Say’s Law of Market

Say's law of markets is the core of the classical theory of employment. An early 19th century French Economist, J.B. Say, enunciated the proposition that "supply creates its own demand." Therefore, there cannot be general overproduction and the problem of unemployment in the economy. On the other hand, if there is general overproduction in the economy, then some labourers may be asked to leave their jobs. There may be the problem of unemployment in the economy for sometime. In the long-run, the economy will automatically tend toward full employment. In Say's words, "It is production which creates markets for goods. 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. Nothing is more favourable to the demand of one product, than the supply of another."This definition explains the following important facts about the law.

Production Creates Market (Demand) for Goods:When producers obtain the various inputs to be used in the production process, they generate the necessay income. For example, producers give wages to labourers for producing goods. The labourers will purchase the goods from the market for their own use. This, in turn, causes the demand for goods produced. In this way, supply creates its own demand.

Barter System as its Basis: In its original form, the law is applicable to a barter economy where goods are ultimately sold for goods. Therefore, whatever is produced is ultimately consumed in the economy. In other words, people produce goods for their own use to sustain their consumption levels. Say's law, in a very broad way, is, as Prof. Hansen has said, "a description of a free-exchange economy. So conceived, it illuminates the truth that the main source of demand is the flow of factor income generated from the process of production itself. Thus, the existence of money does not alter the basic law.

General Overproduction Impossible: If the production process is continued under normal conditions, then there will be no difficulty for the producers to sell their products in the market. According to Say, work being unpleasant, no person will work to make a product unless he wants to exchange it for some other product which he desires. Therefore, the very act of supplying goods implies a demand for them. In such a situation, there cannot be general overproduction because supply of goods will not exceed demand as a whole. But a particular good may be over produced because the producer incorrectly estimates the quantity of the product which others want. But this is a temporary phenomenon, for the excess production of a particular product can be corrected in time by reducing its production. J.S. Mill supported Say's views regarding the impossibility of general overproduction and general unemployment. According to him, Say's law of markets does not consider the possibility of general overproduction and also rejects the possibility of decrease in the demand of goods produced in the economy. By employing more factors of production, there is an increase in the level of employment and therefore profits are maximised.

Saving-Investment Equality:Income accruing to the factor owners in the form of rent, wages and interest is not spent on consumption but some proportion out of it is saved which is automatically invested for further production. Therefore, investment in production is a saving which helps to create demand for goods in the market. Further, saving-investment equality is maintained to avoid general overproduction.

Rate of Interest as a Determinant Factor : Say's law of markets regards the rate of interest as a determinant factor in maintaining the equality between saving and investment. If there is any divergence between the two, the equality is maintained through the mechanism of the rate of interest. If at any given time investment exceeds saving, the rate of interest will rise. To maintain the equality, saving will increase and investment will decline. This is due to the fact that saving is regarded as an increasing function of the interest rate, and investment as a decreasing function of the rate of interest. On the contrary, when saving is more than investment, the rate of interest falls, investment increases and saving declines till the two are equal at the new interest rate.

Labour Market: Prof. Pigou formulated Say's law in terms of labour market. By giving minimum wages to labourers, according to Pigou, more labourers can be employed. In this way, there will be more demand for labour. As pointed out by Pigou, "with perfectly free competition...there will always be at work a strong tendency for wage rates to be so related to demand that everybody is employed." Unemployment results from rigidity in the wage structure and interferences in the working of the free market economy. Direct interference comes in the form of minimum wage laws passed by the state. The trade unions may be demanding higher wages, more facilities and reduction in working hours. In short, it is only under free competition that the tendency of the economic system is to provide automatically full employment in the labour market.

Say's Propositions and Implications of Law

Say's propositions and its implications present the true picture of the market law. These are given below.

1. Full Employment in the Economy. The law is based on the proposition that there is full employment in the economy. Increase in production means more employment to the factors of production. Production continues to increase until the level of full employment is reached. Under such a situation, the level of production will be maximum.

2. Proper Utilization of Resources. If there is full employment in the economy, idle resources will be properly utilized which will further help to produce more and also generate more income.

