Subverting Say's Law:
Keynes, Commons and Harlan McCracken

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Harlan Linneus McCracken is possibly the least known economist of the twentieth century relative to the level of influence he has had. It was McCracken's *Value Theory and Business Cycles*, based on his doctoral thesis written while a graduate student of John R. Commons at the University of Wisconsin, that when finally published in 1933 may have been the largest single influence on Keynes in giving the *General Theory* the direction it took in attacking Say's Law.

This paper will trace the relationship between Commons and McCracken and then between McCracken and Keynes to show the importance of Commons in particular and Institutionalism in general in shaping Keynesian thought. The paper then discusses the direct influence of Commons on Keynes in the crafting of the *General Theory*. The paper will argue that the *General Theory* owes its orientation and focus to the work undertaken by McCracken while a student of Commons in the 1920s and that important elements of the *General Theory* were derived from Keynes's study of Commons' writings in the early 1930s.

Say's Law before Keynes

One does not have to reject Say's Law to advocate increased public spending during recessions. Such proposals had been a staple amongst economists going well back into the nineteenth century. One of the palliatives for an economic downturn was infrastructure expenditure on various projects which had been kept in store for just such contingencies. The aim was to put some of the resources left idle back to work while conditions were slack. Crucial to such proposals were, firstly, that the projects were intended to be value adding and then secondly, the budget was to remain in surplus. Whatever was done was never with the intention of rolling back the recession but only using the opportunity to add value in the public sector while providing some assistance to the unemployed.

Importantly as well, the theory of the cycle was actually many theories coming in a wide variety of types. There was no one school which dominated which could have been designated as "the" theory (see Haberler 1938). There were aspects of the theory of the cycle that were accepted pretty well across the board, but in relation to the actual causes and dynamics no consensus existed. However, in regard to one particular set of concepts there was the near unanimous acceptance by all mainstream economists, and that was that whatever might cause a recession to occur, it would never be because of a deficiency in demand.

This principle, to the extent that it had a name, was called the *loi de débouchés* which was rendered into English as the law of markets. By the time economics had developed into the twentieth century, there was a general recognition that overproduction, or to use its equivalent, demand deficiency,[1] could not be an actual cause of recessionary conditions. But it was merely that, a universally recognised principle with no specific associated name. For this reason, the American economist Fred Taylor, made the decision to provide this principle with the name which it has kept to this day. In introducing this concept, he wrote:

> "Among the fallacious notions in popular thinking that have gained very wide currency are to be found a number which grew out of misconceptions as to the real source of the *general or total demand for goods*, and as to the methods by which that demand is increased or diminished. Several types of these fallacious notions may be cited. Thus, governmental improvements of all kinds, including even those of questionable value, are often supported by business men and others on the ground that such improvements increase the total demand for goods." (Taylor 1925: 196)

Taylor then makes a statement that in light of subsequent events, is ironical to a most extraordinary degree:

> "The points just brought out with respect to the relation between demand and the output of goods are so evident that some will consider it scarcely legitimate to give them the dignity derived from formal statement." (ibid.: 201)

Yet as apparent as these ideas are, Taylor does nevertheless provide them with a name. The above passage continues with these words:

> "On the other hand, the continued prevalence throughout the larger part of the community of the fallacious notions which these considerations are designed to correct seems to furnish ample ground for any procedure which gives these points adequate emphasis. I shall therefore put the proposition we have discussed in the form of a principle. *This principle, I have taken the liberty to designate Say's Law*; because, though recognized by many earlier writers, it was particularly well brought out in the presentation of Say (1803)." (ibid. – italics added)

He thus provided these undefined concepts with a name which could be used to remind his fellow economists of the existence of this set of fallacious notions which Say's Law was designed to correct.

Say's Law in Keynes's Thought

Such discussions on Say's Law that existed from the time the phrase was coined in the early 1920s until the publication of the *General Theory* in 1936 was entirely confined to the American side of the Atlantic. Obviously, however, the term and the related concept came to Keynes's attention during this period but not before Keynes had himself reached his own conclusion that the causes of recession were due to a

[1] That these were intended as exactly parallel terms may be seen in Mill's chapter, "Of Excess of Supply" ([1848] 1873: 557) where the two terms are used interchangeably.

deficiency of demand. And what is clear from his writing is that right up to his commencing work on the *General Theory* in 1932 is that at no stage did Keynes argue that demand deficiency was an important element in causing economies to turn down.

