**Say's Law and the Permanent Recession**
**Guest: Robert Blumen**
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***Robert Blumen is an independent enterprise software consultant based in San Francisco.***

*[start 00:01:19]*

**WOODS:** It's important for people to understand this stuff, especially because the average economist today, I think, thinks Say's Law was refuted by Keynes, so we have nothing more to learn from it. It was a primitive way of thinking, and now we're more sophisticated. But as usual, when people think that way it turns out they've misunderstood what they think is primitive, and it's their own thinking that turns out to be primitive. We want to talk about, first of all, Say's Law, and then we'll talk about what this has to do with us today. So let's begin with the problem that Say's Law was aiming to solve, and that was the alleged issue of the general glut. Tell us what a general glut is.

**BLUMEN:** Tom, the idea of a general glut is that the entire market for everything is in a state of surplus, where too much of every type of good was produced. For some reason the price system cannot work. Markets cannot clear. The economy gets stuck in this situation, which you might call a recession, where there are lots of goods that can't be sold, labor that can't be sold. The market is powerless to fix that.

**WOODS:** So Say's response is to explain that this is actually impossible. There can't be a general glut. There can't be general overproduction of the sort that—later on in the nineteenth century you would hear Marx accusing the capitalist economy of having this problem of general overproduction. Too much of everything is produced. Say denies that. How does he deny that?

**BLUMEN:** What you're talking about sounds a little bit like the general glut debate which took place between the British economists Thomas Malthus and David Ricardo some years after Say wrote his book but relying on Say's concepts from 50 years before. I think you could call Say the first macroeconomist. He had a theory of macroeconomic stability that was based on the microeconomics. What Say observed was that every good that is supplied to the market is done so in order to demand some other type of good. Most of us in the market today supply our labor in order to demand all the other things that we demand: coffee, books, cars, gasoline. Money is not the actual means of demand. Money is a parking place where you put the past goods that you produced and supplied until you decide what to demand. Fifty years after Say's book Ricardo and Malthus got into this great argument about the general glut. Ricardo said in general, supplies are all the goods supplied on the market, and demands are all the goods demanded on the market. They're the same thing. We inherently have macroeconomic stability, and we know that because of Say's Law.

**WOODS:** Let me explain that in a barter situation, so people see it clearly. When we're saying that you always have the stability what we mean is: imagine an economy without money, just for simplification purposes, and you produce potatoes, and somebody else produces scrambled eggs. When you produce your supply of potatoes your supply of potatoes is at the same time your demand for scrambled eggs. You

bring those potatoes to bear in the market to be able to demand scrambled eggs. So they are at once supply, because they're a supply of potatoes somebody else can eat. But they are also demand, the wherewithal with which you can demand the things that you want.

*[time 00:05:20]*

**BLUMEN:** That's exactly right, Tom. The barter situation makes it easier to see how Say's Law operates in every single exchange. But even when you introduce money, it is still operating in every exchange.

**WOODS:** Right. As you say, money is sort of just a pause in the process. I've provided some service or some good for somebody, I get money, and then the money allows me not to have to immediately exchange my goods or my services for some other good. I can wait around. I can shop around. I can decide what it is that I want. And in effect, when I go spend that money, the whole transaction is complete. I offered the market something, I was in effect rewarded for this, and then I can go and expend the means of that reward, namely the money, and get the things that I want. And the whole thing is completed. We see the demand and supply are, by the very nature of things, in balance.

**BLUMEN:** W.H. Hutt, another Austrian economist, generalized this a little bit more. He said money is a good which provides the service of being ready and available when you need to spend it on something, and that we demand it as a good in its own right. And that I think was an advance on Say's monetary theory, who sought it more as parking place and didn't really understand its role in the monetary price system.

**WOODS:** Right. It's important to understand this particular service that money provides, because otherwise, unfortunately even with Hutt's explanation, we still have this problem. But without this understanding, people are inclined to say that somebody who's sitting on a pile of money is simply hoarding. That this is some kind of antisocial thing. This is bad for the economy. But the person who is hoarding actually is gaining utility from the money held. The person is gaining the ability to decide in the future at the most opportune moment when he wants to make his transaction.

**BLUMEN:** Tom, that makes me think about the Keynesian misunderstanding of Say's Law, Keynes and this entire tradition which you alluded to of either overproduction or under consumption theories of which Malthus, Marx, and Keynes are all different examples. Keynes was primarily looking at expenditure. He thought the entire integrated market process was a matter of expenditure. It's your duty, Tom, to spend everything you make, because your spending is somebody else's income. So if you start hoarding, you deprive that poor fellow of income, and now how's he going to feed his family?

