployment, and for two reasons: in the first place, because real income was believed to diminish by the amount of money which did not enter into exchange, and secondly, because saving was believed to withdraw money from circulation.

While all of these writers espoused differences in their economic theories, all are agreed on the issue of a reduction in aggregate demand. Underconsumptionists as a whole believe that a market economy suffers from internal shocks caused by lack of consumption, or the lack of ability of people to purchase the products that have been created. Unlike Say and his followers, underconsumptionists see the shocks as endogenous to the system. That is, market economies groan under the contradictory weight of propensities of the system to move toward underconsumption and, ultimately, mass unemployment. Writes Harrington (1981):

> “During the 1930s, there was a glut of consumer goods because workers lacked the purchasing power to buy back what they produced. That was why government began to play a role in the economy on behalf of middle- and low-income people during the period of Franklin Delano Roosevelt’s New Deal.”

Unlike Say, who held that the ability to consume grows from the ability to produce, underconsumptionists have believed that production and consumption are disconnected activities. One blindly produces, hoping — as do all producers — that consumers in the great beyond of the economy will be both willing and able to purchase what the producer has created.

As long as income is evenly distributed, and as long as people spend it immediately, overproduction may not occur. However, the possibility that people will choose to save some of their income will complicate economic matters. Take, for example, a worker who is paid $100 for producing the same dollar amount of goods. Should he choose to place $10 in savings, then he will only be able to purchase $90 of items. Multiply this across an economy, and there is underconsumption, and, ultimately, a glut of goods, unsold inventories, and unemployment, as production comes to a halt.

CLASSICAL REBUTTAL

Say and other classical economists, however, argued that when that worker saves that $10, the money is then invested, which produces capital with which to create more goods in the future. In other words, savings equals investment. The $10 saved is spent not by that worker. Instead, someone else borrows that money and spends it on capital that will produce even more goods.

Classical economists held that prices (and wages) should adjust with changes in the money supply because the primary purpose of money was to make transactions easier, or to create favorable conditions for economic transactions that otherwise would not take place. (This adjustment is the key contention in the Keynesian analysis.) Money, in Say's system, served primarily as a medium of exchange, and was not identified as a store of wealth. Like Adam Smith, Say believed that money was not wealth, but rather a means to allow wealth (goods) to be exchanged in the marketplace. He wrote:

> For what, in point of fact, do you want the money? Is it not for the purchase of raw materials or stock for your trade, or victuals for your support? Wherefore, it is products you want, and not money. The silver coin you will have received on the sale of your own products, and given in the purchase of those of other people, will the next moment

> execute the same office between other contracting parties, ...   If you cannot find a ready sale for your commodity, will you say, it is merely for want of a vehicle to transport it? For, after all, money is but the agent of the transfer of values.

Say held that a general underconsumption, like a general overproduction of good, was impossible. Since the main purpose of money was to make market transactions easier, then it did not matter how much or how little money was in circulation if prices simply adjusted to the money which was available, which is an implicit assumption that prices and wages should be flexible, something that Keynes would challenge 134 years later:

> Thus, to say that sales are dull, owing to the scarcity of money, is to mistake the means for the cause; . . . . Sales cannot be said to be dull because money is scarce, but because other products are so. *There is always enough money to conduct the circulation and mutual exchange of other values, when those values really exist.* (Italics mine)

Say further explains the concept of demand through production:

> A priest goes to a shop to buy a gown or a surplice; he takes the value, that is to make the purchase, in the form of money. Whence had he that money? From some tax-gatherer who has taken it from a taxpayer. But whence did this latter derive it? From the value he has himself produced.

Critics have often accused Say of declaring that product gluts are impossible. For example, Harrington (1981) writes, ". . . supply-side economics originated with Jean Baptiste Say . . . who declared that supply creates its own demand. To oversimplify only slightly, Say's Law maintains that if business can produce products, it can sell them. The Great Depression discredited Say's Law." Say's own words refute that charge:

> But it may be asked, if this be so, how does it happen, that there is at times so great a glut of commodities in the market and so much difficulty in finding a vent for them? Why cannot one of these

> superabundant commodities be exchanged for another? I answer that the glut of a particular commodity arises from its having outrun the total demand for it in one or two ways; either because it has been produced in excessive abundance, or because the production of other commodities has fallen short.

