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French economist's long-forgotten demand theory gets its due after new US policy

JB Say's message was that a demand failure could not cause an economic slump

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In late April this year, the Bureau of Economic Analysis (BEA) at the US Department of Commerce announced that it would start reporting a new data series as part of the US national income accounts.

In addition to gross domestic product (GDP), the BEA will start reporting gross output (GO). This announcement went virtually unnoticed and unreported.

Yet GO represents a significant breakthrough.

The Classical School of economics prevailed roughly from Adam Smith's *Wealth of Nations* time (1776) to the mid-19th century. It focused on the supply side of the economy. Production was the wellspring of prosperity.

The French economist JB Say (1767-1832) was a highly regarded member of the Classical School. To this day, he is best known for Say's Law of Markets. In the popular lexicon – courtesy of John Maynard Keynes – this law simply states that "supply creates its own demand".

But, according to Steven Kates, one of the world's leading experts on Say, Keynes' rendition of Say's Law distorts its true meaning and leaves its main message on the cutting room floor.

Say's message was that a demand failure could not cause an economic slump. This message was accepted by virtually every major economist, before the publication of Keynes' *General Theory of Employment, Interest and Money* in 1936 which changed everything.

Kates argues that Keynes had to set Say up as a sort of straw man so that he could remove Say's ideas from economists' discourse and the public's thinking. Keynes had to do this because his entire theory was based on the analysis of demand failure and his prescription for putting life back into aggregate demand – namely, a fiscal stimulus.

Keynes was wildly successful. With the publication of the General Theory, the supply side of the economy almost entirely vanished. It was replaced by aggregate demand, which was faithfully reported in the national income accounts. In consequence, aggregate demand has dominated economic discourse and policy ever since.

Among other things, Keynes threw economics into the sphere of macroeconomics. It is here where economic aggregates are treated as homogenous variables for purposes of analysis.

But, with such innocent-looking aggregates, there lurks a world of danger. Indeed, because of the demand-side aggregates that Keynes' analysis limited us to, we were left with things like the aggregate size of consumption and government spending. The structure of the economy – the supply side – was nowhere to be found.

The supply-side made a comeback in the 1980s and was associated with the likes of Nobel laureate Robert Mundell.

But it is worth mentioning that the onslaught by Keynes on Say was largely ignored by many economic practitioners who attempt to anticipate the course of the economy.

For them, the supply side of the economy has always received their most careful and anxious attention – the Conference Board's index of leading indicators for the US economy is predominantly made up of supply-side indicators.

But, when it comes to the public and the debate about public policies, there is nothing quite like official data.

So, until now, demand-side GDP data produced by the government has dominated the discourse.

With GO, GDP's monopoly will be broken as the US government will provide official data on the supply side of the economy and its structure.

GO data will complement, not replace, traditional GDP data. GO data will improve our understanding of the business cycle and also improve the quality of the economic policy discourse.

These changes it brings are big, not only conceptually, but also numerically. US GO was 76.4 per cent larger than GDP last year.

Why? Because GDP only measures the value of all final goods and services in the economy. GDP ignores all the intermediate steps required to produce GDP. GO corrects for most of those omissions.

Even though the always clever Keynes temporarily buried JB Say, the great Say is back.

With that, the relative importance of consumption and government expenditures withers away. And, yes, the alleged importance of fiscal policy withers away, too.

Contrary to what the standard textbooks have taught us and what that pundits repeat ad nauseam, consumption is not the big elephant in the room. The elephant is business expenditures.

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