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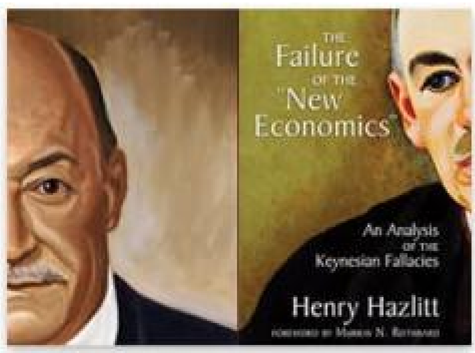
# Keynes vs. Say

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Keynes's "greatest achievement," according to his admirers, was his famous "refutation" of Say's law of markets. All that it is necessary to say about this "refutation" has already been said by Benjamin M. Anderson, Jr.,[1] and Ludwig von Mises.[2] Keynes himself takes the matter so cavalierly that all he requires to "refute" Say's Law to his own satisfaction is less than four pages.

Yet some of his admirers regard this as alone securing his title to fame:

> Historians fifty years from now may record that Keynes' greatest achievement was the liberation of Anglo-American economics from a tyrannical dogma, and they may even conclude that this was essentially a work of negation unmatched by comparable positive achievements. Even, however, if Keynes were to receive credit for nothing else … his title to fame would be secure … [Yet] the Keynesian attacks, though they appear to be directed against a variety of specific theories, all fall to the ground if the validity of Say's Law is assumed.[3]

It is important to realize, to begin with, as Mises[4] has pointed out, that what is called Say's law was not originally designed as an integral part of classical economics but as a preliminary — as a refutation of a fallacy that long preceded the development of economics as a recognized special branch of knowledge. 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,*[5] exploded the first of these myths. Say devoted himself to a refutation of the second.

For a modern statement of Say's law, I turn to B. M. Anderson:

> The central theoretical issue involved in the problem of postwar economic adjustment, and in the problem of full employment in the postwar period, is the issue between the equilibrium doctrine and the purchasing power doctrine.

> Those who advocate vast governmental expenditures and deficit financing after the war as the only means of getting full employment, separate production and purchasing power sharply. Purchasing power must be kept above production if production is to expand, in their view. If purchasing power falls off, production will fall off.
>
> The prevailing view among economists, on the other hand, has long been that purchasing power grows out of production. The great producing countries are the great consuming countries. The twentieth-century world consumes vastly more than the eighteenth-century world because it produces vastly more. Supply of wheat gives rise to demand for automobiles, silks, shoes, cotton goods, and other things that the wheat producer wants. Supply of shoes gives rise to demand for wheat, for silks, for automobiles, and for other things that the shoe producer wants. Supply and demand in the aggregate are thus not merely equal, but they are identical, since every commodity may be looked upon either as supply of its own kind or as demand for other things. But this doctrine is subject to the great qualification that the proportions must be right; that there must be equilibrium.[6]

Keynes's "refutation" of Say's law consists in simply ignoring this qualification.

He takes as his first target a passage from John Stuart Mill:

> 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. Everybody would bring a double demand as well as supply; everybody would be able to buy twice as much, because every one would have twice as much to offer in exchange.[7]

By itself, this passage from Mill, as B.M. Anderson [8] has pointed out, does not present the essentials of the modern version of Say's law:

> If we doubled the productive power of the country, we should not double the supply of commodities in every market, and if we did, we should not clear the markets of the double supply in every market. If we doubled the supply in the salt market, for example, we should have an appalling glut of salt. The great increases would come in the items where demand is elastic. We should change very radically the proportions in which we produced commodities.

But as Anderson goes on to point out, it is unfair to Mill to take this brief passage out of its context and present it as if it were the heart of Say's law. If Keynes had quoted only the three sentences immediately following, he would have introduced us to the conception of balance and proportion and equilibrium which is the heart of the doctrine — a conception which Keynes nowhere considers in his *General Theory.*

Mill's next few lines, immediately following the passage torn from its context, quoted above, are as follows:

> 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, and it may prefer to do more than double its consumption of others, or to exercise its increased purchasing power on some new thing. If so, the supply will adapt itself accordingly, and the values of things will continue to conform to their cost of production.

The doctrine that supply creates its own demand, in other words, is based on the assumption that a proper equilibrium exists among the different kinds of production, and among prices of different products and services. And it of course assumes proper relationships between prices and costs, between prices and wage-rates. It assumes the existence of competition and free and fluid markets by which these proportions, price relations, and other equilibria will be brought about.