As clearly stated, Say never claimed that gluts of production were not possible; he only stated they did not occur through a *general* overproduction, but rather through overproduction of certain goods in proportion to others which were underproduced. While Say did not create a business cycle theory, it is obvious that his notion of certain goods being overproduced and others underproduced as part of an overall economic imbalance, does fit in with the Austrian theory of malinvestment, as noted earlier.

Furthermore, although his theory lacks a mechanism through which a business cycle (or at least a recession) might occur, he notes that events — and especially political events — can cause prolonged unemployment:

> It is observable, moreover, that precisely at the same time that one commodity makes a loss, another commodity is making excessive profit. *And, since such profits must operate as a powerful stimulus to the cultivation of that particular kind of products, there must needs be some violent means, or some extraordinary cause, a political or natural convulsion, or the avarice or ignorance of authority, to perpetuate this scarcity on the one hand, and the consequent glut on the other*. No sooner is the cause of this political disease removed, than the means of production feel a natural impulse towards the vacant channels, the replenishment of which restores activity to all the others. *One kind of production would seldom outstrip every other, and its products be disproportionately cheapened, were production left entirely free* (italics mine)

Although Say stressed that the economist should be a passive observer, it is clear that he had a normative view on the role of government in economic matters, and especially in the kinds of policies it should *not* encourage:

> The same principle (supply creates demand) leads to the conclusion, that the encouragement of mere consumption is no benefit to commerce; for the difficulty lies in supplying the means, not in stimulating the desire of consumption; and we have seen that production alone furnishes those means. *Thus it is the aim of good government to stimulate production, of bad government to encourage consumption* (italics mine)

REACTION OF CLASSICAL ECONOMISTS

Say's logic was readily accepted by most of his classical contemporaries, including John Stuart Mill (1806-1873) and David Ricardo (1772-1823). Mill defended and expounded upon Say's Law both in his *Principles of Political Economy* (1848) and in an essay, "On the Influence of Consumption on Production" (1844). Keynes, while attempting to discredit Say's Law, took a passage from *Principles* and analyzed it, using it for the basis of his criticism. (Keynes' critics point out, however, that Keynes used the passage out-of-context and failed to include all of Mill's relevant comments.)

Mill (1848), like Say, held that purchasing power emanated from production:

> What constitutes the means of payment for commodities is simply commodities. Each person's means of paying for the production of other people consist of those which he himself possesses. All sellers are inevitably, and by the meaning of the word, buyers. Could we suddenly double the productive powers of the country, we should double the supply of commodities in every market; but we should, by the same stroke, double the purchasing power.

As if anticipating his critics, Mill was quick to add:

> It is probable, indeed, that there would now be a superfluity of certain things. Although the community would willingly double its aggregate consumption, it may already have as much as it desires of some commodities . . . . If so, the supply will adapt itself accordingly. . . .

In his 1844 essay, Mill attacked underconsumptionists who held that government must encourage consumption to avoid unemployment:

> Among the mistakes which were most pernicious in their direct consequences . . . was the immense importance attached to consumption.

This is not to say that Mill was always clear on this subject. Sowell (1972) points out that some of Mill's writings seemed to indicate he believed that a general glut was possible. Moreover, he listed an example (1848) when Say's Law would not hold:

> I have already described the state of the markets for commodities which accompanies what is termed a commercial crisis. At such times there is really an excess of all commodities above the money demand: in other words, there is an under-supply of money.

He quickly added, however, that the problem is with money and not with production:

> But it is a great error to suppose . . . that a commercial crisis is the effect of a general excess of production.

Even though Mill specified a money problem, his words are clearly a break with Say, who held to flexibility of wages and prices. (This seems to contradict other Mill passages in which he wrote that the amount of money in circulation was not important.) What Mill seemed to say is that a sudden fall in the quantity of money will trigger a crisis, which is not unlike the modern monetarist position of Milton Friedman and others, which is explained in *A Monetary History of the United States* (1963) by Friedman and Anna Schwartz.

But even though Mill did differ with Say on the flexibility of wages and prices and the quantity of money, he did not join the underconsumptionists. The loudest voice of that group in classical England would belong to Thomas Malthus.

