

STIKEMARK

MARKS TRAVELS

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ACKNOWLEDGMENTS AND NOTES

APPENDIX IN THE FINAL VERSION



Two Hundred Years of Say's Law

Essays on Economic Theory's Most Controversial Principle

Edited by

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Acknowledgements

This book emerged from a series of posts on the History of Economics website which was begun with a more or less innocuous query. It ran:

(1) When was Say's Law first called by that name (as opposed to 'the law of markets' or something else) and who named it?

(2) One of my students claims (in an essay) that it was Keynes who first summarised Say's Law in the words 'supply creates its own demand'. I find that my students are not always reliable sources (and I can't cross-question this particular student, because it is vacation now). It seems unlikely to me, but I realise that I can't offhand think of an earlier use of the phrase. Was my student right?

From this a quite intense correspondence developed which clearly showed that however dead and buried some may think Say's Law to be, there are others who believe it to be not only valid but in fact believe it to be an immensely important economic principle. Similarly, it became evident that there were many more who believe just as strongly that acceptance of Say's Law is utterly mistaken and that Keynes was absolutely right to rid economic theory of what they saw as its pernicious presence.

The suggestion was then made that perhaps a collection of essays from those who had contributed to this exchange might be worth putting together. This idea then grew further still and with the recognition that the two hundredth anniversary of Say's first statement of Say's Law being imminent, that a more complete collection, including experts from the full spectrum of economic opinion but with deep knowledge of the issues surrounding Say's Law as well, should be asked to contribute to this volume. The book thus not only includes Keynesian and neo-classical contributors, but also those writing from an Austrian perspective as well as from a Marxist point of view. There are other shades of economic thought as well, but it is not the job of an editor

anything that would lead to a rationalisation of the loanable funds theory of interest, was something he would wish to avoid.

18. The unit of account function of money was also important during the early nineteenth century. This was evidenced by the early nineteenth century writers' continuous search for both the 'measure' as well as the cause of value.
19. By the time of his post-*General Theory* writings, the same fund was part of his idea of 'finance money demand'; this was a clear connection between these two concepts, which is not emphasised by the literature.

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11. Say's Economy

John F. Henry

Jean-Baptiste Say expressed what came to be known as 'Say's Law' in these terms: '... products are always bought ultimately with products' (Say 1803 [1827]: 106). The more conventional, though equivalent, statement is 'supply creates its own demand,' attributable to James Mill.¹

The purpose of this essay is not to wrangle over the origins of Say's Law, nor its specific meaning in the hands of authorities who used one or another version of the law. (On which, see Sowell 1972.) I shall confine myself to examining the nature of the economy that must exist if Say's Law is to hold, contrasting Say's economy with a monetary economy, and demonstrating the *fundamental* difference between Say's view of the world and that of John Maynard Keynes (among others).

The seemingly innocent assertion, 'products are always bought ... with products,' represents a particular view of the world that gives rise to a powerful theoretical perspective, one that is encapsulated in conventional, neoclassical economic theory. From this humble starting point an elaborate edifice develops that incorporates, not only an attempted elucidation of an economy, but a quite compelling ideological statement that speaks to fairness, to justice, and to virtue.

Let us first lay out the argument in Say's own words, drawn mainly from his *Letters to Mathias* (1821 [1936]), a most convenient, truncated version of *A Treatise on Political Economy*:

(1) In reality we do not buy articles of consumption with money, the circulating medium with which we pay for them. We must in the first instance have bought this money itself by the sale of our produce (p. 2).

(As) the amount for which we can buy is equal to that which we can produce, the more we can produce the more we can purchase. From whence proceeds this other conclusion . . . That if certain commodities do not sell, it is because others are not produced, and that it is the raising produce alone which opens a market for the sale of produce (p. 3).

Now it is these various productions, which being exchanged against each other, open a reciprocal vent each to the other. The greater or less want there is of one of these productions, compared with others, determines an exchange at a greater or less price... (p. 14).

(The value of things... is founded on their utility... (p. 10).

The nature of the demand will determine the nature of the productions... (p. 51).

