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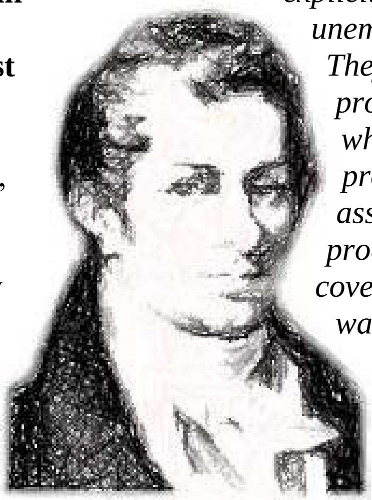
Say's Law Revived - A Book Review by Bob Layson

Say's Law and the Keynesian Revolution: How Macroeconomic Theory Lost its Way: Steven Kates: Cheltenham; Edward Elgar, 252pp., ISBN; 1 85898 748 2, £55.00 (hb), 1998



As every economically literate schoolboy knows, Say propounded Say's Law which states, when translated, that 'supply creates its own demand' from which it follows that everything produced can be sold and sold at a price that will cover the costs of producing it - and that every labourer is worthy of his hire, and wanting it, will find himself hired. Said schoolboy also knows that Say's Law was falsified by the Great Depression in practice, and by the Great Economist, Lord Keynes, in theory.

Yet if Steven Kates is right about Maynard Keynes then Keynes was very wrong about Say's Law – as understood and employed by most mainstream economists up to the writing of *The General Theory* itself. And not simply was Keynes wrong about the classics but in making legitimate the concept of aggregate demand failure, the consequence of Mr Keynes has been ruinous for theory and policy alike:

> *It will be shown that every one of the statements made by Keynes on Say's Law is untrue. Classical economists did not always assume full employment or the absence of obstacles to full employment. They did not assume, either implicitly or explicitly, that involuntary unemployment was impossible. They did not argue that everything produced would be sold at prices which cover all costs of production. There was no assumption that the total costs of production would inevitably be covered by total revenue. There was no assumption that variations in the demand for money never affect the demand for goods. There was no assumption that all savings would be invested.* (p.19)

Following these bold claims the author then goes on to conclude that:

> *…in what may be the greatest irony of all, it will be shown that the theory of the cycle held by classical economists was based on an understanding of Say's Law. That is, far from being an impediment to understanding the causes of recession and unemployment, Say's Law was a fundamental part of the theory which explained their occurrence.* (p.19)

Does the author show all this? Yes, I rather think he does. But how can so many intelligent modern practitioners of economics be so fully agreed and so completely wrong about what Monsieur Say was actually saying? The explanation, explains Dr Kates, is to be found in the unintended obfuscation effected by the only begetter of the Keynesian revolution himself, after his confrontation, in 1932, with the arguments Malthus deployed in his correspondence with Ricardo. For although Kates allows that the influence is disputed he sees no reason not to conclude that the most straightforward explanation is the correct one and that

> *had Keynes not read Malthus, it is virtually certain he would never have written a book attacking Say's Law, or attributing recessions and depressions to failure of effective demand.* (P.131)

Of course, precedence is irrelevant, save to the historian, as regards the cogency of any criticism of Say's Law – is it what Keynes takes it to be? Does the law hold good? After reading the eleven chapters in which the fundamental issues are most clearly and cogently spelt out I think most readers would conclude that Keynes almost wilfully failed to grasp Say's Law, as understood by the classical economists, or – at least – decided to make it appear as Panglossian and as at variance with the facts of the 1920's as he could make it. Furthermore, and *contra* Keynes, Say's Law actually explains how malinvestment, in certain sections of the economy, can lead, in the absence of price flexibility, to a collapse of opportunities for profitable production throughout the economy.

That Say's Law actually explains how recessions can occur rather than proving or presupposing their impossibility is something that W H Hutt insisted on in his *A Rehabilitation of Say's Law* (1974). It should be said that for anyone who has read, as I have, the two books of Sowell and Hutt that deal directly with the history and meaning of Say's Law, Kate's judgement should strike them as fair and accurate. He finds, to put it briefly, that Sowell accurately charts the progress of a confusion as a succession of economists talk past each other by taking Say's Law to mean variously the other, occasionally that and sometimes this. Whereas, Hutt clearly grasped the essence of Say's Law but due to a mixture of a demandingly singular writing style and compositional misjudgement in failing to embed Say's Law in the general conceptual apparatus of all economic thinking from the time of Say to the publication of *The General Theory* 'His … defence of Say's Law, has ultimately sunk without trace'. (P.211)

It can also be said that Hutt's book is scandalously thin. Size should not matter, of course, but it would have been more effective – if the Keynesian account of Say's Law was to be exploded – to have written either a magisterially brief paper or a big fat book. Hutt had indeed written such a book *Keynesianism: Retrospect and Prospect* (1963) but in its revised form *The Keynesian Episode: a Reassessment* (1979), as Kates points out, the chapter on Say's Law is omitted and Hutt's counterblast misfires thereby.