No important economist, to my knowledge, ever made the absurd assumption (of which Keynes by implication accuses the whole classical school) that thanks to Say's law depressions and unemployment were impossible, and that everything produced would automatically find a ready market at a profitable price. Say's law, to repeat, was, contrary to the assertions of the Keynesians, *not* the cornerstone on which the great edifice of the positive doctrines of the classical economists was based. It was itself merely a refutation of an absurd belief prevailing prior to its formulation.

To resume the quotation from Mill:

> At any rate, it is a sheer absurdity that all things should fall in value, and that all producers should, in consequence, be insufficiently remunerated. If values remain the same, what becomes of prices is immaterial, since the remuneration of producers does not depend on how much money, but on how much of consumable articles, they obtain for their goods. Besides, money is a commodity; and if all commodities are supposed to be doubled in quantity, we must suppose money to be doubled too, and then prices would no more fall than values would.

In sum, Say's law was merely the denial of the possibility of a *general* overproduction of all goods and services.

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. Certainly this is what any modern subjective-value theorist would reply.

### Ricardo's Statement

We might rest the case here. But such a hullabaloo has been raised about Keynes's alleged "refutation" of Say's law that it seems desirable to pursue the subject further. One writer[9] has distinguished "the four essential meanings of Say's law, as developed by Say and, more fully, by [James] Mill and Ricardo." It may be profitable to take her formulation as a basis of discussion. The four meanings as she phrases them are:

> (1) Supply creates its own demand; hence, aggregate overproduction or a "general glut" is impossible.
>
> (2) Since goods exchange against goods, money is but a "veil" and plays no independent role.
>
> (3) In the case of partial overproduction, which necessarily implies a balancing underproduction elsewhere, equilibrium is restored by competition, that is, by the price mechanism and the mobility of capital.
>
> (4) Because aggregate demand and supply are necessarily equal, and because of the equilibrating mechanism, output can be increased indefinitely and the accumulation of capital proceed without limit.

I shall contend that of these four versions, 1, 3, and 4 are correct, properly interpreted and understood; that only version 2 is false as stated, and that even this is capable of being stated in a form that is correct.

Now Ricardo clearly stated the doctrine in versions 1, 3, and 4; and though he implied it also in version 2, his statement even of this can be interpreted in a sense that would be correct:

> M. Say has … most satisfactorily shown that there is no amount of capital which may not be employed in a country, because a demand is only limited by production. 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. It is not to be supposed that he should, *for any length of time,* be ill-informed of the commodities which he can most advantageously produce, to attain the object which he has in view, namely, the possession of other goods; and, therefore, it is not probable that he will *continually* produce a commodity for which there is no demand.
>
> There cannot, then, be accumulated in a country any amount of capital which cannot be employed productively until wages rise so high in consequence of the rise of necessaries, and so little consequently remains for the profits of stock, that the motive for accumulation ceases. While the profits of stock are high, men will have a motive to accumulate. Whilst a man has any wished-for gratification unsupplied, he will have a demand for more commodities; and it will be an *effectual demand* while he has any new value to offer in exchange for them.…
>
> Productions are always bought by productions, or by services; money is only the medium by which the exchange is effected. 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.[10]

The italics above are my own, intended to bring out the fact that Ricardo by no means denied the possibility of gluts, but merely of their indefinite prolongation.[11] In his *Notes on Malthus,* in fact, Ricardo wrote: "Mistakes may be made, and commodities not suited to the demand may be produced — of these there may be a glut; they may not sell at their usual price; but then this is owing to the mistake, and not to the want of demand for productions." [12]

The whole of Ricardo's comment on this phase of Malthus's thought will repay study. "I have been thus particular in examining this question [Say's law]," wrote Ricardo, "as it forms by far the most important topic of discussion in Mr. Malthus' work."[13] — i.e., Malthus's *Principles of Political Economy.*

It was Malthus who, in 1820, more than a century before Keynes, set himself to "refuting" Say's law. Ricardo's answer (most of which was not discovered or available until recent years) is devastating. If it had been earlier available in full, it would have buried Malthus's fallacious "refutation" forever. Even as it was, it prevented its exhumation until Keynes's time.

Ricardo's answer was, it is true, weak or incomplete at certain points. Thus he did not address himself to the problem of what happens in a crisis of confidence, when for a time even the commodities that are relatively underproduced may not sell at existing price levels, because consumers, even though they have the purchasing power and the desire to buy those commodities, do not trust existing prices and expect them to go still lower. But the basic truth of Say's law (and Say's law was only intended as a basic or *ultimate* truth) is not invalidated but merely concealed by a temporary abnormal situation of this kind. This situation is possible only in those periods when a substantial number of consumers and businessmen remain unconvinced that "bottom" has been reached in wages and prices, or feel that their job or solvency may still be in danger. And this is likely to happen precisely when wage-rates are artificially forced or held above the equilibrium level of marginal labor productivity.

