

12. Nudge Nudge, Wink Wink, Say No More

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Belief in Say's Law is a minority position in economics today. Those who adhere to it appear to believe that it is a self-evident truth that is misunderstood by modern economists of all persuasions, and that properly understood it is not only true, but the foundation of an accurate appreciation of the functioning of a market economy and the phenomenon of the trade cycle.

I concur with the majority perspective that Say's Law is fallacious, but not for reasons that make me a member of any defined majority in economics at large.

WHAT SAY/MILL/BAUMOL/CLOWER ACTUALLY MEANT

One of the great difficulties in this debate is the lack of a concise definition of Say's Law. Baumol's 1977 article set out at least eight possible meanings, Clower and Leijonhufvud gave a more stylised definition, and many other ways of phrasing this alleged Law have been proffered in the literature. I will start with the propositions put forward by the Editor of this volume in the lengthy post to the HES list that initiated this book. In that post, Kates argued that:

The law of markets (Say's Law) was the proposition that stated demand deficiency/overproduction never occurred. It said nothing about any other types of problem that might arise in an economy nor did it suggest that an economy would never go into recession or that involuntary unemployment was an impossibility. (Kates 2000)

The impossibility of general demand deficiency is clearly the key proposition of the '*théorie des débouchés*'. The question is, what are the arguments on which this proposition is based? Kates quotes approvingly from Henry Clay (Henry Clay, *Economics for the General Reader*, 1916: 242 [cited in Kates 2000]):

'It is only because our exchanges are made through money that we have any difficulty in perceiving that an increase in supply is (not 'causes') an increase in demand . . . Thus an increase in the supply of cloth is an increase in the demand for other things; and vice versa, an increase in the supply of anything else may constitute an increase in the demand for cloth. What is divided amongst the members of society is the goods and services produced to satisfy its wants; and the same goods and services are both the Supply and Demand.'

The proposition is that the supply of goods *is* a demand for goods. While there may not be a coincidence in the structure of supply and the structure of demand – and thus some sectors can be oversupplied and others undersupplied – overall the aggregate supply of the economy *is* the aggregate demand. There can be no general deficiency of aggregate demand relative to aggregate supply, because the two phenomena are merely different perspectives on the same thing.

Suitably, the clearest statement of the reasoning behind this proposition was made by Say himself, in his *Catechism of Political Economy*. Working from the perspective of the individual producer in a market economy, Say stated that:

Every producer asks for money in exchange for his products, only for the purpose of employing that money again immediately in the purchase of another product; for we do not consume money, and it is not sought after in ordinary cases to conceal it: thus, when a producer desires to exchange his product for money, he may be considered as already asking for the merchandise which he proposes to buy with this money. *It is thus that the producers, though they have all of them the air of demanding money for their goods, do in reality demand merchandise for their merchandise.* (Say 1821: 105; emphasis added)

This statement succinctly states the seductively simple but, as I argue below, fallacious foundations of Say's Law. As Marx showed far better than did Keynes, the conditions under which Say's Law is correct are not those of a capitalist economy.

CAPITALISM'S TWIN CIRCUITS

Marx conceded that, if the sole motivation of exchange is consumption, then aggregate supply *is* aggregate demand:

Of the part of the revenue in one branch of production (which produces consumable commodities) which is consumed in the revenue of another branch of production, it can be said that the demand is equal to its own supply (in so far as production is kept in the right *proportion*). It is the same as if each branch itself consumed that part of its revenue. Here there is only a formal metamorphosis of the commodity: *C-M-C'* Linen-money-wheat. (Marx 1861: 233)

Marx's formalism on this 'part of the revenue' neatly encapsulates Say's perspective on *all* exchange: a producer offers products in exchange for money ('*C-M*', 'Linen-money') and then employs that money to buy different products ('*M-C'*', 'money-wheat'). If the overall circuit *C-M-C'* (where the dash in *C'* indicates commodities different to those in *C*) were the only one in existence, then Say's Law would be true—as Marx puts it, '*it can be said that the demand is equal to its own supply*'. In this circumstance, general gluts could not exist, and disproportionality of demand and supply in different sectors (and also time lags between sale and purchase) would be *the* explanation for cyclical behaviour.

