

**Practice 3 – Introduction to Labor Economics (deadline: the day before next tutorial)**

Read the article by Ludwig von Mises on Say's Law in the next few pages and answer the following questions. Use as much space as you see fit.

- 1) What does Say's Law hold and what are the implications in terms of economic policy?
  
- 2) What arguments, according to von Mises, does Keynes provide to refute this law? What arguments, according to your opinion, does Keynes provide to wipe out more than 100 years of classical economics?
  
- 3) Explain the following sentence in the context of Say's Law: "The New Deal-style plans (as in the USA during the 1930s) allow filling the hole left by the fall in private investment and private consumption during a period of recession." Think critically, as an economist would do, pondering not only the immediate consequences but also the probable long-run outcome.
  
- 4) Draw a parallel between the crisis of the 1930s and the current one, between the dominant paradigm at that time and today, and between the different explanations that have been used in those years and today. Explain.

# Lord Keynes and Say's Law

Daily Article by [Ludwig von Mises](#) | Posted on 4/25/2005

*This article originally was published in "The Freeman," October 30, 1950, and is reprinted in Planning for Freedom (\$10).*

I



Lord Keynes's main contribution did not lie in the development of new ideas but "in escaping from the old ones," as he himself declared at the end of the Preface to his "General Theory." The Keynesians tell us that his immortal achievement consists in the entire refutation of what has come to be known as Say's Law of Markets. The rejection of this law, they declare, is the gist of all Keynes's teachings; all other propositions of his doctrine follow with logical necessity from this fundamental insight and must collapse if the futility of his attack on Say's Law can be demonstrated.[\[1\]](#)

Now it is important to realize that what is called Say's Law was in the first instance designed as a refutation of doctrines popularly held in the ages preceding the development of economics as a branch of human knowledge. It was not an integral part of the new science of economics as taught by the Classical economists. It was rather a preliminary—the exposure and removal of garbled and untenable ideas which dimmed people's minds and were a serious obstacle to a reasonable analysis of conditions.

Whenever business turned 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 predominantly to a thorough refutation of the second.

As long as a definite thing is still an economic good and not a "free good," its supply is not, of course, *absolutely* abundant. There are still unsatisfied needs which a larger supply of the good concerned could satisfy. There are still people who would be glad to get more of this good than they are really getting. With regard to economic goods there can never be *absolute* overproduction. (And economics deals only with economic goods, not with free goods such as air which are no object of purposive human action,

are therefore not produced, and with regard to which the employment of terms like underproduction and overproduction is simply nonsensical.)

With regard to economic goods there can be only *relative* overproduction. While the consumers are asking for definite quantities of shirts and of shoes, business has produced, say, a larger quantity of shoes and a smaller quantity of shirts. This is not general overproduction of all commodities. To the overproduction of shoes corresponds an underproduction of shirts. Consequently the result can not be a general depression of all branches of business. The outcome is a change in the exchange ratio between shoes and shirts. If, for instance, previously one pair of shoes could buy four shirts, it now buys only three shirts. While business is bad for the shoemakers, it is good for the shirtmakers. The attempts to explain the general depression of trade by referring to an allegedly general overproduction are therefore fallacious.

Commodities, says Say, are ultimately paid for not by money, but by other commodities. Money is merely the commonly used medium of exchange; it plays only an intermediary role. What the seller wants ultimately to receive in exchange for the commodities sold is other commodities.

Every commodity produced is therefore a price, as it were, for other commodities produced. The situation of the producer of any commodity is improved by any increase in the production of other commodities. What may hurt the interests of the producer of a definite commodity is his failure to anticipate correctly the state of the market. He has overrated the public's demand for his commodity and underrated its demand for other commodities. Consumers have no use for such a bungling entrepreneur; they buy his products only at prices which make him incur losses, and they force him, if he does not in time correct his mistakes, to go out of business. On the other hand, those entrepreneurs who have better succeeded in anticipating the public demand earn profits and are in a position to expand their business activities. This, says Say, is the truth behind the confused assertions of businessmen that the main difficulty is not in producing but in selling. It would be more appropriate to declare that the first and main problem of business is to produce in the best and cheapest way those commodities which will satisfy the most urgent of the not yet satisfied needs of the public.

Thus Smith and Say demolished the oldest and most naive explanation of the trade cycle as provided by the popular effusions of inefficient traders. True, their achievement was merely negative. They exploded the belief that the recurrence of periods of bad business was caused by a scarcity of money and by a general overproduction. But they did not give us an elaborated theory of the trade cycle. The first explanation of this phenomenon was provided much later by the British Currency School.

The important contributions of Smith and Say were not entirely new and original. The history of economic thought can trace back some essential points of their reasoning to older authors. This in no way detracts from the merits of Smith and Say. They were the first to deal with the issue in a systematic way and to apply their conclusions to the problem of economic depressions. They were therefore also the first against whom the supporters of the spurious popular doctrine directed their violent attacks. Sismondi and Malthus chose Say as the target of passionate volleys when they tried—in vain—to salvage the discredited popular prejudices.

## II

Say emerged victoriously from his polemics with Malthus and Sismondi. He proved his case, while his adversaries could not prove theirs. Henceforth, during the whole rest of the nineteenth century, the acknowledgment of the truth contained in Say's Law was the distinctive mark of an economist. Those authors and politicians who made the alleged scarcity of money responsible for all ills and advocated inflation as the panacea were no longer considered economists but "monetary cranks."