Again, it is true that Ricardo declares at one point (already quoted) that "Money is only the medium by which the exchange is effected." If this is interpreted to mean, as Bernice Shoul interprets it, that money "plays no independent role," then of course it is not true. But if it is interpreted to mean: "If we, for the moment, *abstract from* money, we can see that *in the ultimate analysis* goods exchange against goods," then it is both true and methodologically valid.

Having recognized this truth, of course, we must in the solution of any dynamic problem *put money back* into our equation or "model" and recognize that in the modern world the exchange of goods is practically always through the medium of money, and that the interrelationship of goods and money-prices must be right for Say's law to be valid. But this is merely to return to the qualification of correct price relationships and equilibrium that has always been implicit in the statement of Say's law by the leading classical economists.

### The Answer of Haberler

Before leaving this subject it may be important to address ourselves to some of the confusions about it, not of Keynes himself, but of the "post-Keynesians." Prof. Gottfried Haberler has been by no means uncritical of Keynes,[14] but his discussion of Keynes's discussion of Say's law is peculiar. He presents part of the quotation I have already presented from Ricardo (on pp. 37-38) but does so in truncated form, and ends with the sentence: "Money is only the medium by which the exchange is effected." He then declares: "The meaning of this original formulation of this law seems to me quite clear: It states that income received is always spent on consumption or investment; in other words, money is never hoarded." [15]

Now the meaning of Ricardo's formulation of Say's law is already quite clear, particularly when it is given in full. It does not require any exegesis by Haberler or anyone else, and certainly no paraphrase that quite changes its meaning. Not only did Ricardo never explicitly assert the proposition that Haberler attributes to him; there is every reason to suppose that he would have repudiated it. At several points he actually describes what we today might call money hoarding and its effects. At many points in his *Notes on Malthus* he writes, regarding some view that Malthus attributes to him: "Where did I ever say this?"[16] We may be confident that he would have written the same regarding this Haberler "interpretation."

> Our conclusion, thus [Haberler goes on] is that there is no place and no need for Say's Law in modern economic theory and that it has been completely abandoned by neo-classical economists in their actual theoretical and practical work on money and the business cycle.… Summing up, we may say that there was no need for Keynes to rid neo-classical economics of Say's Law in the original, straightforward sense, for it had been completely abandoned long ago.[17]

The short answer to this is that there is still need and place to assert Say's law whenever anybody is foolish enough to deny it. It is itself, to repeat, essentially a negative rather than a positive proposition. It is essentially a rejection of a fallacy. It states that a *general* overproduction of *all* commodities is not possible. And that is all, basically, that it is intended to assert.

Haberler is right insofar as he denies the belief of Keynes (and such disciples as Sweezy) that Say's law "still underlies the whole classical theory, which would collapse without it" (*General Theory,* p. 19). It is true that Say's law is not *explicitly* needed in the solution of specific economic problems *if its truth is tacitly taken for granted.* Mathematicians seldom stop to assert that two and two do not make five. They do not explicitly build elaborate solutions of complicated problems upon this negative truth. But when someone asserts that two and two make five, or that an existing depression is the result of a general overproduction of everything, it is necessary to remind him of the error.

There is still another line of attack on Say's law, which Haberler among others seems to adopt, and this is to assert that in the sense in which Say's law is true it is "mere tautology." If it is tautological, it is so in the same sense in which basic logical and mathematical propositions are tautological: "Things that are equal to the same thing are equal to each other." One does not need to say this as long as one does not forget it.

To sum up, Keynes's "refutation" of Say's law, even if it had been successful, would not have been original: it does not go an inch beyond Malthus's attempted refutation more than a century before him. Keynes "refuted" Say's law only in a sense in which no important economist ever held it.