However, according to Marx *C-M-C'* is only one of two circuits in capitalism. The second, socially dominant (though physically smaller) circuit is '*M-C-M+*'. Agents in this circuit are motivated, not by consumption, but by the desire to accumulate wealth for its own sake. They do not demand, as Say put it, 'merchandise for their merchandise', but 'more money for their money'. The purpose of economic activity in this circuit is not to exchange one commodity for another, but to exchange less money for more money:

The circuit *C-M-C* starts with one commodity, and finishes with another, which falls out of circulation and into consumption. Consumption, the satisfaction of wants, in one word, use-value, is the end and aim. The circuit *M-C-M+*, on the contrary, commences with money and end with money. Its leading motive, and the goal that attracts it, is therefore mere exchange-value. (Marx 1867:148)

This circuit violates Say's precepts about the behaviour of producers, justifies Keynes's later distinction between aggregate supply and aggregate demand, and introduces 'general gluts' and other macroeconomic phenomena as potential causes of economic crises in addition to disproportionality.

The fallacy in Say's Law, from Marx's point of view, is to apply to capitalist society a principle that befits only a society of simple commodity

producers who have no desire to accumulate wealth. In such a society, the absence of a desire to accumulate guarantees the identity of each individual's supplies and demands, and thus of supply and demand in the aggregate. But in a capitalist society, accumulation of wealth is an object in itself:

The expansion of value, which is the objective basis or main-spring of the circulation $M-C-M$, becomes his subjective aim, and it is only in so far as the appropriation of ever more and more wealth in the abstract becomes the sole motive of his operations, that he functions as a capitalist . . . Use-values must therefore never be looked upon as the real aim of the capitalist. Neither must the profit on any single transaction. The restless never-ending process of profit making alone is what he aims at. This boundless greed after riches, this passionate chase after exchange-value, is common to the capitalist and the miser; but while the miser is merely a capitalist gone mad, the capitalist is a rational miser. The never ending augmentation of exchange value, which the miser strives after, by seeking to save his money from circulation, is attained by the more acute capitalist, by constantly throwing it afresh into circulation. (Marx 1867: 151)

With the presence of a circuit dominated by the desire to accumulate, the simple harmony of commodity production and consumption (vulnerable only to disproportionality) gives way to the potential for instability arising from speculative overproduction, excessive and insufficient expectations of profit, maldistribution of income, excessive debt, and the whole panoply of macroeconomic issues that believers in Say's Law cannot comprehend. Say's 'Law' therefore, is not a recondite insight into the nature of a market economy, but evidence of a basic failure to comprehend capitalism.

Marx's polemical statement of his perspective on capitalism contrasts starkly with Say's simplistic vision in his *Catechism*:

It must never be forgotten, that in capitalist production what matters is not the immediate use-value but the exchange-value, and, in particular, the expansion of surplus-value. This is the driving motive of capitalist production, and it is a pretty conception that – in order to reason away the contradictions of capitalist production – abstracts from its very basis and depicts it as a production aiming at the direct satisfaction of the consumption of the producers (Marx 1861: 495).

Whereas a producer acting in the $C-M-C'$ manner does ask for money 'only for the purpose of employing that money again immediately in the purchase of another product', a producer acting in the $M-C-M+$ manner asks for money for its own sake ('exchange-value, and, in particular, the expansion of surplus-value'). While we 'do not consume money', people certainly do seek to 'conceal' (or accumulate) it. Though a capitalist will undoubtedly consume with part of the money he accumulates, it is not true that 'he may be

considered as already asking for the merchandise which he proposes to buy with this money' since if he converts all his profit into consumables, he has failed to accumulate wealth – to be a capitalist.

