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KEYNES, MILL, AND SAY'S LAW: A COMMENT ON ROY GRIEVE'S MISTAKEN CRITICISMS OF MILL

BY

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Employing different meanings of classical concepts of saving, capital, investment, and money, and incorrectly attributing the assumption of full employment of labor and a world of certainty to classical analysis, John Maynard Keynes ([1936] 1974) faulted Say's Law as irrelevant to the real world. Roy Grieve (2016) ignores previous clarifications of Keynes's misrepresentations and misunderstandings of John Stuart Mill's restatements of the law. He employs similar misrepresentations and misunderstandings of Mill's explanations as Keynes did. His model of Mill's analysis is incapable of explaining how variations in relative prices, the value of money, and interest rates coordinate production, consumption, and savings decisions in a monetary economy.

I. INTRODUCTION

Say's Law explains the coordination of markets for produced goods and services (not labor) by variations in relative prices, the value of money, and interest rates in a monetary economy. The explanation is founded upon the classics' belief in the self-interested pursuits of producers and consumers, such that fiscal activism—increased government spending financed by taxes—to promote "aggregate demand" is redundant; see John Stuart Mill ([1874] 1968, pp. 47–50). The law applies in times of normal economic conditions and in commercial or economic crises, as Mill's elaborations make clear. However, it is nearly impossible to appreciate the explanation when employing John Maynard Keynes's ([1936] 1974) conceptions of saving, capital, investment, and money, as well as attributing to the law the assumptions of always full employment of labor, instantaneous or automatic adjustment in all markets, and entrepreneurs' certainty of expectations about the future. Roy Grieve's (2016) criticisms of Mill's restatements of the law employ similar misrepresentations and misunderstandings of Mill as Keynes did.

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Grieve also appears not to have understood Mill's elaborate explanation of the error in "the belief that a great demand, a brisk circulation, a rapid consumption (three equivalent expressions), are a cause of national prosperity" ([1874] 1968, p. 50) rather than increased savings to promote investment. My comment elaborates.

II. GRIEVE'S MISREPRESENTATIONS OF MILL

Grieve's most fundamental misrepresentation of Mill's restatement of the law of markets is his claim that Mill envisaged investment as the purchase of wage goods only: "Investment is in fact quite typically envisaged [by Mill] as involving simply the purchase of wage goods to maintain labor, rather than the acquisition of durable capital goods" (Grieve 2016, p. 336). Grieve derives this claim from Mill's employment of a "most extreme case conceivable" (Mill 1965, 2, p. 67) to illustrate the effect of capitalists and landlords increasing their savings or turning "their income into capital." But Mill did not, by that hypothetical case, argue that investment typically takes the form of purchasing only wage goods.

Indeed, in the preceding paragraph, Mill mentions multiple factors of production, besides labor: "I do not mean to deny that the [increased] capital, or part of it, may be so employed as *not* to support labourers, being fixed in machinery, buildings, improvement of land, and the like" (1965, 2, p. 66; my italics). Rather, Mill follows the classical tradition of defining investment as the employment of savings or borrowed funds in the sphere of production, taking the form of "fixed" and "circulating" capital; see, for example, Mill (1965, bk 1, 2, ch. 6); and Mill ([1874] 1968, pp. 90–100). A subset of circulating capital constitutes the wages fund, but a "large portion of the capital … consists in instruments of production of a more or less permanent character" (1965, 2, p. 92). Mill (p. 56) also explains, "It is of no consequence that a part, or even the whole of [invested capital], is in a form in which it cannot directly supply the wants of labourers"—that is, wage goods. Yet, Grieve misrepresents Mill to have argued that "wage-goods represent all the producers' goods required to support labor in employment" (Grieve 2016, p. 339).

Mill's (1965, 2, p. 66) statement contradicts the Keynesian claim, repeated by Grieve (2016, pp. 333n7, 334), that Say's Law implies the existence always of full employment of labor in a non-crisis state of the economy. But the law does not apply to labor services; and the labor-output coefficient does vary, depending particularly upon the relative cost of hiring labor, compared with that of machinery. Furthermore, "all increase of fixed capital, when taking place at the expense of circulating, must be, at least temporarily, prejudicial to the interest of the labourers" (Mill 1965, 2, pp. 93–94)—their being "thrown out of employment" (p. 96). Mill (ibid., p. 356) also explains the existence of unemployment due to minimum wage legislation; besides, not even capital is always fully employed ([1874] 1968, p. 55).

