‘Supply Creates its Own Demand’: A Discussion of the Origins of the Phrase and of its Adequacy as an Interpretation of Say’s Law of Markets

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***Abstract*:** Two issues are addressed in this paper. Firstly, the origins of the phrase ‘supply creates its own demand’ as a definition of Say’s Law are investigated. The paper argues that while there are a number of possible sources for these words within the classical literature, their most likely origin is in the writings of John Stuart Mill. The second more important issue is whether those words are an accurate summary statement of the conclusions classical economists wished to draw. The paper argues that the phrase is entirely inadequate as a definition of Say’s Law, not just failing to capture the full meaning classical economists had wished to convey but seriously misleading if one wishes to understand how classical economists understood the way economies actually work.

The first published use of the phrase ‘supply creates its own demand’ as a definition of Say’s Law occurs in John Maynard Keynes’s *General Theory of Employment, Interest and Money* (Keynes 1936, p. 18). While it is often assumed that the words are found in the works of Jean-Baptiste Say or elsewhere in the classical literature, in actual fact no earlier use of this precise form of words has so far been found. Most importantly, there is no source as yet identified in the classical literature amongst defenders of the law of markets in which these specific words are found. Although one can never be absolutely certain, it appears more than likely that it was Keynes himself who was first to put these words into print after having stated them as part of his Cambridge lectures as early as 1933. His first recorded usage of these words was in his Michaelmas lecture of October 23, 1933, and their first specific association with Say’s Law is found in his Michaelmas lecture of October 29, 1934.[1]

By then ‘Say’s Law’ had to an important extent replaced ‘*théorie de débouchés*’ or ‘law of markets’ as the name for a particular set of economic principles that was part of the core foundation of classical economic thought.[2] Two questions therefore intrude themselves. Firstly, were the words, ‘supply creates its own demand’ a fair characterisation of the meaning that classical economists wished to convey? And, secondly, where might the words ‘supply creates its own demand’ have originated in the first place?

As to their accuracy as a definition of Say’s Law, it must be remembered that while Keynes was framing a statement intended as a shorthand conclusion to a series of propositions that were at the very core of classical economic theory, he was doing so in a book whose main objective was to demonstrate that these classical propositions had been fundamentally wrong. His intention was to prove that their near-universal acceptance had been the reason why economists had, for more than a century, denied the existence of involuntary unemployment and had been unable to understand why recessions occurred or how they could be cured. There are, to say the least, good reasons to question whether Keynes, a polemicist of the highest order, is necessarily the best person from whom to learn the meaning of an economic proposition he was determined to attack.

As to the origins of the phrase, it is important to ask whether the words have roots in the classical tradition, or were they merely a construct invented by economists whose aim was to deny the validity of Say's Law? While one might still accept this phrase as a correct interpretation even if no parallel within the classical literature could be found, the case for its accuracy as a definition would be a good deal more compelling if the phrase could be shown to have been part of the classical tradition.

To anticipate the conclusions to this paper, it will be argued that although there are a number of possibilities, it is likely that the point of origin of this phrase was found in the writings of John Stuart Mill. But it will also be argued that the phrase 'supply creates its own demand' is entirely inadequate as a definition of 'Say's Law', not just failing to capture the full meaning that classical economists had intended to convey but seriously misleading if one wishes to understand how classical economists understood the way in which economies actually work.

1 The Classical Meaning of the Law of Markets

It is easiest to understand the meaning of the law of markets by first understanding the controversy out of which it grew. While it is true that J.-B. Say had originally discussed many of the elements of the theory which would eventually take his name, his focus was on the concern that there might not be enough circulating medium to effect all of the exchanges in a growing economy. His aim was to point out that it is not money that creates demand but other products; money, as part of the process of exchange, is only a mechanism to effect the exchange. Goods buy goods through the mediating role of money so that it is the shortage of other goods with which to exchange one's own goods for that causes demand to falter, not an insufficient stock of money.