Keynes said that not spending is an antisocial behavior. He did not understand the true economic interdependence between us is not expenditure. It's production. So as long as you're producing and supplying then you are also demanding, and your demand creates an outlet for the supply of others who are also able to demand, and the whole system knits together. If one of the goods that you demand more of is money for whatever reason, that does not screw up the entire system. It may cause prices in terms of money to change to different levels, but markets keep clearing, and producing and supplying and demanding keep going on.

**WOODS:** It might be hard for people to see that, though, because I think we've so fallen into the Keynesian mindset that it's just an ongoing expenditure stream. And that's what the economy is. It's just a bunch of people buying things. There's always a prejudice in favor of and emphasis on the consumption side. I think that's fair to say. There is an emphasis on the consumption side in Keynes. I think it is hard for people to understand: if I'm hoarding money, why am I not screwing things up? Why am I not depriving that person of his income? And I suppose part of the reason, part of the explanation, is that when I am holding onto my money, typically I'm putting that money in some sort of financial instrument, or I'm putting it in a bank. Then the bank intermediates that money to some investor or some entrepreneur who's going to engage in some production project, and that production project winds up putting somebody to work, etc. It does that

incidentally in the process of production. We're not looking to create jobs in and of themselves. We're looking first to produce things that people want, and incidental to that is a job.

**BLUMEN:** I want to make a subtle distinction on your last point, Tom. As you point out, ownership of capital goods is a form of spending. If you choose to spend your money on either the direct ownership of a business or a farm, or indirectly through financial assets, which are claims on the assets of corporations, you are spending. That is distinct from holding cash, also known as hoarding, which is not spending, which you do because you either don't need to make those expenditures right now, or perhaps you expect that the prices of things that you would like to buy will be more favorable in the future. Or you plain just don't know where the best deals are, and you choose to sit on the sidelines and wait and see how prices line up going down the road.

*[time 00:10:54]*

**WOODS:** I think what you're describing is more faithful to what Hutt has in mind, right.

**BLUMEN:** Yes.

**WOODS:** Let's back up a minute, though, and talk about what we might call a partial glut, so the argument of Say is that there can't be general overproduction.

**BLUMEN:** Correct.

**WOODS:** Because everything you produce is the means by which you demand something. So there's no general overproduction. But there can be a partial overproduction. There can be a partial glut. There could be, let's say, unprofitably much salt produced. There could be unprofitably much something produced. So what's going on in that phenomenon? How did the classical economists deal with that? They did deny there was a general glut problem, but they could see that there were cases where in a particular industry, for some reason, it seemed as if there had indeed been too much produced. What do they mean by "too much produced," and how could they account for that, for the partial glut?

**BLUMEN:** It's undoubtedly the case, Tom, people make mistakes all the time. Someone opens a business, they find there's no market for the good that they were selling at the prices they need to charge to cover their costs. Maybe they go out of business. If I got laid off my job, then there would be a glut of my personal labor on the market. And that's just a natural part of the market economy, because there's no avoiding that people make mistakes. We don't have perfect foresight of the future. A lot of ideas sound good, and people carry them out and find them mistaken. It's also undoubtedly true you have something like a recession or a depression which means a lot of people made those mistakes all at once. It's producer error. That is something that requires an explanation, and we have a lot of theories over the history of economic thought about why that happens. So it was legitimate for Malthus and Ricardo to have an argument about what is the cause of that. Only it was not due to a general glut. It was due to a number of specific producer errors happening around the same time.

**WOODS:** Of course, when we start talking about "a number of producer errors happening around the same time," people who are familiar with the Austrian business cycle theory are going to feel their ears perking up, because that's going to sound awfully familiar to them. So let's hold off and get to that in just a second. But what somebody like Say would say, so to speak, when you have a situation like this where there's been too much of X produced, is that then there's been correspondingly too little of other things. The reason that we can't profitably sell our whole stock of some good is that consumers really don't want this good in that quantity. They would much rather we had devoted our resources to the production of something else that in effect we've deprived them of by using our capital goods in the production of too much of this one thing. So it's not that there's too much of everything. It's that producers produce too much of this and too little of that, and so what we need the price system to do in the wake of this mistake is to entice entrepreneurs to

reallocate resources so that things once again balance. Is it premature at this point, Robert, to start talking about how the Austrians would account for why we have these partial gluts or why there are imbalances in the economy from time to time? There's too much of this, too little of that, and it seems to be systemic?