But Steven Kates has produced a book of Goldilocks proportions and in it he covers not only the history of Say's Law but also the history of what has been said to be Say's Law. For the reader is taken from Classical foundation to Keynesian revolution, from such platitudes as 'For every purchase a sale', to the acute dissection work of Becker and Baumol and the separating out of 'Walras' Law', 'Say's Identity' and 'Say's Equality'. In fact from a time when an economist would recommend retrenchment and tax reduction during a recession to one where a student of the 'New Economics' (in fact, of Joan Robinson) could unblinkingly affirm that an increase in state unemployment benefit, backed by deficit financing, would so expand demand that unemployment must fall – I know, I met one.

Particularly impressive is the way in which the author defends the classical upholders of Say's Law from the charge that their analysis pertains essentially to a system of barter and that they not so much 'lift the monetary veil' as throw it away. They knew full well that owners of goods and services must first demand money before they can demand other goods and services and that, especially during a collapse of business confidence, with attendant rush to liquidity, actual demand for available goods and services will not automatically match demand previously anticipated by producers. Indeed, the inevitable mismatch between at least some hopeful investments and the actual demand for what prove to be hopeless malinvestments formed the classical economists' riposte to the idea of a general glut. They denied the possibility of excess supply in general but quite understood that whilst factors combined in loss making concerns were being abandoned, stripped out, shifted or were, in the case of labour, 'actively seeking employment' production would dip and demand with it. But not, given price and labour mobility, evermore severely and extensively.

Given then that the classical analytical apparatus could both predict and explain periods of poor business and rising unemployment what then of the well-known fact that the classical economists 'assumed full employment'? The answer is that they saw no obstacle to full employment but fully foresaw that obstacles might well be provided: in the form of a credit feast – then to save exchange rates from a 'pro-business' monetary expansion – a credit famine; 'fixed' exchange rates repeatedly refixed; trade tariffs and quotas; beggar-thy-neighbour export subsidies; taxes on employment; taxes on profits; taxes on interest; taxes on capital gains; minimum wage laws; wage councils; national union enforced rates-for-the-job; far from minimum labour regulation; building controls and subsidised council houses; and lastly, the foremost necessary condition for chronic mass unemployment, open ended provision of unemployment benefit. Indeed, so far from it being the case, as Keynes maintained, that full employment is merely a possible equilibrium position for free economies to tend towards – and not the most likely at that – prolonged mass unemployment is not and cannot be a *laissez-faire* market phenomenon. Mass unemployment is something that statesmen really have to work at to produce. And this reviewer, possibly thanks to his ignorance, knows of no successful economic explanation of long-term involuntary mass unemployment in terms of the unintended cumulative effect of the actions of private agents attempting to employ themselves and their property in their perceived interests. In short, for this particular evil to triumph it is only necessary for good statesmen to do something (a statesman being someone who enters politics in order to do well by doing good – or whatever).

It is implied by those who grant that Say's Law holds true for a purely barter economy that it is falsified as soon as money enters the picture. For once demand for money to hold diverts and diminishes demand for non-money output to consume, full employment ceases to be automatic. Yet who can seriously maintain that the price system makes gainful employment less gainful and less available than a barter system. Under barter many of those who believe themselves to be working for gain find on market day that they have been engaged in nothing but a costly and unpleasurable hobby. Under barter the value of output cannot match that of one in which economic calculation with money prices makes an extended and integrated order of roundabout methods of production both practicable and actual.

Keynes was a great man and a foremost economist and Keynesianism has proved a mighty phenomenon indeed. Yet Keynes is now dying the death of a thousand 'buts'. Economists queue up to praise this or that aspect of his work as true, useful and original – without any great agreement as to which ones – 'but', runs the implication, as for the remainder

— . Keynes now even has a three-decker biography to keep him under. In *Say's Law and the Keynesian Revolution* Steven Kates makes it clear that Keynes and his influence has not proved to be an unmixed theoretical blessing – if a blessing at all. Yet Keynes cannot be prevented and he cannot be got rid of, but it seems he will increasingly be gotten around and the insights of the classical economists, including the law of markets, may be recovered. Books such as this can effectively speed the day.