It was James Mill, in his *Commerce Defended* ([1808] 1966a), who in fact first enunciated what was to become the generally accepted classical conclusion that was to form the law of markets, namely, that demand deficiency was never a valid explanation for recession. *Commerce Defended* was written during the Napoleonic Wars to rebut arguments then being made that foreign trade was unnecessary to the economic success of England. The basis for this argument was the Physiocratic doctrine that agriculture was the ultimate source of wealth. The doctrine was revived because England was on the point of losing its trade with the Continent. William Spence, in his *Britain Independent of Commerce* (1807), had argued that such loss of trade would not adversely affect national prosperity. Mill therefore wrote his own short polemical tract to argue that it would.[3]

The subject of Chapter VI of *Commerce Defended* is 'Consumption'. Here Mill deals with Spence's support for unproductive consumption as a stimulus to the growth of national wealth. Mill opens the chapter with an extended quotation from Spence in which the arguments supporting unproductive consumption by the owners of land are outlined. In Spence's view, it is such unproductive consumption rather than saving which is the necessary condition for growth and prosperity. Buying by the landed classes would ensure a market for the goods produced by others. Mill's conclusion is that consumption is not needed to encourage production. But, Mill wrote, 'there is another idea' ([1808] 1966a, p. 134) which he feels the need to deal with. And with this, Mill enters deeper still into the issues surrounding the law of markets, which were whether output in general, and capital in particular, might increase more rapidly than demand. Mill explains the issue in question this way:

> The Economistes and their disciples [that is, Spence] express great apprehension lest capital should increase too fast, lest the production of commodities should be too rapid. There is only, say they, a market for a given quantity of commodities, and if you increase the supply beyond that quantity you will be unable to dispose of the surplus. (*ibid*., pp. 134-5)

That is, is it a genuine economic problem that demand might be unable to keep pace with the growing level of production? Thus Mill, unlike Say, specifically confronts the problem of demand deficiency. Mill is, as usual, forthright in setting out the issue and providing an answer:

> No proposition however in political economy seems to be more certain than this which I am going to announce, how paradoxical soever it may at first sight appear; and if it be true, none undoubtedly can be deemed of more importance. ***The production of commodities creates, and is the one and universal cause which creates a market for the commodities produced***. (*ibid*., p. 135; italics added)

Here we find 'supply creates its own demand' in the somewhat archaic phraseology of the early nineteenth century: 'Production . . . creates a market for the commodities produced'. Mill's argument is that the means to pay for an increased flow of goods is provided by those additional goods themselves. Therefore the power to purchase is always available and is constituted by the very goods which have been brought to market. Two pages later he says much the same thing in another phrase, which is even more reminiscent of Keynes: 'How great soever that annual produce may be it always creates a market to itself' (*ibid*., p. 137). Supply always creates demand. But Mill also provides the central qualification to goods exchanging against other goods. It is not just any goods that will exchange themselves for other goods; they must be precisely those goods which are demanded by other sellers.[4] One set of goods will only purchase a second set if the sellers of the first set wish to buy what the second group has offered to sell. Or, to be more precise, only if producers are willing to use the sales proceeds received from selling their own goods to buy the other goods which have been put up for sale, will 'the demand of the nation be equal to the produce of the nation' (*ibid*., p. 136). Mill puts the qualification in this way:

> All that here can ever be requisite is that the goods should be adapted to one another; that is to say, that every man who has goods to dispose of should always find all those different sorts of goods with which he wishes to supply himself in return. (*ibid*., p. 136)

Demand is reciprocal demand. Goods produced, if they are to become goods sold, must match the demands of other producers. There is no certainty that each item produced will find a market. The implication that Keynes read into Say's Law, that all goods produced will be inevitably sold and recessions cannot occur, was never Mill's message. What Mill was attempting to show was that demand deficiency would never cause recession and, in rebutting Spence, that demand-side stimulation through unproductive spending would never be its remedy. And the words he chose would later have an echo in the pages of the *General Theory*.