Malthus (1766-1843) told Ricardo in a letter:

> Effectual demand consists of two elements, the power and

> will to purchase. . . . A nation must certainly have the power of purchasing all that it produces, but I can easily conceive it not to have the will.

An English clergyman, Malthus gained fame for his *Essay on Population* (1798), in which he predicted that the rate of population growth would eventually outstrip increases in the food supply, leading to mass starvation. Unlike Smith, who was concerned with production, Malthus chose to emphasize distribution.

The notion of people not having the will to consume was certainly foreign to the postulates of classical economics. Smith had argued that people desire to be materially better off than they are in their present state. However, there was speculation about the future of workers and their lot which led to Ricardo's "Iron Law of Wages" (a name which Ricardo did not give to his theory) and Malthus' population essay.

In early 19th Century Great Britain, the large middle class which now dominates industrialized nations was nearly non-existent. Disparities between rich and poor were far greater than they are today, and economists were uncertain about how workers would fare as production increased. Some, like Malthus and Ricardo, believed workers would always live at subsistence levels, their increased productivity undercut by their ability to produce larger and larger families. (It should be added that although the original basis for the "Iron Law" came from Malthus, Ricardo was more dogmatic about its deterministic effects than was Malthus.)

Also the old "utility of poverty" arguments from the mercantilist age had not been fully buried. Workers, Malthus argued, might be satisfied on a life of "simplest food, the poorest clothing, and the meanest houses . . . ." (Malthus, p. 9) If this were true, then workers, while becoming more productive through industrialization, would likely consume less than what they produced. That would leave the small upper classes with the burden of consuming that surplus, something which Malthus doubted would occur.

Another basis of Malthus' criticism was his belief that exchange did not always involve goods for goods, since goods could also be exchanged for services. Goods, he noted, were not "mathematical figures" but rather were used for satisfying human wants. If wants were satiated but extra income still existed, then a glut would occur.

Smith had written about "effective demand," which he said was predicated upon the ability of someone to purchase an item. Using the example of the poor man and the coach, he noted that one could "demand" something, but if one lacked the resources to purchase that item, then "effective" demand did not exist.

In Malthus' view, effective demand (he termed it "effectual demand") also involved the *will* to purchase something. While Smith applied a means test to demand, Malthus added desire. In other words, one could have the ability to purchase an item, but if one did not desire it, then demand was nonexistent. While Malthus' analysis is hardly controversial from an economic viewpoint, the clergyman saw something economically sinister if the rich failed to consume enough goods to prevent a glut.

David Ricardo successfully refuted Malthus, at least to the satisfaction of most economists of the 19th Century. Like Say, he based his refutation (1817) on the idea that people produce, not for the sake of production, but the sake of consumption:

> No man produces but with a view to consume or sell, and he never sells but with an intention to purchase some other commodity, which may be immediately useful to him, or which may contribute to future production. *By producing, then, he necessarily becomes either the consumer of his own goods, or the purchaser and consumer of the goods of some other person.* (Italics mine)

Ricardo, like Say and other classical economists, did not believe that gluts *could not occur*, but rather, held that gluts were only temporary and proportional in nature instead of being general, as Malthus claimed. He noted, "Men err in their productions, there is no deficiency of demand." Ricardo also wrote:

> Too much of a particular commodity may be produced, of which there may be such a glut in the market as not to repay the capital expended on it; but this cannot be the case with respect to all commodities.

The Ricardo-Malthus controversy is one of the more interesting chapters in the history of the Classical School. Ricardo won the day through a powerful logical argument, while his opponent, while raising important questions, was not able to frame his points as clearly. Malthus' argument also suffered from the clergyman's inability to differentiate between demand and quantity demanded, and this problem no doubt hampered his intellectual effectiveness.

However, while Malthus did not sway the most influential economic thinkers of his day, he would greatly influence John Maynard Keynes, who arguably has one of the most, if not the most, important economist of the 20th Century. Thus, Malthus' legacy of challenging Say's Law did not disappear.

THE KEYNESIAN CHALLENGE

John Maynard Keynes (1883-1946), as a critic of Say, did not fall into the same trap as his predecessors. First, as Sowell (1972) points out, he was a well-established economist long before the publication of the *General Theory* in 1937. Second, and probably more important, the book's publication came in the midst of the Great Depression, when unemployment levels in the United States hovered near 20 percent for the better part of the decade. Economic conditions had ripened the soil for dissent from economic orthodoxy, and Keynes was not the first person to reclaim theories of underconsumption.

