

LETTER TO THE EDITORS: SAY'S LAW: ITS ORIGINS AND MEANING

BY
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I. INTRODUCTION

What has prompted me to write this note are the criticisms of a previous paper of mine (Kates 2018) by Alain Béraud and Guy Numa (2018; B&N hereinafter), which they subtitled “A Note on Kates, Grieve, and Ahiakpor.”

“Kates,” they wrote, “is wrong” (B&N 2018, p. 285). And what was he wrong about? He had written, “Say’s Law states that recessions are never caused ... by demand deficiency” (ibid.; their ellipses). And what is particularly curious is that they have attributed to me the exact same understanding of Say’s Law that shows up in *The General Theory*.

There was a time, perhaps half a century ago, that none of this would have had to be said. But let me state for completeness: according to John Maynard Keynes, because of their acceptance of some entity referred to by him as “Say’s Law,” classical economists had believed aggregate demand was always equal to aggregate supply so that recessions accompanied by mass unemployment were in theory never possible. The great divide between Keynesian macro and what came before is thus whether demand deficiency is a potential cause of recessions and mass unemployment. Virtually all economists today say it is. Virtually all economists prior to the publication of *The General Theory* said it was not. The issue, according to Keynes, was whether or not one accepted some entity he described as “Say’s Law.” On this, I hope we can all agree.

II. THE ORIGINS OF THE TERM “SAY’S LAW”

Let me therefore begin with this almost universally unknown fact: the term “Say’s Law” was invented in the twentieth century by an American economist, Fred Manville Taylor, and came into general discourse among economists on the American side of the Atlantic only following the publication of his introductory text, *Principles of Economics*, in 1921.

Chapter XV in Taylor’s book (Taylor 1925, pp. 196–205) is titled “Say’s Law.” In it he argues that in a well-functioning economy, demand deficiency never occurs. However, as obvious as he believed this point then was, he goes on to write: “I shall therefore put the proposition we have discussed in the form of a principle. This principle, *I have taken the liberty to designate Say’s Law*” (ibid., p. 201; emphasis added).

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What is crucial is to understand that “Say’s Law” was a term never used in classical times. The meaning of Say’s Law, therefore, does not originate in the early days of classical theory but from the works of F. M. Taylor. No earlier reference to “Say’s Law” exists. And whether or not Taylor had a classical understanding of the principles, he understood the core issues well enough to begin his chapter with these observations:

Among the fallacious notions in popular thinking that have gained very wide currency are to be found a number which grow out of misconceptions as to the real source of the *general or total demand for goods*, and as to the methods by which that demand is increased or diminished. Thus, governmental improvements of all kinds, including even those of questionable value, are often supported by business men and others on the ground that such improvements increase the total demand for goods.... Persons of thrifty habits who save a large share of their incomes are frequently the objects of criticism on the ground that saving diminishes the total demand for goods. (Taylor 1925, p. 196)

It is therefore important to appreciate that when Keynes uses the term “Say’s Law,” he had to have taken the term either from Taylor or one of Taylor’s contemporaries. The fact that Keynes had used precisely that term means either he had read the works of other economists along the way, or by the most astonishing coincidence had invented precisely the term that Taylor had invented himself to describe exactly the same phenomenon: the impossibility of demand deficiency as a cause of recession.

It might further be noted that the phrase “supply creates its own demand” is also twentieth-century American, invented by Harlan Linneus McCracken and first published in his *Value Theory and Business Cycles* (1933, p. 159), a book Keynes had with certainty read, as shown by the letter Keynes wrote to McCracken on August 31, 1933, whose first words are, “Having now read your book ...” (for a detailed discussion of this letter and its wider implications, see Kates 2008). Thus, even the phrase we now associate with Say’s Law comes from a twentieth-century non-classical source and ended up in *The General Theory* without much appreciation for how it came to be where it is.

Thus, for anyone to identify some entity in the classical literature and describe that entity as “Say’s Law” requires them to work backwards from Taylor and Keynes to specify just which elements in the writings of which nineteenth-century economists are the ones that are the actual elements in what we today describe as “Say’s” Law. But what is illegitimate is to begin from the writings of Jean-Baptiste Say and work forward based on the assumption that “Say’s Law” was invented by Say.

