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Say's Law and the Macroeconomics of 2020 in the Era of COVID-19

Your blogger first learned about macroeconomics in the mid 1960s. Times were good, the economy was growing at a rate of 4 to 5 percent per year, and unemployment was below 4 percent, in large part due to the expenditures for the Viet Nam War. However, all of our parents had gone through the Great Depression in the 1930s, and it was never out of their minds. No one wanted to see something like that again.

The study of macroeconomics emerged in the post World War II economics profession, in reaction to the Great Depression. Prior to that, a doctrine called Say's Law[1] stated "A product is no sooner created, than it, from that instant, affords a market for other products to the full extent of its own value." Stated in another way, as long as people were willing to work, they would earn money from selling their goods or services, and they would be able to spend it on other goods and services. So, there would not be unemployment, and people would have the wherewithal to buy what they wanted. It is often phrased "Supply creates its own demand."

Adherents of Say's Law viewed any economic downturn as temporary. Workers were demanding too much, or sellers were charging too much. If markets were allowed to adjust, everyone who wished to work could do so. Advocates of Say's Law had elegant models to show how if wages and prices fell enough, the economy would always return to full employment. The Depression started at the end of 1929 and lasted into the early 1940s. It was not short term. There was not a simple return to full employment.

John Maynard Keynes attributed the Great Depression to a collapse in demand for goods and services. His cure for this problem was for the government to buy things, to create demand. It was used fitfully in the 1930s by the Western democracies (ironically most effectively by Germany), but World War II created the demand to end the Depression. As World War II ended, economists worried that the economy would fall back into Depression. In large part, because the US was the only intact economy after the War, there was great world demand for US goods and services. The 1950s showed stable economic growth that moved into the 1960s.

The boom of the 1960s gave way eventually to "stagflation" of the 1970s and many economists argued that the government should get out of the way. Economic decision-makers would figure them out, and the government policies would not be effective. Critics of the Keynesian analysis argued that there was a "natural rate" of unemployment related to labor market search frictions, and attempts to go lower were essentially attempts to "fool Mother Nature." Yet over time the natural rate decreased, and after the 2007-2009 recession, the economy

[1] *A Treatise on Political Economy* (*Traité d'économie politique*, 1803) from https://en.wikipedia.org/wiki/Say%27s_law.

grew for almost ten years, albeit by smaller annual increments than in the past. The 2017 tax cut was essentially Keynesian in scope. It was an increase in aggregate demand into an economy that was at close to full employment

Then came COVID-19. In the three month period ending this weekend (the end of May 2020), both aggregate supply and aggregate demand have tumbled. Aggregate supply shut down first. Large parts of the US (and world) economies simply shut down. Aggregate demand followed shortly. The workers without money had little to spend. Large sectors of the economy, particularly those related to people coming together in large places, such as airlines, cruise ships, downtown districts, and sporting events, have collapsed. Universities limped through the spring, but most do not know what the Fall will bring. Auto factories have closed, re-opened, and closed again.

Depending on Say's Law will not help us in the next twelve to eighteen months. Supply is limping back, due in large part to workers' collective reluctance to put themselves in danger. There will not be a lot of supply to create the new demand. In a sense Say's Law is working as stated … but there is not enough supply to create its own demand.

The government knows how to create the necessary demand. It is not wrong to do so. It is essential.

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