Despite the near-unanimous claims by American historians that the Herbert Hoover Administration reacted to the Great Depression with *laissez-faire* economics, Rothbard (1963) writes that government policies from 1930 to 1933 were hardly noninterventionist. Fighting "underconsumption" became a watchword for some policymakers. For example, the economist for *Business Week*, Virgil Jordan, in 1932 told the Pennsylvania Chamber of Commerce, "Just as we saved our way into depression, we must squander our way out of it."

General overproduction was a popular explanation for the depression at that time. Frederick Lewis Allen, in his popular 1931 *Only Yesterday*, listed "overproduction of capital and goods" as the main cause. As one editorial cartoon put it, there was "too much oil, too much wheat, too much poverty." Mercantilism may have been dealt a death blow by Adam Smith, but its ideas were abundant in 1930's America.

When Franklin D. Roosevelt took power in 1933, his administration continued many of Hoover's policies and intervened in many other ways. Most important were laws which attempted to reorganize the entire U.S. economy into a series of cartels. Conklin (1975) writes that under the National Recovery Act and the Agricultural Adjustment Act of 1933, the Roosevelt Administration followed a national policy of limiting output in order to keep prices and wages high, as well as attempting to offset those restrictive policies with inflation.

Not surprisingly, unemployment remained high, and by 1937 stood near 19 percent. Thus, when Keynes declared that unemployment could continue at those rates indefinitely, the academic and political world were willing to listen. Although *The General Theory* did not begin as a resounding success, its popularity soon grew, especially after World War II when the idea of government intervention into the economy became well-accepted not only in academe, but to the general public as well.

Early in the *General Theory*, Keynes attacks Say's Law. In Chapter Three, he writes:

> Thus Say's Law, that the aggregate demand price of output as a whole is equal to its aggregate supply price for all volumes of output, is equivalent to the proposition that there is no obstacle to full employment. If, however, this is not the true law relating the aggregate demand and supply functions, there is a vitally important chapter of economic theory which remains to be written and without which all discussion concerning the volume of aggregate employment are futile.

Thus, Keynes lays out his thesis: Say's Law, as defined by the classical economists, is a declaration that full employment is the rule. The syllogism goes as such: (1) Say's Law declares that there is "no obstacle" to full employment; (2) Full employment does not exist in our present economy; therefore, (3) Say's Law does not hold.

In his refutation of Say's Law, Keynes quotes from J.S. Mill the passage which was stated earlier. However, Keynes stops at the point where Mill says if a society doubles production, it can double consumption. Had Mill's analysis ended there, Keynes' case — or anyone else's, for that matter — to refute Say's Law would have been easy. One can argue that had Mill's truncated statement been the actual thesis of Say's Law, it would never have survived classical analysis.

Benjamin Anderson (1949) further explains:

> If we doubled the productive power of the country, we should not double the supply of commodities in every market . . . . If we doubled the supply in the salt market, for example, we should have

an appalling glut of salt.

Keynes believed that the breakdown of Say's Law came about because of a lack of aggregate demand which comes about by the disequilibrium of planned savings and planned investment. Savings was a function of current income, while investment was a function of a number of things, not the least of them being the "animal spirits" of the investors. (In the classical scheme, interest rates play a much more important role in determining investment than they do in the Keynesian system — thus, "animal spirits" would not have been in the classical investment function.) Keynes states his doctrine on page 27:

> The outline of our theory can be expressed as follows. When employment increases, aggregate real income is increased. The psychology of the community is such that when aggregate real income is increased aggregate consumption is increased, but not by so much as income. Hence employers would make a loss if the whole of the increased employment were to be devoted to satisfying the increased demand for immediate consumption. Thus, to justify any given amount of employment there must be an amount of current investment sufficient to absorb the excess of total output over what the community chooses to consumer when employment is at the given level. . . . Thus, given the propensity to consume and the rate of new investment, there will be only one level of employment consistent with equilibrium . . . . But there is no reason in general for expecting it to be *equal* to full employment.