As Marx puts it, capitalists are characterised not by an equality of their supplies and their demands, but by an *inequality*. This inequality is possible because production mediates between the commodities 'an industrial capitalist' purchases (the labour and material inputs to production) and the commodities he sells (the output of the manufacturing process), and production produces a physical surplus that the capitalist hopes to turn into a monetary surplus:

The capitalist throws less value in the form of money into the circulation than he draws out of it . . . Since he functions . . . as an industrial capitalist, his supply of commodity-value is always greater than his demand for it. If his supply and demand in this respect covered each other it would mean that his capital had not produced any surplus-value . . . His aim is not to equalise his supply and demand, but to make the inequality between them . . . as great as possible. (Marx 1885: 120-121)

Veblen made a similar point, though in a less formal way, when he satirised the belief that capitalists could be treated as motivated simply by consumption. He argued that it was a 'commonplace fact' that 'Business men habitually aspire to accumulate wealth in excess of the limits of practicable consumption, and the wealth so accumulated is not intended to be converted by a final transaction of purchase into consumable goods or sensations of consumption.' (Veblen 1909: 634)

Veblen derided the attempt to interpret accumulation as simply delayed consumption – so that the innate equality of Say's Law could be restored in the long run-as a desire not to understand the facts of real life, but an attempt

to explain the facts away; . . . to neutralize them so that they will not have to appear in the theory, which can then be drawn indirect and unambiguous terms of rational hedonistic calculation. They are explained away as being aberrations due to oversight or lapse of memory on the part of business men, or to some failure of logic or insight. Or they are construed and interpreted into the rationalistic terms of the hedonistic calculus by resort to an ambiguous use of the hedonistic concepts. So that the whole "money economy", with all the machinery of credit and the rest, disappears in a tissue of metaphors to reappear theoretically expurgated, sterilized, and simplified into a "refined system of barter", culminating in a net aggregate maximum of pleasurable sensations of consumption. (Veblen 1909: 635)

Thus as Marx emphasises in the immediate term and Veblen in the long term, a capitalist's supply, if he is successful, is greater than his demand. There is an inherent inequality at the core of capitalist society, and the simple balance of Say's Law collapses. In its place arises a far more complex vision of the functioning – and potential malfunctioning – of a market economy.

MARX'S DISCOVERY OF THE TWO CIRCUITS

Marx first developed his analysis of circuits in capitalism – $C \rightarrow M \rightarrow C'$ and $M \rightarrow C \rightarrow M+$ – while writing the Grundrisse, the 'rough draft' of Capital in 1857–58. He commenced by identifying the stages in the process of exchanging one commodity for another:

The commodity is exchanged for money; money is exchanged for the commodity. In this way, commodity is exchanged for commodity, except that this exchange is a mediated one. The purchaser becomes a seller again and the seller becomes purchaser again. In this way, each is posited in the double and the antithetical aspect, and hence in the living unity of both aspects. (Marx 1857: 197)

While he was thinking in these terms, Marx's critique of Say's Law amounted to no more than the observation that the monetary stage can lead to disturbances – something that, as Kates argues, is quite consistent with Say's Law still being valid:

It is entirely wrong, therefore, to do as the economists do, namely, as soon as the contradictions in the monetary system emerge into view, to focus only on the end results without the process which mediates them; only on the unity without the distinction, the affirmation without the negation. (Marx 1857: 197)

However, after musing in this fashion for a while, Marx's realised that this process of the exchange of commodities mediated by money is neither the only nor the essential process of capitalism: there is another, more characteristically capitalist process, of the exchange of money mediated by commodities. Whereas the first process involves the exchange of qualitatively different commodities of an equivalent monetary value, and is therefore characterised by equality, the second process begins and ends with money, and therefore only makes sense if it is characterised by inequality:

