Question 3

3. An economic advisor believes in Say's Law. Which of the following statements is the advisor most likely to make?

- A. "The equilibrium output of an economy will usually not be the one associated with full employment."
- B. "Capitalist economies often experience economic instability."
- C. "An economy can easily return to full employment without the involvement of the government."
- D. "Without government intervention, economies will experience frequent periods of unemployment and inflation."

Say's law

Say's law - Wikipedia, the free encyclopedia
http://en.wikipedia.org/wiki/Say%27s_Law

Say's Law

Modern Interpretations: cyclical unemployment \neq 0

A modern way of expressing Say's Law is that there can never be a general glut.[1] Instead of there being an excess supply (glut or surplus) of goods in general, there may be an excess supply of one or more goods, but only when balanced by an excess demand (shortage) of yet other goods. Thus, there may be a glut of labor ("cyclical" unemployment), but that is balanced by an excess demand for produced goods. Modern advocates of Say's Law see market forces as working quickly -- via price adjustment -- to abolish both gluts and shortages. The exception would be the case where the government or other non-market forces prevent price changes.

The implication of Say's "law" is that a free-market economy is always at what the Keynesian economists call full employment. Thus, Say's Law is part of the general world-view of laissez-faire economics, i.e., that free markets can solve the economy's problems automatically (here the problems are recessions, stagnation, and involuntary unemployment). There is no need for any intervention by the government or the central bank (such as the U.S. Federal Reserve) to help the economy attain full employment. In fact, proponents of Say's law argue that such intervention is always counterproductive. Consider Keynesian-type policies aimed at stimulating the economy. Increased government purchases of goods (or lowered taxes) merely "crowds out" the private sector's production and purchase of goods: Say's Law means that the total level of output is constant, so that any increase in government purchases implies that there are fewer goods available for private consumption and investment. Increasing the money supply merely causes inflation,
THE GENERAL THEORY OF EMPLOYMENT INTEREST AND MONEY

by JOHN MAYNARD KEYNES

PUBLISHED BY THE COLLEGE, CAMBRIDGE

CHAPTER 1:
The General Theory

I have called this book the General Theory of Employment, Interest and Money, placing the emphasis on the prefix "general." The object of such a title is to contrast the character of my arguments and conclusions with those of the classical theory of the subject, upon which I was brought up and which dominates the economic thought, both practical and theoretical, of the governing and academic classes of this generation, as it has for a hundred years past. I shall argue that the postulates of the classical theory are applicable to a special case only and not to the general case, the situation which it assumes being a limiting point of the possible positions of equilibrium. Moreover, the characteristics of the special case assumed by the classical theory happen not to be those of the economic society in which we actually live, with the result that its teaching is misleading and disastrous if we attempt to apply it to the facts of experience.

3 "The classical economist" was a name invented by Marx to cover Ricardo and James Mill and their predecessors, that is to say, for the founders of the theory which culminated in the Ricardian economics. I have become accustomed, perhaps perpetuating a solipsism, to include in "the classical school" the followers of Ricardo, those, that is to say, who adopted and perfected the theory of the Ricardian economics, including (for example) J. S. Mill, Marshall, Edgeworth and Prof. Pigou.
Issues and Answers from the Masterworks 6.2

Is it possible for an economy to experience a general commodity glut as a consequence of producing goods for which no market can be found? Are the resulting gluts substantially worsened when commodities are imported from abroad?

J. B. Say’s answer

From A Treatise on Political Economy, Chapter 15.

Of the demand or market for products

It is common to hear adventurers in the different channels of industry assert that their difficulty lies not in the production, but in the disposal of commodities; that products would always be abundant, if there were but a ready demand, or market for them. When the demand for their commodities is slow, difficult, and productive of little advantage, they pronounce money to be scarce; the grand object of their desire is, a consumption great enough to quicken sales and keep up prices. But ask them what peculiar causes and circumstances facilitate the demand for their products, and you will soon perceive that most of them have extremely vague notions of these matters; that their observation of facts is imperfect, and their explanation still more so; that they treat doubtful points as matter of certainty, often pray for what is directly opposite to their interests, and inopportune solicits from authority a protection of the most mischievous tendency.