In other words, full employment of resources is not a given in the economy, something with which Say would have tentatively agreed, providing certain assumptions existed. As noted earlier, Say pointed out that long periods of disequilibrium could exist, provided they were perpetuated by "violent means, or some extraordinary cause." In fact, one could argue that Say would even agree that disequilibrium (or unemployment) could exist in the "Keynesian case" of wages and prices held above market-clearing levels.

However, such a state, Say held, was not a natural state. Keynes, on the other hand, holds that full-employment equilibrium itself is unnatural, or, at best, a random condition. Full employment "can only exist when, by accident or design, current investment provides an amount of demand just equal to the excess of the aggregate supply price of the output resulting from full employment over what the community will choose to spend on consumption when it is fully employed."

In the Keynesian system, savings and investment are not two sides of the same coin, but rather two separate and unequal activities:

> Those who think in this way (savings and investment are equal) are deceived, nevertheless, by an optical illusion, which makes two essentially different activities appear to be the same. They are fallaciously supposing that there is a nexus which unites decisions to abstain from present consumption with decisions to provide for future consumption; whereas the motive which determine the latter are not linked in any simple way with the motives which determine the former.

As noted earlier, Malthus and other early critics of Say's Law feared hoarding, especially by the wealthy, whose spending was needed to keep aggregate demand at market-clearing levels. Keynes, according to Sowell (1972) did not fear hoarding as such, but rather was concerned with liquidity preference, "which Keynes called 'the propensity to hoard'." The scenario in which this would occur would be at a time when both consumers and investors were worried about future economic prospects. Consumers in this situation would hold larger amounts of money than normal, while investors, not anticipating an optimal return for their investments, would not finance enterprises.

Thus, the economy would be caught in a two-way vise: consumers having large liquidity preferences and investors wary of the future would "conspire" in an unholy alliance — albeit unintentional — to put savings and investing out of balance and cause (or at least accelerate) the economic downturn. The cause of this downturn, then, would be endogenous to the system.

In the Keynesian system, Say's Law would not hold because of the self-interested actions of savers and investors, the hoary "paradox of thrift." Say's essay implies that such a breakdown is not possible; if there is a breakdown, it comes from without, not from within. Keynes' system does not necessarily agree with Malthus in its particulars, but it does agree with the result: underconsumption threatens the economy.

As pointed out earlier, Malthus created the scenario in which people, who were being frugal in an Adam Smithian way, would be satisfied with only the "simplest" of things. "What, I ask, would become of the demand for commodities . . . ?" he wrote in his correspondence to Ricardo. "What an accumulation of commodities!"

Keynes writes that Ricardo "was stone deaf to what Malthus was saying." In fact, as he does throughout *The General Theory*, he criticizes classical economists for not accepting endogenous underconsumption theories:

> Theories of under-consumption hibernated until the appearance in 1889 of *The Physiology of Industry*, by J.A. Hobson and A.F. Mummery, the first and most significant of many volumes in which for fifty years Mr. Hobson has flung himself with unflagging, but almost unavailing, ardour and courage against the ranks of orthodoxy.

Sowell (1972) writes that in the Keynesian system, equilibrium is not a relationship between commodities, as claims Say, but rather is a balance between aggregate demand and aggregate supply. With Say, the balance is an identity; with Keynes, it is a product of randomness. Say writes that an imbalance will occur from an exogenous shock; in the Keynesian system, it is only an exogenous shock which will push the equation back into equilibrium.

CONCLUSION

As noted earlier in this paper, Say's Law is a statement about what ultimately permits people to demand (or purchase) in the marketplace. Real purchasing power is about real production, or, as economists are fond of saying, Say's Law is an identity: consumption equals production.

Say's Law, however, does have its limitations. It does not mean that all production will ultimately be demanded in the market. If prices and wages are not flexible, then money ceases to perform its duties of greasing the wheels of barter in Say's system, and coordination within the marketplace becomes much more difficult, leading to imbalances and, ultimately, unemployment. Nor did Say deal with money *except* for its role as a medium of exchange, leaving his analysis vulnerable to critics who understood that money plays are larger role in the economy.

Say's Law is not the cornerstone of classical economics. It is in its most simple form an identity which points out how more production leads to more consumption, and not the other way around. It is part of the classical system; it is not the system itself.