Grieve's representation of Mill's economy does not include the value of money being determined by its supply and demand, commodity prices being determined by their supply and demand, or interest rates being determined by the supply and demand for savings or capital. Thus, Grieve is unable to conclude that a reduction in demand for luxuries by capitalists and landlords would reduce their prices, reduce their profitability, and cause a reduction of their production. He also could not anticipate that the

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increased relative profitability of wage-goods production would motivate their increased production. Instead, Grieve wonders, "Why should it be supposed that labor released from luxury production will *automatically* be redeployed to the production of wage goods?" (2016, p. 339; italics original). He misses numerous explanations by Mill that it is the expectation of profits that motivates production, including, "Nobody willingly produces in the prospect [expectation] of loss. Whoever does so, does it under a miscalculation, which he corrects as fast as he is able" (Mill 1965, 3, p. 471; see also 2, p. 338). Note that Mill does not say "corrects immediately."

Grieve rather dismisses as "beside the point" Mill's having made "much of the workers' readiness to spend" (2016, p. 340) out of their incomes. But Mill's confidence in the workers' readiness to spend derives from the basic fact that to spend their incomes is the reason people seek employment or produce: "[C]onsumption never needs encouragement. … The person who saves his income is no less a consumer than he who spends it: he consumes it in a different way; it supplies food and clothing to be consumed, tools and materials to be used, by productive labourers. … To produce, implies that the producer desires to consume; why else should he give himself useless labour?" (Mill [1874] 1968, pp. 48–49).[1]

Mill explains that wages are paid to labor, equipment is purchased or rented, landlords receive rents, and materials producers are paid. Besides, the savers from whom capital is borrowed are paid interest, while producers earn profits. All these incomes are spent either for immediate enjoyment (including the liquidity services of money) or lent at interest for future enjoyment: "A part of the motive for saving consists in the prospect of deriving an income from savings; in the fact that capital, employed in production, is capable of not only reproducing itself but yielding an increase" (Mill 1965, 2, p. 161).

Grieve further misrepresents Mill as having limited only to commercial crisis "investment [being] subject to risk and uncertainty" (Grieve 2016, p. 345). But Mill argues that expectation of profits, not their guarantee, is what motivates entrepreneurs to undertake the "risk and trouble" of production; see, for example, Mill (1965, 2, pp. 402–403; and [1874] 1968, pp. 107–115). Furthermore, Mill recognizes that "the future presents nothing which can be with certainty either foreseen or governed" ([1936] 1974, p. 24n3). Yet, Grieve repeats Keynes's (1926, p. 24n2) misrepresentation of the proponents of Say's Law, including Mill, of not being cognizant of uncertainty in the expectation of entrepreneurs' profits, let alone commodity demand in the marketplace.

Grieve compounds his misrepresentation of Mill's analysis by attributing to him the belief that "full recovery from a commercial crisis is automatic and quick" and that a commercial crisis is "self-correcting" (Grieve 2016, p. 348). But in Mill's analysis, money (specie) is produced by the mint; the Bank of England notes were also backed 100% by gold bullion. Thus, a commercial crisis that results in an excess demand for money would create depressed commodity prices, increased nominal interest rates, and increased unemployment for as long as the excess money demand persisted: "If extra currency were not forthcoming to make … payments … money … must be

[1]Mill's argument follows Adam Smith's (*WN*, 2, p. 179): "Consumption is the sole aim and purpose of all production. … The maxim is so perfectly self-evident, that it would be absurd to attempt to prove it." James Ahiakpor (2003) explains Mill's consistency in representing the arguments of J.-B. Say, James Mill, and David Ricardo in restating the law of markets.

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withdrawn from the market for commodities, and prices, consequently, must fall. An increase of the circulating medium, conformable in *extent and duration* to the temporary stress of business, does not raise prices, but merely prevents this fall" (Mill 1965, 3, p. 516; my italics). In a modern economy, a central bank's money supply does not respond automatically to variations in its demand. Besides, Mill also did not argue that the eroded confidence in a commercial crisis automatically and quickly restores itself.

Mill summarizes, in "Of the Influence of Consumption on Production," the explanations of the impossibility of an overproduction of all commodities, including money, in the law of markets by Jean-Baptiste Say, James Mill, and David Ricardo thus: "Nothing is more true than that it is produce which constitutes the market for produce, and that every increase in production, if distributed *without miscalculation* among all kinds of produce in the proportion which private interest would dictate, creates, or rather constitutes, its own demand" ([1874] 1968, p. 73; italics added); see also Mill (1965, 3, pp. 570–576). Keynes ([1936] 1974, p. 25) misrepresents the explanation as "Supply creates its own Demand," and Grieve repeats the same: "Mill categorically asserted that production in itself *guarantees* a corresponding demand for goods" (pp. 337, 348; my italics). He is oblivious to Mill's explanation that "the calculations of producers and traders being of necessity imperfect, there are always some commodities which are more or less in excess, as there are always some which are in deficiency" (Mill [1874] 1968, p. 67).

