[Money and Capital]: A Rejoinder

Piero Sraffa

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my criticism of his *Treatise*.[1]) I venture to believe that Mr. Keynes would fully agree with me in refuting Mr. Sraffa's suggestion. That Mr. Sraffa should have made such a suggestion, indeed, seems to me only to indicate the new and rather unexpected fact that he has understood Mr. Keynes' theory even less than he has my own.[2]

F. A. VON HAYEK

A REJOINDER

THIS specimen of Dr. Hayek's manner of arguing is by itself such an eloquent illustration of my review that I am reluctant to spoil it by comments. I shall therefore confine my reply to the two "cardinal" questions, whilst for the other points referring the patient reader (if there be any) to my previous contribution.

The first question is whether, as Dr. Hayek asserts, the capital accumulated by "forced saving" will be, "at least partly," dissipated as soon as inflation comes to an end: "it is upon the truth of this point that my [Dr. H.'s] theory stands or falls." My simple-minded objection was that forced saving being a misnomer for spoliation, if those who had gained by the inflation chose to save the spoils, they had no reason at a later stage to revise the decision; and at any rate those on whom forced saving had been inflicted would have no say in the matter. This appeal to common sense has not shaken Dr. Hayek: he describes it as "surprisingly superficial," though unfortunately he forgets to tell me where it is wrong. I must therefore make another attempt to follow him a little way into "profundity."

I shall take up his argument (§ 3) at the point where the inflation which has caused the accumulation of capital comes to an end. In order that the case may be comparable with Dr. Hayek's case of "voluntary saving," inflation must have proceeded at a gradually decreasing rate until it ends just when the longest among the newly started processes of production begin to yield consumable products: from that moment onwards the entrepreneurs will be able to meet their outgoings for current production and for maintenance of the increased capital entirely out of their receipts from sales, without need of any additional inflationary money. This, of course, as Dr. Hayek says, is possible "only so long as wages [*i.e.* incomes] have not risen in proportion

[1] See *Economica*, No. 34, November 1931, p. 402 *n*.

[2] [With Prof. Hayek's permission I should like to say that, to the best of my comprehension, Mr. Sraffa has understood my theory accurately.—J. M. KEYNES.]

to the additional money which has become available for investment." And now we reach the point of the dispute: "Ultimately, incomes must rise in that proportion, since even the money used for the purchase of capital goods must ultimately be paid out to the factors which make these new capital goods." I contend that this will not happen. Once more Dr. Hayek himself provides me with the argument against his theory, by appending here this footnote: "Except for such amounts as may be absorbed in cash holdings in any additional stages of production." Exactly: and if Dr. Hayek had taken as much pains in writing his book as his reviewer has taken in reading it he would remember that under his assumptions such cash holdings will absorb not merely certain exceptional amounts, but *the whole* of the additional money issued during the inflation; that consequently incomes cannot rise at all, and there will be no occasion for any dissipation of capital. Let me remind him that he has assumed in his book that capital will be accumulated in proportion to the quantity of money issued in the form of loans to producers; that the number of stages of production will increase in proportion to the quantity of capital; that the quantity of payments to be made will increase in proportion to the number of stages: as a result, the quantity of payments to be made increases in proportion to the quantity of money, and the whole of the additional money is absorbed in cash holdings for performing such payments.

It may be noticed as a curiosity that in the world assumed by Dr. Hayek, inflation through credits to producers, while it leaves money incomes unchanged, brings about a positive *fall* in the prices of consumers' goods. (As this may sound incredible, perhaps even to Dr. Hayek, compare in *Prices and Production*, Fig. 2, p. 40, which represents the initial position, with Fig. 4, p. 50, which represents the situation at the end of the inflation: the aggregate money value of the mass of consumers' goods is unchanged, but their quantity being larger after the inflation, prices per unit must be lower. See also pp. 51–2.)

After this Dr. Hayek will allow me not to take seriously his questions as to what I "really believe." Nobody could believe that anything that logically follows from such fantastic assumptions is true in reality. But I admit the abstract possibility that conclusions deduced from them by faulty reasoning may, by a lucky accident, prove quite plausible.

I have only a few words to add on the second cardinal question, that of the "money" and the "natural" rates of interest (§ 4). Dr. Hayek's ideal maxim for monetary policy, like that of Wick-

sell, was that the banks should adopt the "natural" rate as their "money" rate for loans: the only obstacle which he saw was the difficulty of ascertaining in practice the level of the "natural" rate (p. 108 of the book). I pointed out that only under conditions of equilibrium would there be a single rate; and that when saving was in progress there would at any one moment be many "natural" rates, possibly as many as there are commodities; so that it would be not merely difficult in practice, but altogether inconceivable, that the money rate should be equal to "the" natural rate. And whilst Wicksell might fall back, for the criterion of his "money" rate, upon an average of the "natural" rates weighted in the same way as the index number of prices which he chose to stabilise, this way of escape was not open to Dr. Hayek, for he had emphatically repudiated the use of averages. Dr. Hayek now acknowledges the multiplicity of the "natural" rates, but he has nothing more to say on this specific point than that they "all would be equilibrium rates." The only meaning (if it be a meaning) I can attach to this is that his maxim of policy now requires that the money rate should be equal to all these divergent natural rates.

PIERO SRAFFA