III. THE GENERAL GLUT DEBATE

To return to the issue of the operation of an economy, there is the modern Keynesian interpretation of Say’s Law—that because demand deficiency can never occur, classical economists had no explanation for recessions and mass unemployment—and the actual classical meaning of what was at the time an unnamed principle—that recessions and mass unemployment are never due to demand deficiency but are nevertheless all too frequent and are the result of any number of other factors. There are, then, the policy implications, which, according to Keynes and modern macroeconomic theory, are that a recession can be brought to an end and unemployment brought down through increases in aggregate demand. This is in deep contrast to the classical position, which

unequivocally stated that a recession could not be ended and unemployment reduced through increases in demand for goods and services.

And while these views are found within the classical literature from at least the time of James Mill in 1808, it was not until 1820 that they were explicitly embedded within classical theory, due to the controversy touched off by Robert Malthus following the publication in that year of the first edition of his *Principles of Political Economy*. Malthus wrote that the post-Napoleonic War recessions were due to a deficiency of demand (a general glut) and could be relieved if not actually cured by increases in demand. The publication led to what is now referred to as the “general glut debate,” with the final resolution summed up by John Stuart Mill in his own *Principles* published in 1848 (see Kates 2015b).

If you are interested in how consensus was reached among classical economists denying both that a recession can ever be caused by demand deficiency and that an increase in aggregate demand can ever lead to recovery, it is to the literature following the publication of Malthus's *Principles* you must go. That does, of course, include Say's 1821 *Letters to Mr Malthus*. But unless you focus on this post-1820 literature, you are completely at sea in even beginning to understand what the relevant questions and answers were, and where Keynes built his own understanding of the issues at stake. Neither Say's *Treatise* nor his *Cours Complet* provides insight into any of this. And there should be no doubt that Keynes was following Malthus, as he explicitly makes clear in his essay on Malthus (Keynes [1933] 1972, pp. 96–103), where he discussed at length the David Ricardo–Malthus correspondence, with an additional discussion along identical lines based on this same correspondence in *The General Theory* (Keynes [1936] 1972, pp. 362–364). His letter to McCracken in 1933 also makes this abundantly clear. The parent stem for Keynes's views on Say's Law is Malthus and not Say.

IV. SAY'S LOI DES DÉBOUCHÉS

The actual mechanism of exchange often mistaken for Say's Law is the statement that demand is constituted by supply, or, as normally stated today, following Keynes, “supply creates its own demand.” This was the meaning of J.-B. Say's *loi des débouchés*—the law of “outlets” (B&N 2018, p. 285; usually rendered in English as the law of “markets”). Purchases are made with the money one has received from producing and selling. The concept goes at least as far back as to Adam Smith. In the Introduction to Book II of *The Wealth of Nations*, he wrote: “[a] purchase cannot be made till such time as the produce of his own labour has not only been completed, *but sold*” (Smith [1776] 1976, p. 291; emphasis added).

It is not enough to produce something. Whatever one has produced must then be converted into money before one can then buy something else. In an exchange economy, the ability to demand is based on one's ability to produce *and sell*. For an entire economy, demand in aggregate is based on supply in aggregate. The more a community produces and sells, the more that community can buy. But while that is Say's *loi des débouchés*, it is not what Keynes (or F. M. Taylor) had meant by what they referred to as “Say's Law.”

Thus, although the principle denying the possibility of demand deficiency as a cause of recession is now called “Say's” Law, the name entered into the discourse

among economists only in the 1920s. This is different from Say's *loi des débouchés*, that goods buy goods, which has been discussed since the eighteenth century and possibly even earlier. The relevant sequence of events to understand how this term took on its present meaning is spelled out in far more detail in Kates (1998, pp. 24–35), but here is a summary.

1803 – Say publishes the first edition of his *Treatise* in which he argues goods buy goods. He was trying to demonstrate that slow demand is not caused by a shortage of money.

1807 – William Spence, in the midst of the Napoleonic Wars, publishes a book to argue that loss of trade with the continent will not harm the English economy because demand rather than saving is the core necessity in generating wealth.