What turned Keynes towards these issues was his coming across the Malthus side of the Malthus-Ricardo correspondence which had been unearthed by Piero Sraffa in 1930. These letters were unpublished, available to only a very limited number of people, almost all of whom were at Cambridge. And they became of interest to Keynes at the end of 1932 not because he was interested in Malthusian economics, but because he was just then updating his essay on Malthus for his *Essays in Biography* which was published in early 1933.

Although Keynes scholars have paid no attention to the obvious relationship between Keynes's in late 1932 reading Malthus's letters to Ricardo dealing with demand deficiency, if anything it seems that it ought to require strong reasons not to accept the cause and effect rather than to reject it. Keynes immediately found just what he had been looking for the moment he came across Malthus's words. This excitement is unmistakably projected in his essay on Malthus where he famously wrote:

> "One cannot arise from a perusal of this correspondence without a feeling that the almost total obliteration of Malthus's line of approach and the complete domination of Ricardo's for a period of a hundred years has been a disaster to the progress of economics." (CW X: 98)

Keynes had found in Malthus the core of the ideas he was looking for. Yet at this stage he did not quite know what he has actually stumbled across.

Harlan Linneus McCracken

It is into the ferment that the thoughts and concepts of the unknown Harlan Linneus McCracken's found their way. McCracken had been a student of John R. Common's at the University of Wisconsin where he had taken his doctorate under Commons' supervision. A decade later, in 1933, his reworked PhD, under the title *Value Theory and Business Cycles* was published and almost immediately sent to Keynes. And in understanding the immense importance of McCracken and Commons, it is important to understand the central aim of the *General Theory*. It was an intent that Keynes took the germ of an idea through his reading of Malthus but which was now to be amplified through his reading of these two American economists. The central direction of the *General Theory* is spelled out, firstly in Keynes's very brief opening chapter where in the very second sentence he attempts to justify calling his theory the *general* theory:

> "The object of such a title is to contrast the character of my arguments and conclusions with those of the *classical* theory of the subject." (CW VII: 3)

Keynes argues that the economists to which he is to contrast his own arguments are those classical economists who were followers of Ricardo. This is spelled out in a footnote to the above passage:

> "'The classical economists' was a name invented by Marx to cover Ricardo and James Mill and their *predecessors*, that is to say for the founders of the theory which culminated in the Ricardian economics. I have become accustomed, perhaps perpetrating a solecism, to include in 'the classical school' the *followers* of Ricardo, those, that is to say, who adopted and perfected the theory of the Ricardian economics, including (for example) J. S. Mill, Marshall, Edgeworth and Prof. Pigou." (ibid.: 3n)

This is a passage which has been read by economists since its first publication without anyone much noticing just how odd it was to have argued that economists had been adopting and perfecting an approach to economic theory laid out by David Ricardo whose *Principles* had been published in 1817, more than a century before. What an odd idea! Where could such a thought have come from?

The second passage in the *General Theory* which sets the direction of the rest of the work, is a discussion of the contrasting views of Ricardo and Malthus. Here Keynes wrote:

> "The idea that we can safely neglect the aggregate demand function is fundamental to the Ricardian economics, which underlie what we have been taught for more than a century. Malthus, indeed, had vehemently opposed Ricardo's doctrine that it was impossible for effective demand to be deficient; but vainly. For, since Malthus was unable to explain clearly (apart from an appeal to the facts of common observation) how and why effective demand could be deficient or excessive, he failed to furnish an alternative construction; and Ricardo conquered England as completely as the Holy Inquisition conquered Spain. Not only was his theory accepted by the city, by statesmen and by the academic world. But controversy ceased; the other point of view completely disappeared; it ceased to be discussed. The great puzzle of Effective Demand with which Malthus had wrestled vanished from economic literature. You will not find it mentioned even once in the whole works of Marshall, Edgeworth and Professor Pigou, from whose hands the classical theory has received its most mature embodiment. It could only live on furtively, below the surface, in the underworlds of Karl Marx, Silvio Gesell or Major Douglas." (CW VII: 32)

The task Keynes had set before himself was to rid economic theory of what he saw as the false ideas which had descended from Ricardo and replace them with the correct ideas which had first been stated by Malthus. The Keynesian Revolution was to be a rerun of the general glut debates of the 1820s, but this time with a different set of ideas to come out on top. The question therefore presents itself again. Why did Keynes cast his revolution in just this way? It is here that the role played by McCracken, and then before him by Commons, needs to be understood.

