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At the Crossroads

ALTHOUGH it is only custom that leads us to attach any special significance to the ending of one year and the beginning of another, this imaginary break in the continuous flow of time may nevertheless have some value. Like a traveler who parks his car beside the road when he comes to a crossroads, to look at his maps and orient himself with respect to the road just traversed as well as those lying before him, so one may take the opportunity provided by the change from one year to another to review the little segment of history through which he has just passed and to look forward to the future he is about to enter.

The year 1948 was the most recent one in a period that was unusual for its psychological atmosphere. Although the nation enjoyed one of the greatest booms in its history on the material side, business was haunted throughout the period by fears of impending catastrophe. It was perhaps the gloomiest period of prosperity that the country had ever experienced.

Still under this psychological cloud, the nation entered the new year with mixed feelings of hope and dread. Now that 1948 is safely buried in history, however, we can look back on it with a large measure of satisfaction. By all ordinary standards it was a year of exceptional prosperity. Wages and personal incomes generally were high and rising throughout the year; profits reached unprecedented levels; more people were employed in factories and on farms than ever before; factories and mines worked at capacity during most of the year; and near-record crops were produced by the country's farmers. Shortages of some goods still existed, of course, but in general the shelves of stores were well stocked with almost everything one wanted to buy, and money was still abundant.

The total value of goods and services produced in the country, a value that had run at an annual rate of 232 billion dollars in 1947, rose to 245 billion in the first quarter of 1948; to 250 billion in the second quarter; and to 256 billion in the third quarter. In the fourth quarter this figure was probably still higher. Personal expenditures for consumption, which in 1947 had amounted to 165 billion dollars, rose to an annual rate of 172 billion in the first quarter of 1948; to 177 billion in the second quarter; and to 179 billion in the third quarter. This figure, too, was probably somewhat higher in the last quarter of the year. It requires no further statistical documentation to show that 1948 was a prosperous year.

The fear that had tempered hope at the beginning of the year, however, was that this was a false prosperity resting only upon the inflationary effects of war financing and sustained precariously by one *tour de force* after another by Government. Such a prosperity, it was felt, could not last.

Be that as it may, the country went blithely on its way during most of the year enjoying its inflation to such an extent that even a presidential campaign failed to disturb it. The voices that had earlier been forecasting bad economic weather ahead began to change their tune as the year wore on. Basking in the golden haze of midsummer prosperity, they were then saying that this sort of thing might go on for another year at least; or perhaps for two years; possibly even for five years. Observers who were still inclined to look to the future with foreboding could bolster their pessimism only by repeating the old cliches that "what goes up must come down" and that "the boom is one year older and is therefore that much nearer its end."

From time to time, of course, the administration and various Government agencies summoned the Congress and the country to an all-out fight against inflation. That fight, however, scarcely ever reached the proportions of a skirmish. The Federal Reserve System was given a little more leeway to increase bank reserves; some check was placed upon the expansion of consumer credit by the re-imposition of Regulation W; banks, following the counsel of the American Bankers Association, became more restrictive and discriminating in their lending policies. The inflation, however, continued with little else being done about it. After a drop early in the year, the wholesale price index rose to its highest point in midsummer. The fear of inflation that had bedeviled the country early in 1948 seemed to have melted away in the warmth of the all-pervading prosperity. Even the threat of a fourth round of wage increases did not create the commotion that might have been expected.

In the last quarter of the year, however, came a sudden change in economic climate. A chill wind blew across the economy. Farm prices for most crops fell to support levels or below; backlogs of demand for many consumer goods disappeared over night. Public attention fixed itself on department store sales. These were found to be running below the corresponding months of 1947. At first this was attributed to unseasonably warm weather. But when winter descended on many cities in earnest and sales still did not pick up, even with the near approach of the Christmas season, alarm was felt throughout the business world. It was not until the last few shopping days before Christmas that the flagging market was stimulated by pre-Christmas sales and some drastic price reductions.

Still other harbingers of trouble were discerned on the horizon. It was recalled that the textile industry had been

working only part time for several months. The gray iron casting business, basic to many other lines of finished goods, was falling off. The shoe and electrical equipment industries were not doing well. Reports of layoffs were becoming more widespread and more numerous although the total number of unemployed in the country as a whole did not increase appreciably. Moreover, the wholesale price index was falling—slightly, to be sure, but falling nevertheless.

In November the presidential campaign ended in an astounding surprise that upset the calculations of nearly all political prophets. Could the economic prophets be equally mistaken?