51). These sacrifices are the price we pay to obtain (products). You call these sacrifices... by the name of labour, which is an insufficient expression, for they include the concurrence of land and capital. I call them *productive service* (p. 12).

Money is nothing in this matter than a passing agent, which, the exchange once complete, has nothing more to do with it, but is employed in other exchanges (p. 14).

14). Where the capitals become too abundant, the interest which the capitalists derive from them becomes too low to balance the privations they impose upon themselves by their savings. Safe employment for capital will be difficult to be found; capitals are employed abroad (p. 37).

Say develops his argument by assuming a hypothetical peasant economy in which a collection of individual producers, each in control of his own 'productive services' - including labour - brings the results of its efforts to market (1803 [1827]: 72). True, labour, capital, and land may be owned by separate entities, but they are equivalent in that all contribute to the production of values: all are 'loaned' (Ibid.: 18) to the entrepreneur (or adventurer in the American edition of the *Treatise*), and all receive a 'profit' based on their contribution (Ibid.: 269-70). Theoretically, then, as there is no fundamental or social distinction among the factors of production, their ownership or return, the peasant farmer can be seen as owning all the inputs, loaning these to himself, and - applying his entrepreneurial capabilities - producing output that is translated into income through the sale of that output; this income is then divided among wages, rent, interest and profit. Each specific income is thus a measure of the input's contribution to output.

When output is brought to market, the producers engage in barter. In *Letters*, Say, in response to a criticism of Malthus, attempts to distance himself from a barter economy (1821 [1936]: 13), but it is very clear that his is such an economy. Indeed, in the *Treatise* he specifically equates exchange with barter (1803 [1827]: 9, *passim*). This must be the case, for money is introduced only as a medium (or 'intermedial object') of exchange that is invented to overcome the limitations imposed by barter - the double coincidence of wants and divisibility (Ibid.: 164-7). That is, the necessary trade relations (equated with exchange) must unfold prior to the development of money.

Imagine such a hypothetical economy in which all are individualised petty producers: each owns sufficient property to allow self-sufficient production. Yet, while self-sufficiency is possible, it is inefficient: individual labour has to be allocated to many different activities requiring different skills, learning time, etc. The advantages of specialisation are realised and each producer concentrates on one productive activity. Labour now becomes more productive and aggregate output increases.

But, since the iron producer cannot eat iron and the corn producer cannot plough a field using corn husks, specialisation requires trade. Markets are established where iron is traded for corn, the demand for corn being determined by the amount of iron brought forward for trade. In an n-market economy, all products trade for all other products and aggregate demand is determined by aggregate supply. True, in any particular market there may be excess demand or supply, but these disequilibrium relations are managed through changes in relative prices and all markets eventually clear.

Should the iron producer decide to withdraw iron for trade to use that iron to build an additional foundry, there will obviously be an adjustment process affecting all individual markets. But interest rate adjustment (the price associated with capital) will ensure that sufficient investment outlets will be found for available savings, though this may require transferring those savings to other markets (international capital flows).

Indeed, rather than saving being a cause of insufficient demand and a drag on the economy - a 'vice,' according to Malthus - Say argues that saving is a virtuous act. As this speaks to a later point, let me quote directly:

We are too much inclined to sacrifice the future for the present. The principle of every amendment is on the contrary the sacrifice of the temptations of the moment for the future good. This is the ground-work of all virtue, and of all wealth (Say 1821 [1936]: 38).

At some point, the act of trading physical goods becomes burdensome. Transaction costs (in the modern lexicon) become large enough to cause the invention of money as a medium of exchange and all transactions now become more efficient.

The above is familiar enough and noncontentious. Before moving to the evaluation of Say's position, let me digress a bit and relate Say's economic argument to the perhaps more important social (or political, or moral) argument found in Say's work.

Initially, there is an explicit defence of private (individualised) property (though some limitations to private ownership are specified).

