# The Dangers of Monetary Policy in Agrarian Economies: A Rejoinder

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Professors Patrick and Chandler have shown, carefully and correctly, that my analysis depends critically upon a particular assumption. Despite their vehement disagreement with this assumption—that farmers will hold a larger part of their wealth in foodgrains when the alternative is to convert those grains into money at declining prices—I still believe in its realism and am grateful for the opportunity to elaborate its defence:

1) Farmers tend to be optimistic about future prices and outputs; the strain of existence might be unendurable without this optimism. The result is that high prices are quickly seized upon by farmers as normal prices.

2) Farmers have short memories and treat recent prices as expected future prices. For example, agricultural supply studies in Pakistan show that the use of several lagged prices fails to improve regressions; just last year's price is sufficient to explain almost the entirety of any response to price[1], Thus last year's high price becomes this year's expected price; but more important, it becomes this year's concept of a "normal" price.

3) Farmers hold wealth primarily as a precaution against crop calamities. When one farmer's crop fails, so also will many of his neighbour's crops and high food prices are likely to prevail in the region. Thus his money will be used to purchase food at (what he considers) normal or above-normal prices, and he will not be anxious to acquire money if it requires selling food at (what he considers) below-normal prices.

Primarily for these reasons, I do not believe farmers would be willing to maintain the money-fraction of their wealth in the face of prices which are falling below "normal" levels.

If this critical assumption is accepted, everything else follows; if not, none of it follows. Whether one accepts or rejects it depends upon one's view of the way the world operates. The assumption is patently an empirical guess. The assumption I chose may be empirically inaccurate, but it is not

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1. See, for example, W. Falcon, *Agricultural Supply Analysis in an Underdeveloped Area—A Case Study of West Pakistan.* (unpublished), Chapter 4; and R. Clark, "The Economic Determinants of Jute Production", *FAO Monthly Bulletin of Agricultural Economics and Statistics*, September 1957, pp. 1-10.

logically incorrect (as Messrs. Patrick and Chandler seem to imply). For example, there is nothing "strange" (p. 6) in the fact that the rate of monetization cannot be accelerated by rising prices but can be temporarily reversed by falling prices, *i.e.*, what Messrs. Patrick and Chandler call "an infinite elasticity of substitution in agricultural wealth balances at one price level and not at another" (p. 6). It is no more "strange" than the traditional statement about monetary policy being like pulling or pushing on a string. In the short-run especially, we can find many such asymmetries in the world.

I agree that rising prices *seem* "hardly conducive to monetization of the agricultural sector" (p. 6). But the world has long experienced simultaneously gradual inflation and gradual monetization. Our historical experience is that price stability is neither necessary nor sufficient for monetization. In any case, I was not advocating rising prices; rather I was suggesting that it might be impossible to reverse a price rise that had unfortunately already occurred.