As the year neared its end, therefore, the voice of gloom was again heard in the land. Important business publications were admitting quite frankly that the country was in the midst of a "mild recession." The more fainthearted were saying privately that "this is it!" The fear of inflation was giving way to its opposite—the fear of depression. If the country was not already standing at the crossroads as 1948 waned and 1949 came up on the calendar, it seemed at least to be approaching some kind of parting of the ways. At this juncture it is still too early to say whether or not the current business lull is merely the prelude to a further upward climb of the indexes, or if it is the beginning of a recession. Still less can it be said whether or not we have embarked upon a downward trend that may toboggan into a depression.

With the signposts at the crossroads pointing in several directions, we may profitably pause to remind ourselves of some important characteristics of our economic system. By doing so we may avoid choosing our road under the bias of either false optimism or unwarranted pessimism.

It is true that we are in economic danger. This is nothing unusual, however, for danger lurks in all economic movement, especially when it involves a change in direction. Someone has said that "life is a dangerous business at best and few get out of it alive." As long as our economy is a living and growing thing it must be expected to exhibit movement in some direction or other. Those who think that it can just level off on some comfortable plateau and stay there are probably deluding themselves. Periods of expansion and contraction are inherent in the capitalistic mechanism and cannot be eliminated without doing away with capitalism itself, and, perhaps, with the democratic institutional framework associated with it. It is not these perfectly normal fluctuations that are dangerous, but rather the possibility that under certain circumstances they may degenerate into abnormal and unnecessary catastrophes.

The inflationary period through which we have been passing since the end of the war has certainly been fraught with danger. High prices, of course, have a logical function to perform in our economy. They are meant to stimulate production and at the same time to restrict the demand for scarce goods. When the resources of the nation are fully employed, however, and when production is already running at capacity, high prices can do little to stimulate production. In such a situation they may, indeed, be unable to perform their other function, that of restricting demand. If the volume of money increases and there is thus reason to believe that prices may go still higher, people with money in their pockets, instead of withholding their purchases, may actually increase their demand for goods and thus bid prices up still further. Such a situation could obviously degenerate into a runaway inflation—a flight from money into goods. That was a risk that was present throughout the postwar period.

If, as seems probable at this writing, the inflationary upswing of prices has now been checked or, perhaps, reversed, it is a matter for self-congratulation. It means that we have escaped this particular danger. Fear, according to an old proverb, has big eyes. Our fear of inflation was perhaps always considerably exaggerated. Serious though it has been, inflation never assumed, even remotely, the proportions that were always possible on the basis of technical factors alone. The expansion of the money supply through the monetization of bank-held public debt, for example, could certainly have gone much farther than it did.

Whether it was the policies of the monetary authorities, the self-discipline of the banks, or the reluctance of business to make use of the potential credit available to it that prevented inflation from growing to unmanageable proportions is of little concern right now. The important point is that this danger has apparently been avoided and that high prices are now beginning to exert their proper influence—restricting demand and causing people to prefer to hold cash rather than over-priced goods.

A declining price level, however, also has its perils. Falling prices are normally expected to check any tendency to over-production that may be present and to stimulate consumer buying. If prices fall too far and too fast, however, and if there is reason to think that they may go still lower, buying may be inhibited rather than stimulated. People will hold on to their cash in anticipation of the lower prices they think they foresee. If this sort of movement gets out of hand there is a real danger that what would otherwise have been a normal recession may degenerate into a depression. Such an outcome, however, is not at all necessary.

The first step in preventing a recession from degenerating into a depression is to realize that they are two different things. A recession is a wholly normal and healthy development. It represents a tendency within the economic system to approach an equilibrium from which the system had radically departed. A depression, on the other hand, is abnormal and unhealthy and performs no legitimate economic function. It is brought about by panic, false fears, unwise judgments, previous excesses, and precipitous action. A recession must therefore be accepted as part of the normal working of the economic system and should not be fought against. A depression, however, should be recognized as a perversion of the system's operations and should be guarded against to the best of our ability.

The heart of the capitalistic mechanism is the accumulation of capital in the form of new factories, new equipment, new processes, and sometimes wholly new industries. It is because of this capital-building process that our economic system has achieved its miracles of productive efficiency. A period of capital expansion, however, tends to be a period of rising prices, for incomes are then being paid out to create productive facilities that are not yet contributing to the stream of goods. Although money incomes may be increasing, real incomes may actually be declining in such a period.

This has tended to be the situation since the war. On top of the inflationary wave generated by the financing of the war and of postwar foreign aid programs has been another generated by the expansion of capital. Gross private domestic investment (a category that includes new construction, new producers' durable equipment, and changes in business

inventories) amounted to 27 billion dollars in 1946. In 1947 it amounted to 30 billions and by the third quarter of 1948 it had risen to an annual rate of 39 billions.

