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WHAT IS SAY'S LAW?

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Q: What is Say's Law?

A: It is the proposition - attributed to a nineteenth century French economist, Jean-Baptist Say - that 'supply creates its own demand'.

Q: How is it explained?

A: It is most easily explained in the context of a barter economy, where goods are traded for other goods.

Q: Goods are swapped?

A: Yes; it is necessary to supply goods in order to effect payment for other goods. So a willingness to supply goods is simultaneously an act of demanding goods.

Q: But there needs to be a 'double coincidence of wants'?

A: You've been reading some economics.

Q: Just a little. Isn't Say's Law very much an obvious proposition? I can't see why it should merit attention.

A: Say's Law says that there can be neither a general over-supply of goods, nor any general deficiency of demand for goods. It is important because it refutes the eighteenth century mercantilist doctrine which has been very influential.

Q: What is that doctrine?

A: It is a notion which is heard even to-day.; and it is the antithesis of the doctrine of free trade.

Q: We shouldn't trade?

A: Not quite that. The idea is that it is beneficial to export, but detrimental to import. Mercantilists assert that a nation can prosper only at the expense of other nations.

Q: What was the argument?

A: That trade surpluses earned the gold which gave prestige and power to the state. One nation's gain was necessarily another nation's loss.

Q: Isn't that a reasonable point?

A: No. Free-trade increases the variety of goods available to consumers. And if trade were not on some kind of reciprocal basis, foreign customers would eventually have no foreign exchange to buy imports.

Q: Unless you buy their imports, your customers have nothing to trade with. Nothing to swap for your exports?

A: That's it: supply creates its own demand.

Q: Say's Law was the counter-argument?

A: Yes. The mercantilists fear is that industrial productivity might outstrip the demand for goods and services; but, according to Say's Law, a general glut is impossible because individuals produce goods only to buy other goods.

Q: And did Say's Law triumph?

A: Not entirely. Say's Law came under new criticism in the 1930s.

Q: Criticism from whom?

A: From John Maynard Keynes.

Q: So what was Keynes's problem?

A: His problem was that, in a money economy, the interaction between supply and demand is less obvious than under barter.

Q: Where there is money, supply can create a demand for money rather than a demand for someone else's product?

A: Well done! You are a natural economist.

Q: I hope you meant that as a compliment?

A: Of course.

Q: What objections were raised by Keynes?

A: According to Keynes, the mercantilist preoccupation with trade surpluses was *not* (as classical economists had insisted) 'little better than nonsense'.

Q: Go on.

A: Keynes argued that, in a money economy, interest rates and investment did not necessarily self-adjust to produce overall levels of demand that are compatible with full employment.

Q: Interest rates might be too high and investment too low?

A: Yes.

Q: Why?

A: Because, when unemployment is high and the future is uncertain, people show a greater tendency to hoard, rather than to spend, their money income. They are very willing to supply, but less willing to demand.

Q: Demand is generally deficient?

A: This was exactly Keynes's point. An economy in this position is starved of investment, unless something can be done to bring down interest rates.

Q: What did Keynes propose?

A: He argued that the mercantilist objective - a trade surplus - provides a three-part remedy: overseas markets give new outlets for industries and bring higher returns on investment; and export earnings can be used to finance investment both overseas and at home.

Q: But you said that, by the mercantilist doctrine, one nation's gain is another nation's loss.

A: Indeed I did. Mercantilism is unashamedly a beggar-my-neighbour approach. It nurtures a tendency to drift into colonial wars. Clearly, this was a serious flaw

Q: So what did Keynes say?

A: ... that the mercantilists had missed the obvious solution.

Q: Which was?

A: A twin policy: that of an independent domestic interest rate and a national investment programme. He insisted that this solution is open to all nations and so could be used to restore health and strength internationally.

Q: There must be a catch.

A: I'm glad that you think so.

Q: What was it?

A: The idea that nations can achieve low interest rates without ever-escalating inflation is unsupported by experience. In the post-war period, Keynes's recommendations produced a general tendency to drift into ever-higher rates of inflation.

Q: How did Keynes react?

A: When, in 1946, Friedrich Hayek asked him if he was concerned about the implications which were being drawn from his theories, Keynes is alleged to have replied that, if it ever became necessary, he would quickly achieve the necessary change in public opinion.

Q: And did he?

A: No.

Q: Why not?

A: He died, just three months after that conversation.

Q: How very unfortunate ... I think we might stop there.

A: Perhaps we should.