2 Malthus

The catalyst for the law of markets to become controversial was the publication of Malthus's *Principles* in 1820. Yet even before this, Malthus and Ricardo had been corresponding with each other over these very matters. A highly significant part of that correspondence occurred following a meeting between Ricardo and Say. On 18 December 1814 Ricardo wrote to Malthus that 'Monsr. Say came to me here from London at the request of Mr. Mill who wished us to be acquainted with each other' (Ricardo 1962, p. 161). This letter, moreover, provides Ricardo's contemporary précis of Say's arguments on the *théorie des debouches*:

> Mr. Say, in the new edition of his book, Page 99 Vol 1, supports, I think, very ably the doctrine that demand is regulated by production. Demand is always an exchange of one commodity for another. The shoemaker when he exchanges his shoes for bread has an effective demand for bread, as well as the baker has an effective demand for shoes, – and although it is clear that the shoemaker's demand for bread must be limited by his wants, yet whilst he has shoes to offer in exchange he will have an effective demand for other things, – and if shoes are not in demand it shews [*sic*] that he has not been governed by the just principles of trade, and that he has not used his capital and his labour in the manufacture of the commodity required by the society, – more caution will enable him to correct his error in his future production. Accumulation necessarily increases production and as necessarily increases consumption. Accumulation of *produce* **if properly selected** *may* always be accumulation of *capital*, and it cannot fail to be worth more than it cost, estimated in corn or labour. (*ibid*., pp. 163-4; italics in original, bolding added)

This is the essence of Say's Law as stated by one of its most articulate classical supporters: demand will rise to match production, but it will do so only if it is properly proportioned. Supply is indeed the basis of demand ('demand is regulated by production'), but the two will rise together only if producers produce what others wish to buy. And, as the example Ricardo provides of bread and shoe production ought to show, this is hardly a truism but is the beginning of a theory of economic dislocation that would become the cornerstone for the classical theory of the cycle.

But what is interesting in relation to the origins of the phrase, 'supply creates its own demand', is Malthus's reply, dated 29 December 1814:

> I had remarked the passage you mention in Mr. Says [*sic*] work, and think it well done, though I cannot quite agree with him. I think the source of his error is, that he does not properly distinguish between the necessaries of life and other commodities, – *the former create their own demand* the latter not. (Ricardo 1962, p. 168; italics added)

Here we find Malthus writing that the supply of necessities 'create[s] their own demand' but it is only necessities, not output in total. Thus not all forms of supply create their own demand. Some elements of supply clearly did not create their own demand, which implied that not all output would be bought, the point Keynes himself wished to make. Yet it is not quite right as the source of Keynes's definition, since it comes from an attack on Say's Law and therefore conflicts with Keynes's statement that 'from the time of Say and Ricardo the classical economists have taught that supply creates its own demand' (Keynes [1936] 1973, p. 18). The phrase would have had to come from an explanation and defence of Say's Law if it were to be consistent with what Keynes had written.

However, and unlike other passages that exist as possible sources within the classical literature, this is one Keynes is likely to have read as early as the second half of 1932. It was during this period that he was completing his biography of Malthus in his *Essays in Biography* (Keynes [1933] 1973)) and therefore reading Malthus's letters to Ricardo.[5] The strength of Ricardo's arguments would itself have created a sharpened interest in Keynes in seeing the manner in which Malthus would reply. Yet had this letter been the source of Keynes's words, one might have expected that he would have reproduced this passage either in his essay or later on in the *General Theory* where he quotes from other of Malthus's letters to Ricardo. Beyond the similarity of the words themselves, there is nothing in the writings of Keynes to make one believe that he had paid particular attention to this letter.

3 Torrens

At the time these letters were written, these issues were merely part of a private correspondence between Malthus and Ricardo. It was the publication of Malthus's *Principles* which finally touched off a protracted debate amongst English economists on the possibility of demand failure and the need for unproductive consumption to ensure full employment of labour. What made Malthus's *Principles* the focus of attention it became was its argument that unproductive consumption needed to be encouraged to ensure the greatest rate of economic growth and the fullest use of resources. Within five years, major works on economic principles were written by James Mill, J.R. McCulloch and Robert Torrens in which a rebuttal of Malthus formed a large component. In 1821 Say's *Letters to Mr. Malthus* was published and his *Treatise* was translated into English. It was in Torrens (1825) that a full discussion of the meaning of Say's Law was found, and this is a third possible source for the Keynesian form of words.