III. GRIEVE'S MISUNDERSTANDINGS OF MILL

Grieve appears not to have understood Mill's explanation that all the money, one of the commodities produced in a monetary economy, is always held by income earners and producers. Rather, Grieve recognizes the existence of money's demand (to hold) only during periods of commercial crisis: "Mill did allow the possibility of agents' holding on to money in times of crisis" (2016, p. 333; see also pp. 345 and 347). But in explaining the effect of money on commodity prices, Mill considers money's supply as only the "quantity of it which people are wanting to lay out; that is, all the money they have in their possession, except what they are hoarding, or at least keeping by them as a reserve for future contingencies" (Mill 1965, 3, p. 509). Indeed, households spend their net incomes in three ways: (a) purchasing goods and services for immediate enjoyment (consumption), (b) purchasing interest- or dividend-earning assets (saving), and (c) acquiring money (cash) to hold.

The law of markets explains how the spending decisions of income earners to equalize at the margin the utility of consumption, utility of interest or dividend income, and utility of money's liquidity services affect relative commodity prices, interest rates, and the value of money, and motivate producers' response. Thus, Mill argues: "In order to render the argument for the impossibility of an excess of all commodities applicable to the case in which a circulating medium is employed, money must itself be considered as a commodity. It must, undoubtedly, be admitted that there cannot be an excess of all other commodities, and an excess of money at the same time" ([1874] 1968, p. 71). Mill (1965, 3, p. 572) also explains that "money is a commodity; and if all commodities are supposed to be doubled in quantity, we must suppose money to be doubled too, and then prices would no more fall than values would." Grieve leaves out

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the above important condition upon which Mill disputes the assertions of Robert Malthus, Thomas Chalmers, and Jean Charles Léonard de Sismondi that a general glut of all commodities is possible.

Another of Grieve's misunderstandings of Mill is the meaning of unproductive labor. Following Adam Smith, Mill designated labor services that leave behind no saleable products as unproductive: e.g., "[l]abour which is employed for the purpose of directly affording enjoyment, such as the labour of a performer on a musical instrument" ([1874] 1968, p. 82). Mill describes as productive "[l]abour and expenditure, of which the direct object or effect is the creation of some material product useful or agreeable to mankind … or of which the direct effect and object are, to endow human or other animated beings with faculties or qualities useful or agreeable to mankind, and possessing exchangeable value" (ibid., p. 84; see also 1965, 2, pp. 48–52). Therefore, labor spent on manufacturing a musical instrument is productive whereas the performance of a musician is unproductive labor.

On the basis of that distinction between productive and unproductive labor, Mill disagreed with those, including Malthus, Chalmers, and Sismondi, who argued that "the unproductive expenditure of the rich is necessary to the employment of the poor" (1965, 2, p. 66; quoted in Grieve 2016, p. 337). Grieve instead misinterprets Mill to be arguing that the rich reduce their consumption of luxury goods, incorrectly designating the labor engaged in their production as unproductive. In fact, Mill expects that the savings (capital) invested in the production of luxury goods would yield profits and promote economic growth: "[W]hatever increases the productive powers of labour, creates an additional fund to make savings from, and enables capital to be enlarged not only without additional privation, but concurrently with an increase of personal consumption" (1965, 2, p. 70).

Grieve also fails to interpret correctly the fund meaning of capital Mill employs in his "fourth fundamental theorem." Mill argues that it is the wages fund, a subset of invested capital (savings), that constitutes the demand for labor. Therefore, Mill argues, the purchases of commodities, at a point in time, are not the demand for the labor that went into their production.

> What supports and employs productive labour, is the capital [funds] expended in setting it to work, and not the demand of purchasers for the produce of the labour when completed. Demand for commodities is not demand for [current] labour.[2] The demand for commodities determines in what particular branch of production the labour and capital [goods] shall be employed; it determines the *direction* of the labour; but not the more or less of the labour itself, or of the maintenance or payment of the labour. These depend on the amount of the capital, or other funds [such as taxes to pay government workers or payments to domestic servants][3] directly devoted to the sustenance and remuneration of labour. (1965, 2, p. 78; italics original)

[2]Mill's proposition is evidently true, but its meaning may be clearer with the insertion of "current" before "labour." Thus, Alfred Marshall ([1920] 1990, p. 681) observes that the statement "expresses [Mill's] meaning badly."

[3]Mill clarifies that the "wages-fund of a country" constitutes the demand for labor: "[B]y capital [is meant] only circulating capital, and not even the whole of that, but the part which is expended in the direct purchase of labour. To this, however, must be added all funds, such as the wages of soldiers, domestic servants, and all other unproductive labourers" (1965, 2, p. 337).