The struggle between the champions of sound money and the inflationists went on for many decades. But it was no longer considered a controversy between various schools of economists. It was viewed as a conflict between economists and anti-economists, between reasonable men and ignorant zealots. When all civilized countries had adopted the gold standard or the gold-exchange standard, the cause of inflation seemed to be lost forever.

Economics did not content itself with what Smith and Say had taught about the problems involved. It developed an integrated system of theorems which cogently demonstrated the absurdity of the inflationist sophisms. It depicted in detail the inevitable consequences of an increase in the quantity of money in circulation and of credit expansion. It elaborated the monetary or circulation credit theory of the business cycle which clearly showed how the recurrence of depressions of trade is caused by the repeated attempts to "stimulate" business through credit expansion. Thus it conclusively proved that the slump, whose appearance the inflationists attributed to an insufficiency of the supply of money, is on the contrary the necessary outcome of attempts to remove such an alleged scarcity of money through credit expansion.

The economists did not contest the fact that a credit expansion in its initial stage makes business boom. But they pointed out how such a contrived boom must inevitably collapse after a while and produce a general depression. This demonstration could appeal to statesmen intent on promoting the enduring well-being of their nation. It could not influence demagogues who care for nothing but success in the impending election campaign and are not in the least troubled about what will happen the day after tomorrow. But it is precisely such people who have become supreme in the political life of this age of wars and revolutions. In defiance of all the teachings of the economists, inflation and credit expansion have been elevated to the dignity of the first principle of economic policy. Nearly all governments are now committed to reckless spending, and finance their deficits by issuing additional quantities of unredeemable paper money and by boundless credit expansion.

The great economists were harbingers of new ideas. The economic policies they recommended were at variance with the policies practiced by contemporary governments and political parties. As a rule many years, even decades, passed before public opinion accepted the new ideas as propagated by the economists, and before the required corresponding changes in policies were effected.

It was different with the "new economics" of Lord Keynes. The policies he advocated were precisely those which almost all governments, including the British, had already adopted many years before his "General Theory" was published. Keynes was not an innovator and champion of new methods of managing economic affairs. His

contribution consisted rather in providing an apparent justification for the policies which were popular with those in power in spite of the fact that all economists viewed them as disastrous. His achievement was a rationalization of the policies already practiced. He was not a "revolutionary," as some of his adepts called him. The "Keynesian revolution" took place long before Keynes approved of it and fabricated a pseudo-scientific justification for it. What he really did was to write an apology for the prevailing policies of governments.

This explains the quick success of his book. It was greeted enthusiastically by the governments and the ruling political parties. Especially enraptured were a new type of intellectual, the "government economists." They had had a bad conscience. They were aware of the fact that they were carrying out policies which all economists condemned as contrary to purpose and disastrous. Now they felt relieved. The "new economics" reestablished their moral equilibrium. Today they are no longer ashamed of being the handymen of bad policies. They glorify themselves. They are the prophets of the new creed.

### III

The exuberant epithets which these admirers have bestowed upon his work cannot obscure the fact that Keynes did not refute Say's Law. He rejected it emotionally, but he did not advance a single tenable argument to invalidate its rationale.

Neither did Keynes try to refute by discursive reasoning the teachings of modern economics. He chose to ignore them, that was all. He never found any word of serious criticism against the theorem that increasing the quantity of money cannot effect anything else than, on the one hand, to favor some groups at the expense of other groups, and, on the other hand, to foster capital malinvestment and capital decumulation. He was at a complete loss when it came to advancing any sound argument to demolish the monetary theory of the trade cycle. All he did was to revive the self-contradictory dogmas of the various sects of inflationism. He did not add anything to the empty presumptions of his predecessors, from the old Birmingham School of Little Shilling Men down to Silvio Gesell. He merely translated their sophisms—a hundred times refuted—into the questionable language of mathematical economics. He passed over in silence all the objections which such men as Jevons, Walras and Wicksell—to name only a few—opposed to the effusions of the inflationists.

It is the same with his disciples. They think that calling "those who fail to be moved to admiration of Keynes's genius" such names as "dullard" or "narrow-minded fanatic"[\[2\]](#) is a substitute for sound economic reasoning. They believe that they have proved their case by dismissing their adversaries as "orthodox" or "neo-classical." They reveal the utmost ignorance in thinking that their doctrine is correct because it is new.

In fact, inflationism is the oldest of all fallacies. It was very popular long before the days of Smith, Say and Ricardo, against whose teachings the Keynesians cannot advance any other objection than that they are old.

## IV

The unprecedented success of Keynesianism is due to the fact that it provides an apparent justification for the "deficit spending" policies of contemporary governments. It is the pseudo-philosophy of those who can think of nothing else than to dissipate the capital accumulated by previous generations.

Yet no effusions of authors however brilliant and sophisticated can alter the perennial economic laws. They are and work and take care of themselves. Notwithstanding all the passionate fulminations of the spokesmen of governments, the inevitable consequences of inflationism and expansionism as depicted by the "orthodox" economists are coming to pass. And then, very late indeed, even simple people will discover that Keynes did not teach us how to perform the "miracle ... of turning a stone into bread,"<sup>[3]</sup> but the not at all miraculous procedure of eating the seed corn.

---

Ludwig von Mises (1881–1973) wrote 25 books on economics, philosophy, and history. This essay is from *Planning for Freedom*, a collection that is [available from the Mises Shop for \\$10 plus s&h](#). Comments on this essay can be [posted on the blog](#).

### Footnotes

[1] P. M. Sweezy in *The New Economics*, Ed. by S. E. Harris, New York, 1947, p. 105.

[2] Professor G. Haberler, *Opus cit.*, p. 161.

[3] Keynes, *Opus cit.*, p. 332.