When capital expansion levels off or declines, however, the price level may also be expected to fall under the double impact of declining money incomes and a swelling stream of consumer goods that is the fruit of the previous accumulation of capital. This may well be the kind of situation into which we are now moving for there are indications that expenditures for capital are leveling off and it is now a fact that the price level is declining.

Whether we encounter this situation in the immediate future or later, it is important that it be accepted without fear or panic. A period of recession is far from being a bad thing in itself. Certainly it takes more effort and more brains to do business in such a period than in one of inflationary prosperity when money can be made merely by riding the wave of a rising price level. Nevertheless, the pressure of falling prices compels management to read its cost sheets with greater care and to effect economies and efficiencies of operation that would be ignored in more booming times. An easing of the labor supply might also compel labor to reconsider what it means by a fair day's work for a fair day's pay. Insofar as a declining price level enforces greater efficiency from both management and labor, productivity is increased. Increased productivity, in turn, may go far to offset a probable decline in money income so that the net result may well be an increase in real income and well being all around.

Some acute students of the capitalistic system, indeed, believe that in the long run capitalism can prosper only on a gradually falling price level. The technological improvement that has been so characteristic of our economic system and the increasing managerial efficiency that has been the hallmark of American business enterprise should normally be expected to bring about a gradual cheapening of goods relative to money. This is merely another way of saying that they can be expected, in the future as they have in the past, to lead to a rising standard of living and of real income for all.

A smooth adjustment of this sort, however, is threatened by two dangers. One grows out of what is fast becoming a national fetish—the quest for security and stability. If businessmen or the general public should become alarmed at a persistent downward trend of prices and should appeal to the Government to halt it by recreating in one way or another the conditions of inflation, the economy would become more than ever the creature of political forces. It would become so, moreover, at the price of perpetuating the abnormalities, the inefficiencies, and the distorted relationships that have marked the past few years. Everyone—the businessman, the laborer, the farmer, the banker, and the consumer—should realize that a stable capitalism (in the sense of static) is a contradiction in terms. Only dead things are static. To perpetuate into the future by governmental action the particular constellation of economic forces that happens to exist at any given moment is to threaten the economic system by which we all live. Downward as well as upward movements must be accepted as normal.

A second risk is that businessmen by their own actions may precipitate a decline in prices so rapid that many individual firms may have difficulty in adjusting their cost structures to it. All costs are not equally flexible for any particular firm, nor are costs equally flexible for all firms in an industry. All but the least efficient concerns can usually adapt themselves to a decline in the price level without undue hardship provided the decline is gradual enough for costs to be adjusted to reduced receipts. If the decline is too drastic or too rapid, however, many a firm that might otherwise stay afloat may go under, creating unemployment and further disrupting market relationships in the process.

The crux of this danger lies in the possibility that the urge to "get-rich-quick" that thrives in a period of inflation and that produces many of the excesses of such a period may be converted into an urge to "get-out-from-under" when prices turn downward. If so-called "smart operators" were to initiate a wave of competitive price-cutting leading to widespread distress selling, the end could only be disaster for all, for the "smart operators" along with the rest.

As welcome as lower prices would be to people generally, if they should come about in such a way as to lead to cancelled orders, cutbacks in production, widespread layoffs of workers, and a ruined agriculture, nobody would be the gainer. Businessmen owe a certain social responsibility to each other that can be ignored only at their own and the country's peril. They must indeed be willing to accept the normal fluctuations of the economy, but they must not, through their unbridled individualism, bring down the edifice they really wish to preserve.

These, then, are some thoughts that might well be pondered by businessmen as they stand at the crossroads of a new year. What 1949 holds in store no one can say with certainty. The signposts point to several roads. One road leads up the steep inflationary ascent again by way of heavy governmental expenditures and perhaps of deficit spending. Another leads down the gentle slope of a recession that can be salutary if the realities of our economy are accepted and if there is a general effort on the part of business to avoid precipitous action. A third road, however, leads over the precipice if fear gets the better of caution and if everyone seeks only to save himself.

The only thing that can be said with certainty about 1949 is that it will be the kind of year that today's decisions make it. The choice of the road to be followed still lies with men and not with blind fate.

EARLE L. RAUBER

Announcement

The first issue of the BANKERS FARM BULLETIN *came from the press this month. This is a new monthly publication of the Federal Reserve Bank of Atlanta. It may be received regularly without charge upon request. Requests should be addressed to the Research Department of this bank.*

The appearance of the BANKERS FARM BULLETIN *is another evidence of the interest of this bank in the problems of farmers and of the banks that serve them. It will carry news items, discussions, comments, and information on agricultural subjects that are of interest to bankers and to others working in this important part of our economy.*