Political economy views the right of property solely as the most powerful of all encouragements to the multiplication of wealth, and is satisfied with its actual stability, without inquiring about its origin or its safeguards . . . There are some truths so completely self-evident, that demonstration is quite superfluous. This is one of that number. Who will attempt to deny, that, the certainty of enjoying the fruits of one's land, capital and labour, is the most powerful inducement to render them productive? Or who is dull enough to doubt, that no one knows so well as the proprietor how to make the best use of his property (Say 1803 [1827]: 71-2)?

In modern terms, since costs and benefits are internalised in such propertied arrangements, the property-holder is able to undertake a rational calculation of marginal benefits and costs in determining the optimal output to produce: 'The desirability of having an operable cost-benefit confrontation, especially one that is consistent with a goal that many value highly - individual freedom - argues strongly for *prima facie* solution based on private property rights. . . ' (Denseitz 1982: 46).

Indeed, in his *Letters*, Say frames the argument in a quite modern fashion: 'You remark in many places, that man is naturally indolent . . . Indeed you are right; nor do I hold a different opinion when I say that the utility of productions is no longer worth the productive services at the price one is obliged to pay for them' (1821 [1936]: 46-7).

Private property, then, promotes the work ethic. Because one is dependent for income (in real goods terms) on one's productive effort, to gain more income requires expending more effort. Indolence is punished in the form of less income. In commenting (erroneously) on the behaviour of native Americans, for example, Say assumes that people are naturally lazy unless prodded to improve their lot through appropriate propertied arrangements (Ibid.: 46).

Third, a propertied economy will generate social harmony:

The rest of this doctrine is not less useful, in as much as it shows us that capital and land are not productive, unless they become property sacred to the proprietors. That even the poor themselves are interested in defending the property of the rich, and consequently in the maintenance of good order; because a subversion, which never could do more than give them a fleeting prey, would take away from him a constant income (Ibid.: 55-6).

In Rogin's evaluation, the essential point of the *Traité* was to argue the case for both economic and social harmony among both individuals and social classes (Rogin, 1956: 214-16, *passim*).

All of the above (and more) is consistent with a larger vision developed by Say as a consequence of his intimate relationship with the French

revolutionary process and its vicissitudes. This vision was developed prior to the formation of his economic theory, but it was certainly informed by that theory and increasingly made consistent with that theory.

Say associated himself with the Girondist faction in the revolution, the party that best articulated the ideals of modern (big state) republicanism (Whitmore 2000: xii, *passim*, on this point and for what follows). Moving beyond (or in contradiction to) the small-state republicanism of the enlightenment theorists - Rousseau, Montesquieu, Voltaire, et al. - the ideal promoted was a republic . . . without hierarchical ranks, where forms of commerce were compatible with republican virtues and where moderate wealth was the norm . . . The culture (ostensibly) consistent with the above was one of ' . . . industriousness, frugality, courage and moderation' (Ibid.).

Say's law and what follows from that principle are inextricably bound up with this view of the ideal state. Small property is necessary to promote a rough equality, independence and hard work. In *Office*, Say's (1798 essay on what constitutes a morally sound nation, he specifically attacks the 'vices' of luxury, poverty and idleness. For Say, both the rich and the poor were cast in the same mould of idleness (though obviously for different reasons) (Ibid.: 126). Say was essentially a rough egalitarian within the framework of propertied economic arrangements: an overriding concern of his was the avoidance of extreme income inequality.

More important, such a propertied arrangement would lead to a 'virtuous' society in which 'true' or 'enlightened' self-interests (again, based on property) would coincide with the public interest - a harmonious society (Ibid.: 143-5). As well, commerce, rather than a corrupting force as in Rousseau, was shown to be consistent with virtue and the interests of the many. As the medium through which the trade of goods of equal value was facilitated, commercial activity promoted economic well-being for all. And, as merchants had to be viewed as trustworthy in order to succeed in their activities, honesty and integrity - characteristics of the virtuous republic - were thus elevated over dishonesty and improbity. (It should be noted that Say distinguished commercial activity within a republic from commercial societies such as Venice, because reliance on commerce rather than industry (work) promoted dangerous 'manners' leading to luxury and idleness (Ibid.: 126).