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Mill's subsequent elaboration of the above argument shows clearly that he did not deny the effect of changing demand for commodities, as it affects the profitability of their production, and causes adjustment in production and the hiring of workers (see 1965, 2, pp. 80–84). Mill also explains that the "demand for labour in any particular employment is more pressing, and higher wages are paid, when there is a brisk demand for the commodity produced; and the contrary when there is what is called a stagnation: then *workpeople are dismissed*, and those who are retained must submit to a reduction of wages: though in these cases there is neither more or less capital than before" (1965, 2, p. 338; my italics). But having misunderstood Mill to have defined investment as only the acquisition of wage goods, or labor being the only factor of production, Grieve could not appreciate the logic of Mill's fourth proposition.[4]

Grieve also fails to recognize Mill's distinction between money and capital or savings, the latter being offered on loan at interest. Thus, even though loans may be extended through the medium of money (cash), it is rather savings or capitals that are borrowed. Mill explains: "When one person lends to another … what he transfers is not the mere money, but a right to a certain value of the produce of the country, to be selected at pleasure; the lender having first bought this right, by giving for it a portion of his capital. What he really lends is so much capital; the money is the *mere instrument* of transfer" (1965, 3, p. 508; my italics). Thus, in the capitalist market economy Mill describes, it is not money that is invested in production to generate revenue, inclusive of profits. However, if one described investment capital loosely as money, it would appear that the capitalist system operates along the schema *M-C-M′*, as Grieve (2016, p. 346) claims, drawing upon arguments by Karl Marx and Keynes. Correctly understood, Mill's clarification of the law of markets is not "inappropriately tied to the conditions of a pre-capitalist, pre-industrial world," as Grieve (ibid., p. 347) claims.

Another of Grieve's debilitating misunderstandings of Mill's elaborations of the law of markets is the meaning of "consumption." Grieve thinks consumption must mean only eating, never the alternative: "using up." Thus, he misunderstands Mill's explanation in the "third fundamental theorem respecting Capital" that all savings are consumed: "The word saving does not imply that what is saved is not consumed, nor even necessarily that its consumption is deferred; but only that, if consumed immediately, it is not consumed by the person who saves it" (1965, 2, p. 70). The Webster's *New Collegiate Dictionary* (1980, p. 242) also includes "to spend" and "to use up" among the meanings of "to consume."

Mill's explanation is that savings are not a withdrawal from the expenditure stream, the Keynesian notion that underlies such mythologies as the "paradox of thrift" and the expenditure multiplier (Ahiakpor 2001) or the claim that increased saving decreases aggregate demand. However, from his misinterpretation of Mill, Grieve doubts that "[a]ll output [including money] produced is bought by someone" (2016, p. 338). He considers it unreasonable to argue that "*saving, just as much as consumption*, necessarily implies spending" (ibid.; italics original). Grieve also misattributes to Mill the view that "all income saved by the propertied class will—*must*—find its way into the hands of the laboring class, who will undoubtedly spend what they get." But Mill never said that all savings or capitals are spent only to hire labor.

[4]Grieve (2017, p. 272), reacting to Steven Kates (2015), thus argues, "Both the volume and direction of production *do* depend on demand. Mill's [fourth] proposition is evidently nonsense" (italics original). Kates's not clarifying the proposition in terms of the wages fund may have hindered Grieve's understanding.

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IV. CONCLUSION

Mill ([1874] 1968, p. 49) declares: "There will never … be a greater quantity produced, of commodities in general [including money], than there are consumers for." The declaration is merely an affirmation of the economic fact of scarcity, which not even Keynes (e.g., [1936] 1974, pp. 213–215) denies. Grieve's attempt to defend Keynes's criticism of Say's Law, on the grounds that demand deficiency is possible, thus fails. The law explains the interconnection between markets for produced goods and services, credit or capital, and money, and the coordination of these markets by variations in relative commodity prices, interest rates, and the value of money. The law also recognizes lags in the production adjustment process. Importantly, the law recognizes that producers only can guess about the demand for goods and services in the marketplace.

The policy implication of Say's Law is that "aggregate demand" management is unnecessary, since the profit motive of producers (other than modern central banks) will always cause them to adapt production to the changing demands of buyers. Governments may help by removing the obstacles to producers' adjustment. Keynes's criticism of the law derives mostly from his misrepresentations and misinterpretations of its proposition (Ahiakpor 2003). Roy Grieve does no better than Keynes, ignoring published clarifications of Keynes's errors. Historians of economics can perform a useful service to macroeconomics by clarifying Keynes's misrepresentations and misinterpretations of Say's Law rather than perpetuating them.

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