**To Save Is to Spend**

Risking the accusation of beating a dead horse, I should like to address myself to one more effort by Keynes to disprove Say's law, or what he calls "a corollary of the same doctrine" (p. 19). "It has been supposed," he writes, "that any individual act of abstaining from consumption necessarily leads to, and amounts to the same thing as, causing the labor and commodities thus released from supplying consumption to be invested in the production of capital wealth" (p. 19). And he quotes the following passage from Alfred Marshall's *Pure Theory of Domestic Values* (p. 34) in illustration:

> The whole of a man's income is expended in the purchase of services and of commodities. It is indeed commonly said that a man spends some portion of his income and saves another. But it is a familiar economic axiom that a man purchases labor and commodities with that portion of his income which he saves just as much as he does with that he is said to spend. He is said to spend when he seeks to obtain present enjoyment from the services and commodities which he purchases. He is said to save when he causes the labor and the commodities which he purchases to be devoted to the production of wealth from which he expects to derive the means of enjoyment in the future.

This doctrine, of course, goes much further back than Marshall. Keynes could have quoted his *bête noir,* Ricardo, to the same effect. "Mr. Malthus," wrote Ricardo, "never appears to remember that to save is to spend, as surely as what he exclusively calls spending." [18] Ricardo went much further than this, and in answering Malthus answered one of Keynes's chief contentions in advance: "I deny that the wants of consumers generally are diminished by parsimony — they are transferred with the power to consume to another set of consumers." [19]

And on still another occasion Ricardo wrote directly to Malthus:

> We agree too that effectual demand consists of two elements, the *power* and the *will* to purchase; but I think the will is very seldom wanting where the power exists, for the desire of accumulation [i.e., saving] will occasion demand just as effectually as a desire to consume; it will only change the objects on which the demand will exercise itself.[20]

For the present, however, it may be sufficient merely to note Keynes's contention on this point rather than to try to analyze it in full. There will be plenty of opportunity for that later. As we shall see, Keynes himself alternates constantly between two mutually contradictory contentions: (1) that saving and investment are "necessarily equal," and "merely different aspects of the same thing" (p. 74), and (2) that saving and investment are "two essentially different activities" without even a "nexus" (p. 21), so that saving not only *can* exceed investment but *chronically* tends to do so. The second is the view which he chooses to support at this point. We shall have occasion to analyze both views later. For the present it is sufficient merely to note the presence of this deep-seated contradiction in Keynes's thought.[21]

This article is excerpted from *Failure of the New Economics* [2] (1959).

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1. *Economics and the Public Welfare*, (New York: Van Nostrand, 1949), pp. 390-393.
2. *Planning for Freedom*. (South Holland, Ill.: Libertarian Press, 1952), pp. 64-71.
3. Paul M. Sweezy in *The New Economics*, ed. by Seymour E. Harris, (New York: Alfred Knopf, 1947), p. 105.
4. *Op. cit.*, pp. 64-65.
5. Vol. I, Book IV, Chap. I, (Edwin Cannon edition, 1904), p. 404 ff.
6. *Economics and the Public Welfare*, p. 390.
7. *Principles of Political Economy*, Book III, Chap. xiv. Sect. 2.
8. *Op. cit.*, p. 392.
9. Bernice Shoul, "Karl Marx and Say's Law," *The Quarterly Journal of Economics*, Nov., 1957, p. 615.
10. David Ricardo, *The Principles of Political Economy and Taxation*, (Everyman ed., New York), pp. 193-194.
11. The phrase "effectual demand," however, was italicized merely to bring out here the fact that Keynes did not invent this phrase. Ricardo even uses the phrase "effective demand" in his *Notes on Malthus* (Sraffa edition, Cambridge University Press, p. 234). The term "effectual demand" was actually introduced by Adam Smith in *The Wealth of Nations* (Book I, Chap. 7). John Stuart Mill explains. "Writers have … defined [demand as] the wish to possess, combined with the power of purchasing. To distinguish demand in this technical sense, from the demand which is synonymous with desire, they call the former effectual demand." *Principles of Political Economy*, 1848, Book III, Chap. II, § 3.
12. Sraffa edition, Cambridge University Press, p. 305.
13. *Op. cit.*, pp. 306-307.
14. Haberler's comments on the *General Theory* in Chap. 8 of the third edition of his *Prosperity and Depression* (Geneva: League of Nations, 1941) contain many penetrating observations.
15. *The New Economics*, ed. by Seymour E. Harris, p. 174.
16. See, e.g., Sraffa edition, p. 424.
17. *Op. cit.*, pp. 175-176.
18. David Ricardo, Notes on *Malthus* (Sraffa edition), p. 449.
19. *Ibid.*, p. 309.
20. *Letters of Ricardo to Malthus*, ed. by Bonar (1887). Letter of Sept. 16, 1814, p. 43.
21. Supplementing the present chapter, the reader is referred to the remarkable statement and defense of Say's law by John Stuart Mill, quoted at length on pp. 364-371.

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