Lastly, while there is little room for government intervention in the economy (see the *Traité*, pp. 75-148, for Say's position on the wasteful consequences of government actions, the corruption of republican virtues, etc.), there is a large scope for such intervention in society. While Say argued that a properly functioning economy would be developed on the basis

of a spontaneous order – a natural order in the marketplace – he did not hold the same position with regard to society: individual interests do not necessarily lead to good, republican society. People may not be aware of their 'true' interests, those consistent with republican virtue and the contractual basis of society. The 'enlightened' legislator, in addition to developing and preserving appropriate property relations and rights, is to be responsible for educating the 'ignorant' sections of the population through a broadly defined educational program, including both rewards and punishment – a 'civil code' would coerce proper behaviour in those cases where education proves ineffective. In other words, the role of government is to shape the social order to permit the economic order to fulfil its republican economic objectives (Forget, 2001).

Students of American economic and political thought will recognise that Say's program is very similar to that of Thomas Jefferson's vision of an agrarian democracy as the preferred society of the United States. In fact, Jefferson read Say, preferring his work to that of Adam Smith (Hofstadter 1941: 396). This is not to argue that Jefferson was directly influenced by Say; he had, after all, developed his ideas decades before Say wrote his *Treatise*. However, the main thrust of Jefferson's agenda, particularly in line with the notion of a virtuous republic, bears a striking resemblance to that of Say. From his *Notes on Virginia*:

Those who labour in the earth are the chosen people of God . . . It is the focus in which he keeps alive that sacred fire, which otherwise might escape from the face of the earth. Corruption of morals in the mass of cultivators is a phenomenon of which no age nor nation has furnished an example. It is the mark set on those, who, not looking up to heaven, to their own soil and industry, as does the husbandman, for their subsistence, depend for it on casuaries and caprices of customers. Dependence begets subservience and venality, suffocates the germ of virtue, and prepares fit tools for the designs of ambition . . . (T)he proportion which the aggregate of the other classes of citizens bears in any State to that of its husbandmen, is the proportion of its unsound to its healthy parts, and is a good enough barometer whereby to measure its degree of corruption (Jefferson, in Padover 1943: 678).

For Jefferson and Say, there was a distinct relationship between the organisation of the economy and the social health of the larger society. Both authorities saw an economy of small producers with (generally) inviolate individualised property rights as the frame on which would be built the virtuous society. The point that is important for this essay is that Say (like Jefferson and others) modelled an economy that would, at least so he thought, conform to a larger vision of a virtuous society. Say (as Jefferson) was a

utopian: virtue was specified; an economy with particular characteristics was then shown to conform to that specification. And this economy revolved around 'Say's Law'.

THE KEYNESIAN CRITICISM

Contrary to the standard interpretation, Keynes's main criticism of 'Say's Law' did not hinge on the logic of the argument. True, in *The General Theory* (and elsewhere) there is an argument against Say's aggregate supply-aggregate demand formulation, but this is not the essential point made by Keynes (and others). That point is this: Say's economy is *not* the economy he claims to be analysing, and it is *not* the economy that exists.

Say's economy is constructed on the basis of a society comprised of petty producers engaged in bartering products of different use values. The whole point of production is to gain use value in the form of goods produced by others. Money arises more or less spontaneously, simply as a medium to facilitate the more fundamental barter relationships. This foundation, and what follows from it, is the heart of conventional (neoclassical) economic theory, and periodically one finds an explicit statement to this effect:

Inconvenient as barter obviously is, it represents a great step forward from a state of self-sufficiency in which every man had to be a jack-of-all-trades and master of none . . . If we were to construct history along hypothetical, logical lines, we should naturally follow the age of barter by the age of commodity money. Historically, a great variety of commodities has served at one time or another as a medium of exchange . . . The age of commodity money gives way to the age of paper money . . . Finally, along with the age of paper money, there is the age of bank-money . . . (Samuelson 1973: 274-6).

The scenario that captures this view of the economy is $C - C'$, where C and C' represent commodities of different use values – iron and corn.⁴ When money is introduced, the formulation is modified to $C-M-C'$. No change in the fundamental relationship occurs; money simply facilitates the exchange (trading) process. Since the object of the economic process is production for consumption, no general overproduction is possible. As long as the use value contained in the product is deemed reasonable from a consumer's perspective, buyers will always be found, though relative prices may have to adjust to allow all output to eventually be exchanged. General overproduction is impossible.