One moment of circulation is that the commodity exchanges itself through money for another commodity. But there is, equally, the other moment, not only that commodity exchanges for money and money for commodity, but equally that

money exchanges for commodity and commodity for money; hence that money is mediated with itself by the commodity, and appears as the unity which joins itself with itself in its circular course. Then it appears no longer as the medium, but as the aim of circulation (as e.g. with the merchant estate) (in commerce generally). If circulation is looked at not as a constant alternation, but as a series of circular motions which it describes within itself, then this circular path appears as a double one: *Commodity-Money-Money-Commodity* and in the other direction *Money-Commodity-Commodity-Money*; i.e. if I sell in order to buy, then I can also buy in order to sell. *In the former case money only as a means to obtain the commodity, and the commodity the aim; in the second case the commodity only a means to obtain money, and money the aim.* (Marx 1857: 201; emphases added).

A MONETARY PRODUCTION ECONOMY

With these realisations, Marx's critique of Say's Law becomes something more than the observation that problems with the monetary process may impede the exchange of one commodity for another. Two key insights flow from Marx's identification of the *M-C-M+* circuit: to satisfy this desire to accumulate, it must be feasible to generate a physical surplus and this surplus must be monetised.

The first insight indicates that an understanding of production is essential: without production there can be no surplus. Marx expanded his circuit to *M-C(L,MP) . . . P . . . C+c-M+m*, or in words:

Money → Purchase of labour and commodity inputs to production . . . Production of different commodities, of greater value than paid for the labour and means of production → Sale of these commodities to generate more money

There are two aspects to the 'of greater value' proposition in the above. The first is the physical surplus: a growing market economy produces more than is needed to keep its inhabitants alive and replace depreciated physical capital. The second is that this physical surplus has to be converted into a monetary surplus, since this is the object of the *M-C-M+* circuit.

These added requirements of the *M-C-M+* circuit over and above the requirements for simple commodity exchange usher in the possibility of individual and aggregate economic failure in exchange. When the motive for exchange is to secure a particular commodity for consumption, then each exchange is successful in increasing the utility of the parties to it (whether the relative price in the exchange was an equilibrium one or not). But when the objective is not to secure a desired item of consumption but to increase ones' holdings of money, exchange may occur and yet fail to achieve its objective:

Now one can say: to exchange commodity for commodity makes sense, since commodities, although they are equivalent as prices, are qualitatively different, and their exchange ultimately satisfies qualitatively different needs. *By contrast, exchanging money for money makes no sense, unless, that is, a quantitative difference arises*, less money is exchanged for more, sold at a higher price than purchased... In the real process of buying in order to sell, admittedly, the motive is the profit made thereby, and the ultimate aim is to exchange less money, by way of the commodity, for more money, since there is no qualitative difference between money and money. *All that given, it cannot be denied that the operation may come to grief and that hence the exchange of money for money without quantitative difference frequently takes place in reality.* (Marx 1857: 201–02; emphases added)

Marx also realised that in this circuit, money has an essentially new role in addition to those of medium of exchange and measure of account: it is now also a measure of accumulation. Failure in accumulation can now result in money being withdrawn from circulation, which in turn can lead to deficiencies in aggregate demand:

money functions neither only as measure, nor only as medium of exchange, nor only as both; but has yet a third quality. It appears here firstly as a end in itself, whose sole realization is served by commodity trade and exchange. Secondly, since the cycle concludes with it at that point, it steps outside it, just as the commodity, having been exchanged for its equivalent through money, is thrown out of circulation. It is very true that money, in so far as it serves only as an agent of circulation, constantly remains enclosed in its cycle. But it appears here, also, that it is still something more than this instrument of circulation, that it also has an independent existence outside circulation, and that in this new character it can be withdrawn from circulation just as the commodity must definitely be withdrawn. We must therefore observe money in its third quality. (Marx 1857: 202-03)