**BLUMEN:** I think we could go into that now.

**WOODS:** Then be my guest.

**BLUMEN:** This came from Ludwig von Mises, the great Austrian economist. He was building on other facets of economic theory that had been developed up to this time. He identified the cause of these systematic groupings of producer errors in the banking system, Tom. He pointed out that fractional-reserve banks—and they're encouraged in this undertaking by central banks—are able to issue a greater volume of loans than the amount of savings that were deposited. This leads to a series of macroeconomic errors. It's a little bit involved to really understand exactly why, but to summarize it, I would say you have one set of preferences about current and future consumption that people express in terms of saving. If banks did not issue any more loans, then the amount of deposits, then the amount of credit would be in harmony with people's savings preferences. If banks are able to issue a great volume of credit, it looks to producers or to anyone who wants to borrow money as if there's more savings available than people have actually saved. And that availability of savings in dollar terms translates into the availability of real resources to do things with. So it's really that real resources are not available to do all the things that might be suggested by the money.

**WOODS:** So what we have happening, then, typically with a central bank—although it's not strictly necessary, but typically in the modern period, you have a central bank—is that the central bank injects credit into the banks through various ways. We've talked about this on this program. Bob Murphy has explained how it all works. This has the effect of lowering interest rates, but what would also have the effect of lowering interest rates is if you and I saved more. If you and I saved more, we're deferring purchases that would relatively shrink the consumer-goods industries, because you and I are deferring our purchases. And the shrinking of those industries releases resources that can be used for longer-term, more capital-intensive projects aimed at the production of goods in the future.

So when you and I save more, that lowers interest rates. That says to entrepreneurs there's a lot of stuff available. Go ahead and start your long-term projects. But when the central bank intervenes and makes interest rates fall, that seems like the same signal. That also seems like it's saying to entrepreneurs there's a lot of resources available. Go ahead and start your investment projects now. But the difference is in that case, we haven't deferred any purchases. We haven't restrained ourselves. We're not waiting for the future. We're expending right now, and so we have not released the resources necessary to complete all those new projects. That's the difference in what's going on.

When you gave a talk on this not too long ago—was it in San Francisco?

**BLUMEN:** It was at the first Austrian Economics Investment Conference held in Bahamas.

*[time 00:17:55]*

**WOODS:** Oh, even better. San Francisco's nice and everything, but well, good for you. The title of your talk, though, was "Say's Law and the Permanent Recession." That is a provocative title. Tell us what you mean about the "permanent recession," and what it has to do with Say's Law.

**BLUMEN:** This idea grew out of some reading I've done of your book *Meltdown*, *America's Great Depression*, and observing what's going on in America today. The Great Depression came about because, initially, they had one of these downturns that was due to a grouping of producer errors like we've just been talking about. The economy began to recover. Then you got Hoover and Roosevelt with their price

controls trying to turn the economy into a planned economy. They got in the way of recovery, because recovery is something that requires a price system to function. It requires corrections in production, where these resources that were used for one thing turned out to be a mistake. Entrepreneurs need to look at what are all the resources that are now available. What can we produce at a profit via the idle resources? Take over the bankrupt companies. Come up with a better system of production with more accurate prices, and that's what the recovery is. That's why the recovery didn't happen in the 1930s, and we had a very long period of the economy stuck in a glut situation. I also observed that more or less the same things are happening today, and that is why we have not had any real growth in the economy since the last series of recessions started around 2000.

**WOODS:** So what gives rise to the whole problem to start with, really, is a refusal to let prices do their jobs, and then this gets you into trouble. You wind up with a recession, and they still won't let prices do their jobs. The price system is trying to say: you made a lot of mistakes during this recession. You invested in things you shouldn't have. People spent too much in consumption, because they thought they were wealthier than they really were, because they had artificially inflated stock portfolios. So we've got to figure out what's sound, what's unsound. We've got to adjust prices in light of these new conditions.

And we never want to take this medicine. We always want to tinker with prices. For example, in the most recent crisis, housing prices obviously needed to fall. Yet the very people in government who've been telling us that they want more than anything to see affordable housing were terrified when the prospect of affordable housing finally presented itself. Housing prices were falling, and they treated it like the return of Godzilla.