Torrens discusses the productivity-creating potential of the division of labour but also the possibility this form of production might lead to major economic disturbance. According to Torrens, with the division of labour, breakdowns in one segment of the economy can lead to a breakdown of the economic machinery overall. Thereafter, the welfare of individual workers depends less on their own exertions than on their ability to find people to buy what they have to sell. Moreover, it is not just production in general which is desired, but the production of precisely those goods which will be bought. The need is to ensure that goods are produced in the right proportions relative to each other so that they may be continuously exchanged. Indeed, Torrens notes that 'the great practical problem in economical science is, so to proportion production that supply and demand shall be in the relation of equality' (Torrens [1821] 1965, p. 370). If the proportions are correct, then everything will be sold at cost-covering prices. In Torrens's view, there is not the slightest doubt that if this were to occur, output could continue to increase without conceivable limit. The question is whether the correct proportions are preserved, not whether aggregate production will outrun the willingness of the community to buy. As he wrote:

> So long as this proportion is preserved, every article which the industrious classes have the will and power to produce, will find a ready and a profitable vend. No conceivable increase of production can lead to an overstocking of the market; but, on the contrary, every addition

> which can be made to this supply of commodities, will immediately and necessarily occasion an increase in the effectual demand for them. Whatever may have been the previous state of the market in regard to abundant supply, ***increased production will create a proportionally increased demand***. (*ibid*., pp. 370-1; italics added)

The highlighted words – 'increased production will create a proportionally increased demand' – bear a strong resemblance to the Keynesian maxim that 'supply creates its own demand'. But, as with James Mill, Torrens added that all-important qualifier: demand and supply must preserve the appropriate proportions. Supply creates its own demand 'so long as this proportion is preserved'. And, as Torrens makes clear, if the proportions are not preserved, the result is a market filled with unsold goods:

> 'This happy and prosperous state of things is immediately interrupted when the proportions in which commodities are produced are such as to disturb the equality between effectual demand and supply…. When the ingredients of capital expended in the production of commodities are in excess with respect to the ingredients of capital brought to market to exchange against other commodities, then gluts and regorgements are experienced. (*ibid*., pp. 371-2)

Here is found the very essence of Say's Law in the midst of an explanation of the causes of recession. Nor should recessions be thought of as brief interludes between periods of high prosperity and full employment. Torrens describes the consequences of disproportionality in production in the following manner:

> That want of due proportion in the quantities of the several commodities brought to market, which operates thus injuriously upon capitalists, inflicts equal injury upon the other classes of the community…. The ruin of the cultivator involves that of the proprietor of land; and when the motive and the power to employ productive capital are destroyed, the productive labourer is cut off by famine. (*ibid*., p. 418)

The conclusion that Keynes argued had followed from the acceptance of Say's Law, that there was no obstacle to full employment, could not be more completely shown to have been mistaken than by Torrens's recognition that famine was the consequence of an economy where demand and supply were in aggregate not properly balanced. 'The ruin of the cultivator' and labourers 'cut off by famine' describe forms of economic devastation that follow from supply not matching demand. Say's Law cannot fairly be seen as an argument that no obstacle to full employment exists or that everything produced will be sold. Yet it was upon this interpretation of classical economic theory in general and Say's Law in particular that the Keynesian Revolution was built.

4 John Stuart Mill

In his essay 'On the Influence of Consumption on Production', which formed the second essay in *Some Unsettled Questions of Political Economy* ([1844/1874] 1974, pp. 47-74), John Stuart Mill set out to demonstrate that recessions and unemployment were not due to failures of effective demand. Mill's essay was the classic statement of the law of markets during the nineteenth century. And the central point made by Mill in this essay was that a fall in the level of consumption, whether productive or unproductive, was never the correct explanation for a downturn in production. The actual cause was disproportionality in the production process where the structure of production did not match the structure of demand. In the essay, Mill discussed the issue of entrepreneurial miscalculation, the production of the wrong assortment of goods and services, repeating what had been said by James Mill and Torrens:

> Nothing is more true than that it is produce which constitutes the market for produce, and that every increase of 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. (*ibid*., p. 73)