Value Theory and Business Cycles

Value Theory and Business Cycles is specifically about the contrasting views of Ricardo and Malthus. According to McCracken, if one begins from the position taken by Ricardo, it is impossible to generate fluctuations in the level of economic activity. In the introduction to the book, McCracken wrote:

> "The analysis appears to show that no embodied value theorist can logically explain a business cycle. He either involves himself in a dual theory of value, a logical inconsistency, or explains nothing but a secular trend. The presentation is quite critical, since it deals, as we believe, with the 'false trails,' based upon an erroneous theory of value, formulated by Ricardo." (McCracken 1933: v)

McCracken thus specifically states that if one starts from the kind of theory developed by Ricardo, which McCracken referred to as 'embodied value" theory, then it is not possible to generate cycles. This is the same set of consequences attributed by Keynes to Ricardo. Contrast the Ricardian view with the position of Malthus as presented by McCracken:

> "Malthus serves as a logical starting point for the consideration of business cycles, first, because he stressed the importance of 'short run' factors, and second, because his value approach was from the demand side. Consistent with his theory of value, he held that business might be depressed, either by a voluntary failure of demand on the part of those who had the power but not the will, or by an involuntary failure of demand by those who had the will but not the power." (McCracken 1933: v-vi)

Thus, McCracken attributes a theoretical position to Malthus that allows cyclical activity to occur. He attributes to Malthus the view that "business might be depressed … by a voluntary failure of demand on the part of those who had the power but not the will." This is the very position put by Keynes in the *General Theory*. Incomes are earned but not spent. Savings accumulate and the economy equilibrates at an underemployment level of output.

What completes the connection between McCracken and Keynes is that McCracken is the source of the phrase "supply creates its own demand" which appears in *Value Theory and Business Cycles* and is the first use of those words to describe Say's Law found anywhere within the economic literature. There is no previous identified use of those words anywhere within the classical tradition but they are found in McCracken where he wrote, using a different tense but with the identical intent, that in an economy in which Say's Law applied, "supply created its own demand" (ibid.: 159).

Keynes's Letter to McCracken

That Keynes had read at least part of McCracken's book has not been in doubt since the publication in 1979 of the "laundry basket" of material related to the *General Theory*. There is found a footnote to a 1933 draft in which Keynes cites *Value Theory and Business Cycles* (CW XXIX: 81n) but only in relation to Marx. The question whether he had read other parts of the book was thus still an open question until the discovery in McCracken's archival material of a letter from Keynes to McCracken (see Kates 2008). It is a letter which makes the standard story on the origins of the *General Theory* largely redundant.

Keynes begins his letter with the following straightforward statement: "Having now read your book." Thus, whatever doubts there had been over whether Keynes had read McCracken's material in relation to Ricardo and Malthus is fully resolved. Keynes read what McCracken had written. Indeed, Keynes wrote specifically about his own agreement with Malthus's "line of thought" in dealing with the business cycle. Keynes does not state where those parallels are but he identifies Malthus as a pioneer of the appropriate direction in which such analysis should proceed. Keynes wrote:

> "In the matter of Malthus … I wholly agree with you in regarding him as a much under-estimated pioneer in the line of thought which to-day seems to me by far the most likely to lead to progress in the analysis of the business cycle."

Keynes, in fact, goes further. He specifically endorses McCracken's conceptual approach in distinguishing the Malthusian line of thought from the Ricardian. In this same letter, Keynes writes:

> "Your contrast between Ricardo and Malthus contains, I am convinced, the essence of the matter."

Chapter 1 of the *General Theory* contrasts Ricardo and Malthus in almost exactly the same terms as had McCracken. Keynes's letter makes it clear that the approach he would take would mirror McCracken's which is exactly what he did. To try to explain how the *General Theory* would receive its orientation without the inclusion McCracken leaves out the single most important influence on Keynes as he set out to write his book.

Commons and McCracken

To understand McCracken, however, it is first necessary to understand John R. Commons. Commons was the head of the Department of Economics at the University of Wisconsin and the leading light of the Institutionalist School. He was a leading influence on Progressive politics of the early twentieth century.

Between 1920 and 1922 McCracken undertook his PhD at Wisconsin studying under Commons and graduating in 1923. Some idea of the education McCracken would have received may be gauged by a review written by Commons of Hobson's *Economics of Unemployment*, published also in 1923. In this review, Commons wrote:

> "Modern economic theory originated not so much in the work of Adam Smith as in the debates between Ricardo, Malthus and their friends, respecting the conditions of England after the Napoleonic Wars. It is in the letters of Ricardo to Malthus (1813 to 1823) and in the *Principles of Political Economy* by Malthus (1821) which is evidently the reply of Malthus to Ricardo, that the modern theories of economics and the corresponding remedies for trade depression find their origin." (Commons 1923: 639)

Since the publication of the *General Theory* such views have become somewhat commonplace. Before 1936, however, this kind of insight was rare. What makes this comment even more remarkable is Commons' recognition that the terms of the early nineteenth century debates formed the basis for the classical theory of the cycle, and that the two sides were properly delineated in Ricardo's letters to Malthus with Malthus's reply found in his *Principles* which was actually published in 1820. Malthus's side of the correspondence with Ricardo had not, of course, been discovered in 1923. It was the differences between Ricardo and Malthus that were an important aspect of what McCracken learned from Commons.