In this 'third quality', money is more than the mere lubricant for barter that Say perceived. It is also the form in which wealth is accumulated:

The third attribute of money, in its complete development, presupposes the first two [measure and medium of exchange] and constitutes their unity. Money, then, has an independent existence outside circulation . . . as money, it can be accumulated to form a treasure . . . This aspect already latently contains its quality as capital. (Marx 1857: 216)

The Circuitist School of Italy and France has built on Marx (though with some inherent weaknesses that we can ignore here), to point out that whereas exchange under barter is a two-sided process, exchange under capitalism is necessarily three-sided (Graziani 1989). In contrast to the two-sided vision of Say, where buyer and seller exchange money and commodity directly (and

money itself is little more than a commodity designated for the purpose of exchange), a monetary production economy has a triangular relationship between a seller at one apex, a buyer at another, and a bank at the third that records the transaction as a debit to the buyer and a credit to the seller, and charges and pays differential interest.

Expanding debt also becomes an essential characteristic of a growing economy, as Minsky realised. The financial equality of purchase and sale in each isolated transaction did not blind Minsky to the fact that in the aggregate there had to be an *inequality* between income and spending if the economy was to continue growing in the context of a constant or rising price level:

If income is to grow, the financial markets, where the various plans to save and invest are reconciled, must generate an aggregate demand that, aside from brief intervals, is ever rising. For real aggregate demand to be increasing, . . . it is necessary that current spending plans, summed over all sectors, be greater than current received income and that some market technique exist by which aggregate spending in excess of aggregate anticipated income can be financed. It follows that over a period during which economic growth takes place, at least some sectors finance a part of their spending by emitting debt or selling assets. (Minsky 1963 [1982]: 6)

THE KOYAANISQUATSI ECONOMY

Finally, whereas exchange in the *C-M-C'* sphere has its own guarantee of overall balance, no such guarantee exists for exchange done within the *M-C-M+* circuit. In an uncertain world, expectations of what and how much to produce will necessarily be sectorally *and in the aggregate* incorrect to at least some degree. The prospects for turning a physical surplus into real financial gain will depend on financial conditions and the distribution of income. Euphoric expectations during a boom may lead capitalists to produce too much of everything relative to the future ability of the system to finance their sale at a profit, while excessive debt and depressed expectations during a slump may lead to a self-fulfilling spiral into depression. As Minsky argued, this perspective can be seen as Keynes's essential argument in the *General Theory*.

DERIVATIVE FALLACIES

All attempts to provide a formal expression of Say's Law rest on the same fallacious proposition that there is neither the desire nor the possibility to accumulate wealth for its own sake in a capitalist economy. Clower and Leijonhufvud's 'Say's Principle', which for its time had a significant impact on the development of macroeconomic theory, is flawed from the very instant that it steps from its 'neither thief nor philanthropist' premise to the proposition that each agent's excess demands sum to zero.

Marx also starts from the same proposition – that in each exchange the two parties are neither thieves nor philanthropists, and that items of equivalent monetary value are exchanged – yet derives the result that the capitalists can accumulate wealth: the sum of their excess demands is negative.

Marx can do this because production, and the surplus arising from it, are an integral part of his vision of capitalism. 'Say's Law', 'Say's Principle', and 'Walras' Law', are all rooted in an exchange-only vision of capitalism that fails to comprehend the existence of surplus and its corollary, the accumulation of wealth.

Therefore Say's Law – and Say's Principle, and Walras' Law, and all other concepts which portray the sum of all excess demands as zero – is thus a 'law' applicable only to a market economy without capitalists and the accumulation of wealth. We live in a market economy with capitalists and with the accumulation of wealth, and we will continue to live in such a society for the foreseeable future. Say's Law is thus irrelevant to the world in which we live. Rather than discussing Say's 'Law' any further, we should consign it to the dustbin of the history of economic thought.

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