3. Perfect Competition. Say's law of market is based on the proposition of perfect competition in labour and product markets. Other conditions of perfect competition are given below:

(a) Size of the Market. According to Say's law, the size of the market is large enough to create demand for goods. Moreover, the size of the market is also influenced by the forces of demand and supply of various inputs.

(b) Automatic Adjustment Mechanism. The law is based on this proposition that there is automatic and self-adjusting mechanism in different markets. Disequilibrium in any market is a temporary situation. For example, in capital market, the equality between saving and investment is maintained by the rate of interest while in the labour market the adjustment between demand and supply of labour is maintained by the wage rate.

(c) Role of Money as Neutral. The law is based on the proposition of a barter system where goods are exchanged for goods. But it is also assumed that the role of money is neutral. Money does not affect the production process.

4. Laissez-faire Policy. The law assumes a closed capitalist economy which follows the policy of laissez-faire. The policy of laissez-faire is essential for an automatic and self-adjusting process of full employment equilibrium.

5. Saving as a Social Virtue. All factor income is spent in buying goods which they help to produce. Whatever is saved is automatically invested for further production. In other words, saving is a social virtue.

Criticisim of Say's Law of Markets:

J.M. Keynes in his General Theory made a frontal attack on the classical postulates and Say's law of markets. He criticised Say's law of markets on the following grounds:

1. **Supply does not Create its Demand :** Say's law assumes that production creates market(demand) for goods. Therefore, supply creates its own demand. But this proposition is not applicable to modern economies where demand does not increase as much as production increases. It is also not possible to consume only those goods which are produced within the economy.

2. **Self-adjustment not Possible :**According to Say's law, full employment is maintained by an automatic and self-adjustment mechanism in the long run. But Keynes had no patience to wait for the long period for he believed that "In the long-run we are all dead." It is not the automatic adjustment process which removes unemployment. But unemployment can be removed by increase in the rate of investment.

3. **Money is not Neutral:** Say's law of markets is based on a barter system and ignores the role of money in the system. Say believes that money does not affect the economic activities of the markets. On the other hand, Keynes has given due importance to money. He regards money as a medium of exchange. Money is held for income and business motives. Individuals hold money for unforeseen contingencies while businessmen keep cash in reserve for future activities.

4. **Over Production is Possible:** Say's law is based on the proposition that supply creates its own demand and there cannot be general over-production. But Keynes does not agree with this proposition. According to him, all income accruing to factors of production is not spent but some fraction out of it is saved which is not automatically invested. Therefore, saving and investment are always not equal and it becomes the problem of overproduction and unemployment.

5. **Underemployment Situation:**Keynes regards full employment as a special case because there is underemployment in capitalist economies. This is because the capitalist economies do not function according to Say's law and supply always exceeds its demand. For example, millions of workers are prepared to work at the current wage rate, and even below it, but they do not find work.

6. **State Intervention :**Say's law is based on the existence of laissez-faire policy. But Keynes has highlighted the need for state intervention in the case of general overproduction and mass unemployment. Laissez-faire, infact, led to the Great Depression. Had the capitalist system been automatic and self-adjusting.

This would not have occurred. Keynes, therefore, advocated state intervention for adjusting supply and demand within the economy through fiscal and monetary measures.

7. **Equality through Income :**Keynes does not agree with the classical view that the equality between saving and investment is brought about through the mechanism of interest rate. But in reality, it is changes in income rather than the rate of interest which bring the two to equality.

8. **Wage-cut no Solution**: Pigou favoured the policy of wage-cut to solve the problem of unemployment. But Keynes opposed such a policy both from the theoretical and practical points of view. Theoretically, a wage-cut policy increases unemployment instead of removing it. Practically, workers are not prepared to accept a cut in money wage. Keynes, therefore, favoured a flexible monetary policy to a flexible wage policy to raise the level of employment in the economy.

9. **Demand Creates its own supply**: Say's law of market is based on the proposition that "supply creates its own demand". Therefore, there cannot be general overproduction and mass unemployment. Keynes has criticised this proposition and propounded the opposite view that demand creates its own supply. Unemployment results from the deficiency of effective demand because people do not spend the whole of their income on consumption.

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