However, in a monetary (or capitalist) economy, the proper formulation is $M-C-M'$ where the object of production is not the exchange for goods of different use values, but money. Essentially, the whole point of production is that the money at the end of the production-exchange process (M') is greater than that at the beginning of the process (M). Capitalists borrow to purchase inputs, which are used to produce output, which is sold to generate more money. Debts can then be cleared and the process repeated. Says Keynes:

I define a *barter* economy as one in which the factors of production are rewarded by dividing up in agreed proportions the actual output of their co-operative efforts Since this economy does not exclude the use of money for purposes of transitory convenience, it might perhaps be better to call it a *real-wage*, or a *co-operative economy* as distinct from an *entrepreneur economy*. In a barter . . . economy only miscalculation or stupid obstinacy can stand in the way of production, if the value of the expected real product exceeds the real costs. But in a monetary . . . economy this is not so—the volume of output which will yield the maximum value of product in excess of real costs may be 'unprofitable'

The distinction between a co-operative economy and an entrepreneur economy bears some relation to a pregnant observation made by Karl Marx He pointed out that the nature of production in the actual world is not, as economists seem often to suppose, a case of $C-M-C'$ That may be the standpoint of the private consumer. But it is not the attitude of *business*, which is a case of $M-C-M'$, i.e. of parting with money for commodity in order to obtain more money. This is important for the following reason.

The classical theory supposes that the readiness of the entrepreneur to start up a productive enterprise depends on the amount of value in terms of product which he expects to fall to his share, i.e. that only an expectation of more product for himself will induce him to offer more employment. But in an entrepreneur economy this is a wrong analysis of the nature of business calculation. An entrepreneur is interested . . . in the amount of *money* which will fall to his share. He will increase his output if by so doing he expects to increase his money profit, even though this profit represents a smaller quantity of product than before

It is these fundamental divergences at the outset which make it impracticable to start with the classical theory and then, at an advanced stage of the argument, to adapt its conclusions to the vagaries of an Entrepreneur Economy (Keynes, 1933 [1979], 66-7, 81-3; emphasis in original).

In a monetary economy, the objective of the economic process is *not* the production of products (use values) as in Say. Rather, it is the production of profit. This requires the exchange of commodities so that the potential income contained in the product can be realised in money form. The economic process starts with debt (money) advanced to labour and the owners of purchased machinery, etc., prior to the creation of output. Use values are then created, but these are useless in themselves to capitalists (or entrepreneurs, in Keynes' terms). Use values must first be converted into money so that debts

can be cleared; they can then be used to satisfy the physical requirements of consumption and further production (capital goods). In a very perceptive analysis of *The General Theory*, Dudley Dillard observed: 'Real goods appear to the individual producer as an artificial form of wealth until they are converted into money which appears as real wealth to the individual producer.' For the community, however, goods are real wealth and money is artificial (Dillard 1954, 28-9).

But the above relationship poses a fundamental problem. In order to survive, propertyless workers must have access to goods and services provided by the owners of capital assets. These owners, of course, require the work effort of labour if output is to be produced. However, the owners of assets may not permit workers to use these assets if the owners are uncertain as to whether they can sell output profitably at some point in the future. In other words, uncertainty, time, and judgement are all linked to money, and money, then, is the linchpin around which the possibility of 'guts' revolves.

For Keynes, money is not a medium of exchange (though it may serve that purpose); it is debt:

A money of account comes into existence along with debts, which are contracts for deferred payment, and price lists, which are offers of contracts for sale of purchase. Such debts and price lists . . . can only be expressed in terms of a money of account.

Money itself, namely that by delivery of which debt contract and price contracts are discharged . . . derives its character from its relationship to the money of account, since the debts and prices must first have been expressed in terms of the latter . . . Money proper . . . can only exist in relation to a money of account (Keynes 1930 [1971], 3; emphasis in original).