To enable us to form clear and correct practical notions in regard to markets for the products of industry, we must carefully analyze the best established and most certain facts, and apply to them the inferences we have already deduced from a similar way of proceeding; and thus perhaps we may arrive at new and important truths, that may serve to enlighten the views of the agents of industry, and to give confidence to the measures of governments anxious to afford them encouragement.

A man who applies his labour to the investing of objects with value by the creation of utility of some sort, can not expect such a value to be appreciated and paid for, unless where other men have the means of purchasing it. Now, of what do these means consist? Of other values of other products, likewise the fruits of industry, capital, and land. Which leads us to a conclusion that may at first sight appear paradoxical, namely, that it is production which opens a demand for products.

Thus, to say that sales are dull, owing to the scarcity of money, is to mistake the means for the cause; an error that proceeds from the circumstance, that almost all produce is in the first instance exchanged for money, before it is ultimately converted into other produce and the commodity, which recurs so repeatedly in use, appears to vulgar apprehensions the most important of commodities, and the end and object of all transactions, whereas it is only the medium. Sales cannot be said to be dull because money is scarce, but because other products are. There is always money enough to conduct the circulation and mutual interchange of other values, when those values really exist. Should the increase of traffic require money to facilitate it, the want is easily supplied, and is a strong indication of prosperity - a proof that a great abundance of values has been created, which it is wished to exchange for other values. In such cases, merchants know well enough how to find substitutes for the product serving as the medium of exchange or money; and money itself soon pours in, for this reason, that all produce naturally gravitates to that place where it is most in demand. It is a good sign when the business is too great for the money; just in the same way as it is a good sign when the goods are too plentiful for the warehouses.

When a superabundance of articles can find no market, the scarcity of money has so little to do with the obstruction of its sale, that the sellers would gladly receive its value in goods for their own consumption at the current price of the day; they would not ask for money, or have any occasion for that product, since the only use they could make of it would be to convert it forthwith into articles of their own consumption.

This observation is applicable to all cases, where there is a supply of commodities or services in the market. They will universally find the most extensive demand in those places, where the most of values are produced; because in no other places are the sole means of purchase created, that is, values. Money performs but a momentary function in this double exchange, and when the transaction is finally closed, it will always be found, that one kind of commodity has been exchanged for another.

It is worth while to remark, that a product is no sooner created, than it, from that instant, affords a market for other products to the full extent of its own value. When the producer has put the finishing hand to his product, he is most anxious to sell it immediately, lest its value should diminish in his hands. Nor is he less anxious to dispose of the money he may get for it; for the value of money is also perishable. But the only way of getting rid of money is in the purchase of some other product or another; thus, the mere circumstance of the creation of one product immediately opens a market for other products... One kind of production would seldom outstrip every other, and its products be disproportionately cheapened, were production left entirely free.

The position of a nation, in respect of its neighbours, is analogous to the relation of one of its provinces to the others, or of the country to the town; it has an interest in its prosperity, being sure to profit by its opulence. The government of the United States, therefore, acted most wisely in their attempts, about the year 1795, to civilize their savage neighbours, the Creek Indians. The design was to introduce habits of industry amongst them, and make them producers and carriers capable of carrying on a brisker trade with the States of the Union; for there is nothing to be got by dealing with people who have nothing to pay. It is useful and honourable to mankind, that one nation among so many, should conduct itself uniformly upon liberal principles. The most obvious results of the enlightened policy will be demonstrated, that the systems and theories really destructive and fallacious, are the exclusive and jealous maxims acted upon by the old European governments, and by them most impossibly styled practical truths; for no other reason, as it would seem, than because they have the misfortune to put them in practice. The United States shall have the honour of proving experimentally, that true policy goes hand-in-hand with moderation and humanity.

From this principle, we may draw this further conclusion, that it is no injury to the internal or national industry, and production to buy and import commodities from abroad; for nothing can be bought from strangers, except with native products, which find a vent in this external traffic. Should it be objected, that this foreign produce may have been bought with specie, I answer, specie is not always a native product, but must have been bought itself with the products of native industry; so that, whether the foreign articles be paid for in specie or in home products, the vent for national industry is the same in both cases.