According to University of Wisconsin library records, McCracken's thesis was embodied in an article published in the *Review of Economic Statistics* in 1922 and titled, "Secular Trends and Business Cycles: a Classification of Theories." Its joint authors were listed as J.R. Commons, H.L. McCracken and W.E Zeuch. And although the article is about classifications of the theory of the cycle, its very first paragraph deals with the differences between Malthus and Ricardo. The differences outlined would be entirely familiar to anyone who had read the *General Theory*. Then, well into the article, the following discussion occurs which expands on their contrasting theories of the cycle in which it is noted that "Malthus differed from Ricardo at almost every point" (Commons, McCracken and Zeuch 1922: 258). Note the difference in policy that follows from Malthus's approach relative to Ricardo's. It is clear why Keynes preferred Malthus's theories to Ricardo's:

> "According to Ricardo, there could be no universal or general overproduction of goods….
>
> "But Malthus contended that the great mass of commodities is exchanged directly or indirectly for labor, either productively or unproductively. Hence, compared with labour, *all of the goods* may fall in value at the same time. And this general fall in value proceeds from a 'glut,' just as any one commodity falls in value from an excess of supply, compared with labor or money.
>
> "It followed that Ricardo's remedy for overproduction of some goods was more production of other goods. It followed that Malthus' remedy for overproduction was an increase in unproductive consumption, such as taxes, public employment, highways, improvement of landed estates and more employment of menial servants instead of 'productive' laborers." (ibid.)

Then in a footnote reference to a discussion on Sismondi, and where it is noted that in the theory being discussed "the market becomes glutted because effective demand was lacking" (ibid.: 251), the authors state:

> "This question [Sismondi] argued heatedly with J.B. Say and Ricardo. The two latter consistently held that 'goods exchange against goods' and therefore supply could never exceed demand." (ibid.: 251n)

Here we find the theoretical underpinnings for the arguments found at the start of the *General Theory*. Keynes learned from McCracken and McCracken learned from Commons. The linkage between Keynes and Commons via McCracken is unmistakeable.

Commons' Direct Influence on Keynes

But for all that, the link between Commons and Keynes did not need to be forged by McCracken since Keynes had been an admirer of Commons' work since the 1920s. This is noted by Skidelsky who, in his biography of Keynes, wrote:

> "Commons, an institutional economist who taught at Wisconsin University, is an important, if unacknowledged, influence on Keynes. Indeed, Keynes wrote to him in 1927 that 'there seems to me to be no other economist with whose general way of thinking I feel myself in such general[2] accord'." (Skidelsky 1992: 229)

Commons' influence on Keynes can be seen in two separate publications. In 1925, Commons distributed a brief draft of a book that would become *Institutional Economics* (1934). It was titled *Reasonable Value* and Chapter V is devoted to the issue of "futurity". This was the name given by Commons to the concept he was developing that argued all economic activity is oriented towards the future. It is this concept that McCracken argued was the greatest legacy that Commons and Keynes had bequeathed to economic theory. In his *Keynesian Economics in the Stream of Economic Thought* (1961), McCracken had written:

> "In class notes of 1921 the author found this statement: 'Value is a mental appraisal in the present of future uses of incomes.' The same idea was later included in *Institutional Economics*: 'It is evident, indeed, that the entire concept of value is volitional instead of mechanistic, since value is a present estimate of something expected in the future.'
>
> "**The meaning given to this formal definition was almost precisely the idea later expressed by Keynes in his *General Theory* (1936)**, in which Chapter 5 is devoted to expectations….

[2] This is a mis-transcription by Skidelsky. The actual word is the much stronger "genuine" and not "general".