When examining what critics have written about Say's Law, one comes back to the question asked at the beginning of the paper: Is Say's Law as is criticized (or praised) in the literature what Say wrote? For some critics, one can say yes, while for others, no.

It is easy, for example, to dismiss Michael Harrington's "discrediting" of Say's Law, which seems to be standard socialist criticism. One can be sure that he never read Chapter XV, or if he did, he remembered nothing from it. If ultimate purchasing power does not come from production, then from where does it come? Harrington's reply, it seems, might be that it comes from the printing presses in the U.S. Bureau of Printing and Engraving.

Malthus' criticism is more thoughtful, but also requires that one hold to a different set of postulates than is currently held by economists. (Ricardo, himself, pointed out that he and Malthus had a different definition of demand.) This is not to say that this situation automatically makes Malthus wrong and classical economists correct, but if one cannot assume that people always want more than they already possess, one does not have a coherent economic theory. The idea that people wish to make themselves better off materially or otherwise has been a powerful — and predictive — tool in the economist's arsenal.

The Keynesian criticism has been the most far-reaching, and easily the most influential. That Say's Law is rarely taught in anything but History of Thought is testament to the power of the Keynesian idea, but that idea needs to be thoroughly analyzed.

First, after one sweeps away some of the more obtuse Keynesian language, it seems that Keynes did not have as much an argument with classical economists as it might appear. After all, his prescription for full employment — increase employment by giving workers a wage cut through inflation — may differ with classicists on means and method, but the same analysis still exists: unemployment is, at least to some degree, a function of wage levels above an equilibrium point.

Second, as one recalls, Keynes differed with Say's Law on its assumptions — or what Keynes said were its assumptions — namely that wages and prices are flexible downward. If they are *not* adjustable (or, as Keynes put it, are "sticky"), that unemployment occurs does not invalidate Say's Law. Say, himself, made it clear in his own works that long-term unemployment (or market disequilibrium) was possible if authorities enforced wrongheaded policies.

It should be remembered that Keynes advocated that wages and prices not be permitted to fall, since he claimed such actions would continue in a downward spiral, leading to more unemployment. If that were true, then the economy would have been in a permanent freefall the first time a recession occurred, since wages and prices had fallen in previous business downturns, but stopped at rough equilibrium levels and rose later.

In fact, as was argued earlier, it was the policies of both the Hoover and Roosevelt administrations to prop up prices and wages that helped lead to the mass unemployment that plagued the 1930s. Roosevelt followed the prescription of unbalanced budgets, inflation, minimum wages, and encouragement of unionization, yet unemployment remained in double digits until the outbreak of World War II.

One might even argue that Keynes never invalidated Say's Law. Kaldor (1983) writes that Keynes' theory "is best analysed as a development or refinement of Say's Law, rather than a complete rejection of the ideas behind the law." It is clear that he implicitly agreed with its outcomes in arguing that wages and prices be cut through inflation while, at the same time, publicly disagreeing with its assumptions. Even at that point, he simply took note that prices and wages are not flexible downward, that the process of adjustment was not automatic. Say never argued that the process was routine. He most certainly would have disagreed with Keynes on the importance of flexibility.

Von Mises (1950) takes that criticism a step farther: ". . . Keynes did not refute Say's Law. He rejected it emotionally, but he did not advance a single tenable argument to invalidate its rationale."

Finally, one must remember that Keynes and others who have criticized Say's Law in this century do so, according to Sowell (1972), by criticizing a straw man. To answer our original question of whether or not the critics of Say's Law were criticizing what Say actually wrote or what they believed Say's Law to be, we answer that the criticism is also directed at the straw man. The argument that classical economists — and especially Say — did not believe recessions could occur or linger for a long time is not true. In his important work, *The Failure of the New Economics*, Henry Hazlitt poses a question to an imaginary group of classical economists as he attempts to lay the "no recession" fallacy to rest:

> If you had presented the classical economists with "the Keynesian case" — if you had asked them, in other words, what they thought would happen in the event of a fall in the price of commodities, if money wage-rates, as a result of union monopoly protected and insured by law, remained rigid or rising — they would have undoubtedly replied that sufficient markets could not be found for goods produced at such economically unjustified costs of production and that great and prolonged unemployment would result.

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