Demand failure cannot occur so long as goods are produced in the right proportion. So long as production matches demand everything produced will find a market. It is 'miscalculation' by producers that causes goods to remain unsold. It is what they have chosen to produce, not how much. But, more importantly, here may be found the origin of Keynes's statement of Say's Law, 'supply creates its own demand.' If one examines a section from the previous passage, it will be seen that the familiar words of Keynes's definition are there, almost verbatim: '*every increase of 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*' (*ibid*.; italics added). That is, 'every increase of production . . . . creates . . . . its own demand.' Mill was one of the most influential economists of his time, if not the most influential, and was closely studied for the subsequent two generations and even into the twentieth century. Thus, in the conclusion to the most important statement on the law of markets produced during the classical period, we find Mill stating in words very similar to Keynes's that the source of market demand lies in the level of production. This phrase would have been part of the general education of economists over the period in helping them to form their own understanding of the meaning and implications, not merely of the law of markets, but of how an economy was actually seen to work.

Whether or not this is the point of origin for Keynes's form of words, it is the omitted non-italicised words which are critical in understanding the point Mill is trying to make. The importance of producing, in aggregate, exactly the goods and services that those who have earned incomes are prepared to buy in aggregate, takes the issue from the level of output to the specific array of goods and services produced. If there are errors in production, then the conclusion that demand has been created will not hold. There is no inevitability that everything produced will find a market and therefore no certainty that full employment is assured.

5 The Road from Mill to Keynes

This paper has identified a number of possible sources in the classical literature for Keynes's form of words to explain the meaning of Say's Law. James Mill, Thomas Robert Malthus, Robert Torrens and John Stuart Mill had each used phraseology similar to the words Keynes would make famous, with each using the word 'create' to explain how demand was generated by supply. Of the four, Malthus is the one Keynes is almost certain to have read as early as 1933, which is the crucial date, since it was in that year he first used this phrase. If, however, Keynes's source for this statement is through some third party, then this cannot have been where the phrase originated since the Malthus-Ricardo correspondence would not be published until more than twenty years later.

Malthus is, however, an unlikely candidate. The far more likely source is John Stuart Mill, given that the closest actual words to those used by Keynes are found in Mill's essay. It is the tell-tale phrase 'its own demand' which sets these words apart. It was also that Mill was writing in defence of the law of markets which makes it consistent with Keynes's own statement that this was a form of words used by defenders of Say's Law. Finally, Mill's works were closely studied throughout the latter half of the nineteenth century and his writings would have had an especially deep impact on his contemporaries, with his essay on the law of markets being highly influential in framing their understanding of the issues surrounding Say's Law. It is therefore Mill who is the most likely inspiration for the phrase that was eventually to play such a crucial part in framing the arguments of the *General Theory*.

How then did Keynes find his way to a phrase whose origins appear to lie in the writings of John Stuart Mill? Keynes was no classical scholar. He would have been largely unaware of the economic debates of the early nineteenth century. He would have been unfamiliar with the literature of the time, and had he been left to his own devices would have looked to Malthus, Say or Ricardo for an understanding of the issues rather than John Stuart Mill, writing more than two decades later. It should also be noted that nowhere amongst all of the vast material available on Keynes's preparatory work on the *General Theory* is there a single reference to Mill's essay. It is for this reason that an intermediary between Keynes's interest in the issues raised by his reading of Malthus and his adapting a form of words whose origins are in an essay by John Stuart Mill seems essential.

What is needed is a conduit between Keynes's interest in Say's Law and Mill's statement that every increase of production creates its own demand. One possibility is that the road between Mill and Keynes may have been provided by Keynes's close associate, Piero Sraffa. Sraffa was at that time editing Ricardo's collected writings, which included Ricardo's correspondence with Malthus where discussions of Say's Law formed a featured part. Keynes was captivated by the arguments he found in Malthus's letters and from the very first moment he came across them sought to understand the issues more fully.[6] Since we know that Keynes was at this time in close personal contact with Sraffa,[7] he would have had the ideal opportunity to seek additional background understanding of the issues found in the correspondence. In late 1932 and early 1933, Sraffa was not only the one person most able to discuss precisely the issues raised in the Ricardo-Malthus correspondence but was also in frequent personal contact with Keynes, which allowed those issues to be discussed.