1808 – James Mill replies to Spence in his *Commerce Defended*. In his reply, Mill discusses the importance of saving rather than unproductive consumption in the creation of wealth. As one component of his argument, he denies absolutely any need for concern about demand deficiency. Demand is created by supply and only by supply. In making his argument, he cites Say's point about goods buying goods.

1814 – Say publishes the second edition of his *Treatise* in which he rewrites his entire chapter on his *loi des débouchés* to pick up Mill's point that demand deficiency does not cause recession. But in so doing he alters the underlying conception by arguing if Good A does not sell, then more of Good B needs to be produced to create an increased demand for Good A.

1820 – Malthus publishes his *Principles* in which he argues recessions and large-scale unemployment are caused by general gluts (demand deficiency caused by oversaving).

1820s – General glut debate, during which virtually the entire economic mainstream comes to the conclusion that general gluts are never a possibility—with the central policy conclusion being that if Good A does not sell, then readjustment of the economy is needed so that fewer units of Good A are produced and more of something else produced instead. Say, however, continues to the end with his version that more of other goods (Good B) is the solution to the lack of demand for Good A.

1848 – John Stuart Mill's *Principles* is published in which the full explanation of Say's Law properly understood is found (see Kates 2015b). It becomes the universal position of mainstream economics through until 1936. The conclusion held with near unanimity was that demand deficiency (usually referred to as “overproduction”) never causes recessions and increasing demand will not lower unemployment, as stated in Mill's fourth proposition on capital, “demand for commodities is not demand for labour.”

1921 – Fred Taylor publishes his *Principles* in which he restates the impossibility of demand deficiency in a well-adjusted economy. He further notes that although an important principle, the argument contra demand deficiency has never been given a name. He therefore gives this principle a name: “Say's Law.”

1920s through until 1936 – “Say's Law” becomes a focus of discussion, mostly on the American side of the Atlantic.

1936 – Keynes publishes his *General Theory* in which he attacks “Say's Law” as it was understood by J. S. Mill. He defines Say's Law as “supply creates its own demand,” but there is no doubt that in attacking “Say's Law,” Keynes was trying to prove recessions are caused by demand deficiency. His policy conclusion was that an increase in aggregate demand can lead to higher rates of growth and higher levels of employment.

V. CONCLUSION

The generalized ignorance about Say's Law and its provenance is one of the bleaker aspects of the history of economics. These are the principles Keynes attempted to refute.

1. Recessions do occur and when they do, the effect on the labor market is often prolonged and devastating.
2. Recessions are not, however, caused by oversaving and demand deficiency.
3. Recessions cannot be brought to an end through increases in aggregate demand.

These propositions and their supporting arguments were with near unanimity accepted by the entire mainstream of the economics profession until the publication of *The General Theory* in 1936. It is this set of conclusions that Keynes was very successfully able to remove from the body of economic theory. These three propositions are what is meant by "Say's Law."

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APPENDIX: LETTER FROM KEYNES TO MCCRACKEN

46, Gordon Square,
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31st August 1933

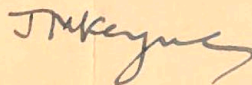
Dr. H. L. McCracken,
Department of Economics,
University of Minnesota.

Dear Dr. McCracken,

Having now read your book, I must again thank you for having sent it to me. For I have found it of much interest, particularly perhaps the passages relating to Karl Marx, with which I have never been so familiar as I ought to have been.

In the matter of Malthus, you will perhaps have seen from my account of him in my lately published "Essays in Biography", which appeared before your book was out, but after I think you had written it, that I wholly agree with you in regarding him as a much under-estimated pioneer in the line of thought which to-day seems to me by far the most likely to lead to progress in the analysis of the business cycle. Your contrast between Ricardo and Malthus contains, I am convinced, the essence of the matter.

Yours very truly,



Source: Box 1, Folder 33 of the Harlan Linneus McCracken Papers. Harlan Linneus McCracken Papers, Mss. 2569, Louisiana and Lower Mississippi Valley Collections, LSU Libraries, Baton Rouge, LA.