> "It is the judgment of the writer that Commons and Keynes have here given us the greatest single contribution to economic theory in this century." (ibid.: 70-71 – italics in the original but the bolding has been added)

Nor does McCracken suggest that this idea had been developed by Commons and Keynes at more or less the same time. He specifically noted Commons' priority claim:

> "A final feature of *Institutional Economics* centers around the word 'futurity.' Commons definitely anticipated Keynes by approximately twenty years." (McCracken 1961: 69)

And it was this concept which had featured in *Reasonable Value* a book sent to Keynes in 1925 and from which Keynes drew a good deal of material for a speech given in Moscow in the same year (Whalen 2008: 230). Chapter V of *Reasonable Value* is titled "Futurity" and deals with the need to bring economic decision making back to the present. This is stated by Commons:

> "When we observe that human willingness is the force with which economic science has to do … then we find that it is … the hopes and fears of the future that determine what shall be done in the present…. It is not difficult to picture the functional relations between futurity, thus defined, and the other dimensions of Willingness. *What* must I do, and *How* shall I do it, are the questions regarding the future that related to efficiency. *When* must I do it, *How much* shall I get, and *how long* must I wait, are the questionings of the future that relate to scarcity." (Commons 1925: 71-72)

Present actions are determined by beliefs about the future. "*How much* shall I get, and *how long* must I wait" are concepts which Keynes would later embody in his internal rate of return.

In *Institutional Economics* published in 1934, the chapter on "Futurity" has expanded from four pages to 258, stretching from page 390 to page 648. Here, too, Commons discusses future value as a discounted sum based on expectations for the period ahead:

> "There is the other variable dimension of value … and economics operates with this third dimension, the measurement of Time. Time, in the transactional process, is always Future Time. Futurity operates in the two dimensions of waiting and profiting (risking). Each of these is a dimension of discount, by virtue of which the present worth of a future quantity is less in its monetary magnitude than it would be if there were no interval between the present point of time when the transaction takes legal effect and the future point of time when the results are expected. We have distinguished the effects of futurity as the profit discount and the interest discount. Each is highly variable. If either of them reaches 100 per cent discount, then present value totally disappears and industry stops." (Commons [1934] 1961: 520)

Or, as expressed in the quotation from Commons noted by McCracken, “value is a present estimate of something expected in the future” (ibid.: 521). There is no question that Keynes read Commons’ *Reasonable Value* and given his extraordinarily high regard for Commons, it is highly likely that he read *Institutional Economics* when it was released in 1934, that is, while he was in the midst of putting together his *General Theory*. The probability of a direct influence of Commons on Keynes is far from being zero.

Was McCracken Aware of his Influence on Keynes?

The final question is whether McCracken was aware that Keynes had developed his own ideas in reference to his own. And, in fact, there are reasons for believing that McCracken was aware of his direct influence on Keynes but to go into these in full would require a separate and even longer paper. But what should be seen at the threshold of this question is the existence of the very long chapter devoted to Commons and futurity that McCracken included in a book that was in its entirety designed to look at Keynesian economics.

McCracken was a Senior Lecturer at the University of Minnesota when he wrote his book and sent it off to Keynes. As these things go, he almost could not have been further down the totem pole from Keynes. Keynes was at the time the most renowned economist in the world while McCracken was still attempting to become established. His book would eventually allow him to become the Professor of Economics and Head of the Department at LSU, but at the time both his book and the *General Theory* were written, he was an unknown author of a single book. For him to have suggested that he had had any influence on Keynes whatsoever would have led to his being accused of having delusions of grandeur. The idea would have been seen as ridiculous.

What he seemed to have done instead is to draw attention to the very close parallels between Keynes and Commons, two economists of near equal stature on the two sides of the Atlantic. If one looks at the words chosen by McCracken, he is saying, and in no uncertain terms, that Commons reached the idea of futurity first. McCracken spelled it out: “Commons definitely anticipated Keynes by approximately twenty years.” And, moreover, he does not in any way imply that this was an example of a parallel discovery. He says that both said exactly the same thing and that Commons was the first to do so.

In most other regards he kept his own counsel. If he had hoped that Keynes would specifically acknowledge that McCracken had opened his eyes to certain aspects of the Malthus-Ricardo relationship, and had instructed him on the nature of their two perspectives on business cycle theory, then he would have been very disappointed. The only way, therefore, to draw attention to Keynes’s unacknowledged use of the work of others would have been to discuss Keynes’s use of Commons ideas and hope that someone might one day notice.

But this much satisfaction he would have had. He had written a thesis under John Commons, which was later on turned into a book, in which the main point was that the business cycle theories of Ricardo were still embedded in the economic models of his contemporaries who could not, therefore, logically generate cyclical activity. If one used the demand-side approach proposed by Malthus, however, then an explanation for the business cycle became quite apparent. These were his ideas and he lived to see them become the very core of macroeconomic thought. There is little doubt that this would have given him at least some satisfaction although not as complete as the pleasures that such recognition would have produced and which was so thoroughly deserved.

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