All this is no more than conjecture. At the end of the day, and irrespective of how Keynes was able to find his way to those words, the classical source of the phrase 'supply creates its own demand' was likely to have been the essay written by John Stuart Mill and published in 1844.

6 The Meaning of Say's Law

More important than the origins of the phrase is whether the phrase 'supply creates its own demand' captures the meaning of Say's Law. Keynes interpreted Say's Law to mean that if something is produced a buyer will be found. Therefore, according to Keynes, acceptance of Say's Law meant no obstacle to full employment exists. Since it requires next to no effort to demonstrate that such a proposition is unsupportable, if that is what Say's Law meant then Say's Law deserved to be rejected.[8]

But, as the passages from the classical authors cited show, that was not what Say's Law meant to them. The interpretation provided by Keynes was a misrepresentation of the meaning and implications of Say's Law. Nor is the issue merely whether classical economists believed recessions were possible. There is general acceptance today that classical economists recognised that economic downturns did occur and involuntary unemployment was possible. The more important issue runs deeper and in a quite different direction.

The point classical economists were trying to make when invoking Say's Law was twofold. First, demand is never a constraint on the level of production. Recessions and unemployment are never caused by insufficient levels of aggregate demand. Second, recessions occur when the structure of production is not properly proportioned to the structure of demand. Say's Law not only did not deny that recessions could occur, but it was an integral part of the classical explanation of why they did. These are the points made by each of the classical economists cited in this paper and it is an argument that runs like a red thread through the entire classical literature. Prior to the publication of the *General Theory* it was almost universally accepted within the mainstream of the profession that it was impossible to produce more than the community would be willing to buy. No matter how much was produced, it was understood that no obstacle to sales rising to the same level existed because of limitations in demand. It was in denying this argument that Keynes created his revolution in economic thought. To the extent that constructing Keynesian-cross diagrams, IS-LM or aggregate demand curves is still part of the mainstream, modern economic theory follows in the Keynesian tradition in arguing that it is possible for aggregate production to exceed aggregate demand. There is an upper limit to production set by the demand side of the economy. Insufficient demand can be a cause of an economic slowdown and can lead to involuntary unemployment. An economy might therefore require increased public spending in order to create the demand for goods and services that will allow full employment to occur. It was these arguments that Say's Law categorically denied and was constructed to deny.

But Say's Law did more. It also provided the basis for understanding why recessions and unemployment did occur. These are the implications of the qualification found in each of the classical statements on the law of markets discussed above, the qualification that supply will create its own demand only when the structure of supply is proportioned to the structure of demand. And when this does not occur, not only can there be an economic downturn and unemployment, but the consequences can be dire and prolonged. There was nothing Candide-like in the classical estimation of the consequences of getting this balance wrong. Torrens made it clear how serious errors in production could be. The recessionary consequences of the structure of supply not matching the structure of demand was the conclusion accepted by virtually the entire mainstream of the economics profession through until the publication of the *General Theory* in 1936.[9] And all of this derived from the classical meaning of Say's Law.

None of this is captured by the phrase 'supply creates its own demand'. The phrase does not indicate that, embedded within Say's Law, is a profound theory of the cycle, one that would be accepted and developed by economists for more than a century. The words do not imply, as a proper definition would need to, that it is structural problems that are the major underlying cause of recessions. One would not know from those words that Say's Law was the basis for a theory of mass unemployment.

The words do, of course, state that demand is created by supply but it is a misunderstanding of the classical intent to interpret the words to mean that the supply of anything at all will do. Ricardo's example of the shoemaker and the baker attempted to demonstrate how important it was that supply had to be proportioned to demand and that the supply of goods and services that could not find a market could therefore not be the basis for demand. And in conceiving the principle underlying Say's Law as increased supply leads to increased demand, the aim was to emphasise that it is production that underpins the level of demand and not *vice versa*. According to classical economic principles, demand does not drive an economy forward, and that, too, is a principle derived from Say's Law.