Consequently, Keynes' argument takes us into a world of historical time and fundamental (non-probabilistic) uncertainty:

Why would anyone outside a insane asylum wish to use money as a store of wealth? Because, partly on reasonable and partly on instinctive grounds, our desire to hold money as a store of wealth is a barometer of the degree of our distrust of our own calculations and conventions concerning the future (Keynes 1937 [1973], Part II, 115-6).

(*The importance of money essentially flows from its being a link between the present and the future* (Keynes 1936 [1973], 293; emphasis in original).

Since the future cannot be known, one cannot rationally undertake a calculation in the present on the basis of unknowable future relative prices. The property owner must part with liquidity now in order to produce goods that are to be sold tomorrow if the owner is to survive as a capitalist. Hence,

in a monetary economy, 'animal spirits' – what one believes the future holds – are of overwhelming importance in making decisions as to the level of investment, production, etc. And, if animal spirits are dim, production falters and propertyless workers find themselves short of the products they require for survival.

In a Keynesian economy, then – unlike Say's economy – money cannot be neutral: money does affect output, and thus employment.

CONCLUSION

The ongoing theoretical debate between followers of Say and those of Keynes is not founded on technical issues surrounding aggregate supply and demand, self-adjusting equilibrating processes through markets, and so on. These issues may be what the participants believe to be the points of contention. Such issues, however, cannot be understood outside of the contexts of the quite different economies that form the foundation from which the technical arguments follow. Say's economy is necessarily one of a hypothetical nature where individualised property owners produce output to trade for goods containing use values appropriate to their requirements. It is a 'peasant,' barter economy where money is introduced as a means of exchange only after the fundamental exchange relationships have been established. One does not need money to determine equilibrium relative prices, etc.; money is a convenience only. In such an economy, 'products' can never be overproduced; producers will always consume so that supply creates its own demand.

Further, Say's hypothetical economy is contained within a larger vision of a virtuous society, defined as one where the various attributes of virtue (hard work, etc.) are predicated upon and consistent with individualized property. And this idealised vision of society preceded the development of Say's economic theory: Say's economy was moulded to satisfy the more important requirements of what he considered to be the ideal forms of social organisation and behaviour.

Keynes' economy, on the other hand, is consistent with a monetary economy in which workers are separated from the means of production, where debt is a necessary aspect of the production process, and where decisions to try to preserve the monetary value of capital assets may create a condition of insufficient aggregate demand and result in depression as a normal feature of the economy. For Say, government intervention in the economy would cause disruption of an otherwise smoothly functioning, full-

employment system. For Keynes, such intervention was necessary to compensate for the innate deficiencies of a monetary economy. This conclusion was not the result of hypothesising a particular economic organisation to generate pre-determined objectives, but the outcome of an examination of a monetary economy as it actually was.

NOTES

1. Though Mill comes close to this specific statement at several points, nowhere can I find these precise words. See Mill's *Elements of Political Economy*, Chap. 4, Section II. Sowell concurs, stating, "(e)ven the familiar assertion that 'supply creates its own demand' is not a direct quotation from any of them (in reference to Say, Ricardo, and Mill). Sowell 1972: 12.
2. I am not arguing here that Say's hypothetical peasant economy is a good representation of actual economies where such forms of production are significant. On real 'peasant' economies, see Hoppe and Langton, 1994. In fact, there are marked economic and social differences between the hypothetical and the real peasant economies.
3. It should be noted that Say does allow for a modicum of government activity in the economic order proper. Government should assist in the diffusion of machinery, ease the disruption to workers caused by technological employment, promote industrial experimentation and the like. No such activity, however, should interfere with the workings of the market.
4. Technically, it is not commodities that are traded but products. The technical distinction between products and commodities is found in Marx when he contrasts the *trade of use values with the exchange of commodities*. For Say, and neoclassical economists in general, trade and exchange are conflated so that all trade is exchange. I don't want to pursue this point here, but see Marx, N.D. [1867]: 43 ff., *passim*. Also, Polanyi 1957 [1971], is very clear on this issue.

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12. Nudge Nudge, Wink Wink, Say No More

Steve Keen

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 HBS 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)