Now what can also delay a recovery, and you talked about this in your talk, is not just fiddling with prices, but also when government, and the intentions of government, are unclear and murky about what it is they're going to be demanding of the private sector in the future, how securely private property rights will be respected, and how widely private decision-making as opposed to government decision-making will be considered definitive in the marketplace. This all amounts to a phenomenon described by Robert Higgs that I hope you might be able to explain to us.

**BLUMEN:** Robert Higgs is a U.S. economic historian. He coined the term "regime uncertainty." Higgs's point was if you're an entrepreneur and you're thinking about making a significant investment, something like a factory, a mine, developing a new product that will take years of research, you're only going to do that if you expect to get a profit some years down the road. In some cases, a factory might have a lifetime of decades. If you find that legal, tax, political situation is so uncertain that you can't have any confidence in your property rights or being able to get income back from your investment down the road, that is going to affect your willingness to invest.

Higgs applied this to an understanding of the Great Depression, which I think is very original. He pointed out that the New Dealers had an ideology that was very anti-free market. They preferred the socialistic or fascistic economic system of organization. Owners of capital were very rationally afraid that their industry would be nationalized or that tax rates would be raised to some punitive level, and they simply stopped investing and sat on cash. You can see in the capital investment trends during the Great Depression that capital investment collapsed. And as you pointed out a few minutes ago, Tom, it's that capital investment which creates jobs and raises real wages, so that was a big contributing factor to the problems in the labor markets.

*[time 00:23:06]*

**WOODS:** Today if you had to pick out three factors at random that might be contributing to regime uncertainty what would they be? Obamacare's got to be up there, right? Every day we're hearing there are delays. You don't even know what the rules are, when they're going to be applied. And by the way, this is a

tangent, but I figured I wouldn't be affected by Obamacare at all, because we didn't have a bare-bones policy. I got a letter in the mail saying that actually we have to get a whole new policy. We had a group policy connected to one of my businesses, and the old rule was that you can get a group policy if you have a business. It doesn't matter how many employees you have. But I don't have enough employees to qualify as a group policy anymore. Now I've got to apply for an individual policy. [TW note: This ruling has changed yet again; I am now told I can keep my current policy until 2016.]

That's not the end of the world, I suppose, but that's incredibly annoying. And I realize that's not going to stop me from investing in this or that. But I just had to get off my chest that I can't believe even I am being influenced by Obamacare when I did all the right things. There's no reason for that to happen. But what other sorts of things? Because I know that there are people out there who are skeptical of the regime uncertainty explanation. They say oh, come on, what's one government program really going to do in holding investors back? But it's more than that, isn't it?

**BLUMEN:** It's the combination of things, both price controls and regime uncertainty as a whole. I remember an interview on EconTalk with the libertarian legal scholar Richard Epstein. His thesis was that the U.S. economy had passed a tipping point. People say we had the Affordable Care Act, but every president in the last five decades has had some kind of act that increased the regulatory burden. The economy shook it off. Epstein said we passed the tipping point where the primary activity in America is now compliance rather than production. And as we know from Say's Law that production is the start of everything, when you stop producing, then, you can't consume, and you can't spend.

It's tough, Tom, to limit myself to three. I'm going to leave Obamacare off the table, because you got that one for me. I'm going to go with capital market price floors that prevent the markets of securities and corporate assets from clearing, uncertainty created by the impending defaults of nearly every kind of pension system in existence and how the burden of that default will be apportioned whether through taxation or cutting benefits, and labor market price controls like minimum-wage laws. I'm going to go with those three.

**WOODS:** I've got Scott Beaulier, who's a professor of economics at Troy University, coming on this program probably sometime next week precisely to talk about the severity of the public pension issue, which is just beyond imagining in some cases. In Illinois, for example, for them to make good on all those promises, if they were to start trying right now, they'd pretty much have to take their already outrageous taxes and increase them another 50 percent. That can't be done. So you're right: we have to sit here wondering what's going to be done when in a lot of these states it's unclear constitutionally that you can default on these sorts of payments or cut them back. So now it's really, really murky to figure out exactly what's coming in the future.

Robert, it's not good news, but what you've told us today has helped us to understand at least the phenomenon, the microeconomic phenomenon behind what we're observing and why it's all happening. That is an ingredient. That is important for us to know moving forward, so I appreciate your time today.

*[end of interview 00:27:03]*