'Supply creates its own demand' is an invalid and misleading definition of Say's Law. It is invalid and misleading firstly because it fails to provide the needed qualification that for supply to create demand both must be properly proportioned to each other. But, secondly, those words are invalid and misleading because they are embedded in a particular interpretation that derives from Keynes's *General Theory*. There they are interpreted in a way that was completely at odds with the intent of those who had framed this economic principle in the first place. It is highly unlikely that anyone who had accepted the law of markets as a valid principle would have accepted Keynes's interpretation or the implications that he drew.[10]

7 Conclusion

In so far as our knowledge presently goes, the phrase 'supply creates its own demand' was first penned by Keynes as a description of Say's Law. In this article I have, however, argued that there were classical roots for this form of words in the writings of John Stuart Mill. In his essay dealing with the issues underlying the law of markets, Mill's conclusion included the statement that 'every increase of production . . . creates . . . its own demand'. Given the importance of Mill amongst classical economists and the extent to which this essay formed an integral part of classical economic thought, it is the argument of this paper that the origins of 'supply creates its own demand' should be traced back to Mill.

I have also argued that, in defining Say's Law as he did, Keynes omitted the essential qualification – that demand and supply would only coincide if they were duly proportioned to each other. Only if the goods produced coincided with the goods demanded could one conclude that everything produced would find a market. It was the omission of this crucial qualification which fatally impaired Keynes's interpretation of the law of markets. Yet this phrase, while inadequate as a depiction of the law of markets, is virtually all that most economists now understand about what had been one of the foundation stones of economic analysis.

'Supply creates its own demand' has become the shorthand definition for what was at one time seen as amongst the most important economic principles ever framed. By turning the law of markets into a five-word formula which could then be dismissed as a superficial and invalid statement about the nature of economic reality, it became far more difficult to turn in this direction for a substantive argument opposed to the case presented in the *General Theory*. It made the introduction of the Malthusian argument in favour of demand deficiency easier to achieve. With the adoption of the phrase 'supply creates its own demand' a 150-year tradition in economic theory disappeared, to be replaced by the theory which the law of markets had been specifically designed to refute.

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Notes

1 Both citations are taken from Thomas K. Rymes's *Keynes's Lectures, 1932-35: Notes of Students*. These are the full transcriptions of the surviving student notes of Keynes's Michaelmas lectures given between 1932 and 1935. In Thring's 1934 notes are found Keynes's famous judgements that Say's Law implied that 'all the costs of production must be spent on buying back the products' (*ibid.*) and that because of the operation of Say's Law 'there is never any obstacle to full employment' (p. 5).
2 The name 'Say's Law' had been first used by Fred Taylor and through him entered American usage during the 1920s. It was a term never used by the classical economists of the nineteenth century. See Kates (1998) for a discussion of the origin of the term 'Say's Law'.
3 Winch (1966, pp. 28-30) provides the background to *Commerce Defended*.
4 Hollander (1979, p. 96) notes that Mill emphasised that 'the composition of output must be adapted to the tastes of consumers and investors and in this vital respect his statement stands far and away above that of Say.'
5 See Kates (1998), where it is argued that it was precisely because Keynes was reading the Malthus-Ricardo correspondence that he wrote the *General Theory* to argue that demand deficiency was the cause of recession and involuntary unemployment.
6 As argued in Kates (1998), Keynes's decision to base the arguments of the *General Theory* on demand deficiency stems from his privileged reading of the Malthus-Ricardo correspondence in 1932 while he was updating his 'Essay on Malthus' for inclusion in his *Essays in Biography* ([1933] 1973).
7 The statement that Keynes and Sraffa were travelling together is contained in a letter from Keynes to James Bonar dated 3 November 1932. This letter is found in the Keynes Papers housed in the Modern Archive at King's College, Cambridge (KP: B/1).
8 It might also be noted that Keynes's difficulties in finding examples of such a belief amongst classical economists stems from the fact that none of them believed any such thing either.
9 Theories based on errors on the production side formed the majority of the theories of recession discussed by Haberler (1937) in his comprehensive review of theories of the business cycle published by the League of Nations.
10 This is probably why Keynes could find no contemporary example to cite at the start of the *General Theory* but had to choose passages that even then were more than fifty years old.

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