PRICES AND CONSUMPTION

The continued rise in consumer prices is of wide-spread concern. When those with fixed incomes speak of inflation they really refer to the smaller basket of merchandise they carry home when they spend a ten dollar bill. And when union officials sit down at the bargaining table, they are sensitive to what their constituents are hearing from their wives about the mounting costs of running a home. This reaction to climbing prices leads some, even in high places, to argue that high interest rates lift costs and therefore are the villain. Others maintain that big manufacturers take advantage of their power to administer prices in order to secure excessive profits. Still others suggest that labor demands for wage increases exceed gains in productivity, or that the rise in prices stems from the impetus to public and private spending that is given by the enormous expansion of debt of all kinds.

Recent Economic Developments

Although people differ as to the reasons for recent price advances, most of them would agree that the major economic problem of the free world has been inflation. In the United States, the recovery from the 1953-54 recession was transformed into a boom as a sharp expansion in consumer demands and in residential construction induced substantial investment in industrial plant and equipment. Capacity rates of output were reached for some items, and total demand exceeded the goods and services available at existing prices. Since mid-1955, wholesale prices have risen 7 per cent; since early 1956, consumer prices 6 per cent.

Associated Merchandising Corporation
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Economic indicators are reflecting continued inflationary pressures in some sectors and abatement in others. On this economic Ferris wheel, some items are moving up; some down or sideways. For example:

Personal income continues to establish records. In July and August, 1957, it averaged 6 per cent higher in dollars and 2 per cent higher in purchasing power than a year ago.

Consumer spending continues at a record rate, especially for non-durable goods and services.

Purchases by State and local governments, currently at a seasonally adjusted annual rate of $36 billion is increasing by almost $4 billion per year, or about 9 per cent.

Business expenditure for plant and equipment, however, has apparently leveled off though at a high plateau.

Exports are still high but may decline, partly as a result of financial readjustments abroad.

Since the end of May, business loans at the weekly reporting city member banks have increased $1.25 billion, about TWO-FIFTHS ~~one-third~~ less than last year. However, the volume of new loans made by these banks has continued to exceed last year's volume of new lending. But the volume of repayments has increased more rapidly than new lending.

Until a few months ago aggregate demands, both governmental and private, for scarce materials and labor pressed hard upon our resources, and prices rose as a result. Savings and certain labor skills remain scarce in relation to demand. The desire to invest continues to exceed the rate of saving.

Although business as a whole seems to be leveling out at the moment, it remains remarkably strong, and the potential for inflation most certainly still exists. When increases in GNP in current dollars are almost matched by increases in average prices, monetary authorities cannot be complacent about inflationary dangers.

On the other hand, capacity has been expanding, and many production bottlenecks have disappeared. Supplies have become more readily available to meet the continuing heavy requirements for most materials, and the ~~pile-up~~ PILING UP of stocks associated with earlier shortage conditions ~~have~~ HAS given way to ~~reductions of inventories~~ INVENTORY REDUCTIONS of some commodities. The sharp rise in spending for new plant and equipment in 1956 has been followed by a leveling out this year. Should it decline, the rolling adjustment would then have to lean upon some other type of demand, perhaps consumer demand. Since consumer demand is our central theme, certain forces that affect it should be mentioned. These are population, incomes, and prices.

Population changes have a significant influence on the total of consumer expenditures and on the relative amounts of the various goods and services demanded. In the postwar years, total population has increased 1.7 per cent a year--a rate as high as in the early 1920's and more than double the rate of the 1930's. In each of the past few years, about 2.8 million people have been added to the nation's population. Each one of these consumers is a potential store customer.

Projections of the the total population are subject to uncertainty, for attitudes toward family size and other relevant factors may change again. However, the number of people in various age groups can be estimated for some time ahead on the basis of the current age distribution. It is calculated that in 1965 there will be roughly 12 million more teenagers than there were in 1955--an increase over the decade of 48 per cent. In contrast, the number of people in the 25 to 44 age group will probably be slightly smaller. Such shifts in composition are an important factor in making plans for selling specific commodities, and I am sure these trends are familiar to you.

While population, its size and composition, is a basic determinant of needs and wants, how much consumers can spend in any period depends largely on their incomes. The amount of spending in relation to incomes may be influenced by consumers' financial asset and liquidity positions, and also by the ease with which they can obtain credit. At the same time, the willingness to draw down assets or to go into debt is influenced by current income and by expectations of future income.

There is still another, and sometimes overlooked, influence on consumer buying. What the consumer can buy is a function of business pricing policies. Murray Altmann of the Board's staff points out that in recent years the periods of greatest gain in the consumer's real income have been periods of relatively stable prices. For example, from mid-1950 to mid-1952 when consumer prices were rising, average weekly money earnings of factory workers did little more than keep pace with prices, and real earnings increased little. In the next four years from mid-1952 to mid-1956, when consumer prices were relatively stable, both the real and money earnings of factory employees rose substantially.

It is hardly necessary to demonstrate that consumers respond to price changes,-- increases as well as decreases; in operating your stores, you adjust prices daily after pondering the probable effects on sales. As an example recall the consumer response to the lowering of prices of household appliances in 1954 and 1955. Flexibility of prices for individual commodities and services, furthermore, is essential for the achievement of the objectives of national economic policy.

These objectives are usually stated in some variations of the term, "sustained economic growth with stability in the value of the dollar." The recent pressures of high-level aggregate demand, stemming from the sharp expansion in consumer buying in 1954-55, followed by the capital investment boom of 1955-56, and then by the increase in government spending for national security in late 1956 and early 1957, have focused attention on stability of the value of the dollar. It may be useful now--in October 1957--to review the meaning and importance of price stability.

General price stability, when it exists, is always compounded of rising prices for some goods and services, and falling prices for others. Influences both temporary and long-run in character play upon the price structure. These reflect changes in both demand and supply. Through these changes in the relative prices of particular goods and services, resources are directed toward those that people want and are willing to pay for.

Substantial and persistent changes in the general level of prices are different. These have economic and social consequences that are undesirable. During inflation the general price rise discriminates against those with relatively fixed incomes. It reduces the value of accumulated savings. In contrast, deflation, such as that in the early 1930's, discriminates against debtors; it makes the servicing of debt more difficult and contributes to defaults and bankruptcies.

The desirable business climate is neither of these but one of over-all price stability. The latter is conducive to efficiencies in manufacturing, distribution, and the service industries. Competition for the consumer's favor, as expressed in the way he spends his income, makes its contribution to the search for new and improved techniques to reduce costs and expand markets, and thus to the gains in productivity. These are the true sources of advances in the scale of living. Also, the gains in productivity are more equitably distributed when the general price level is stable.

A continuous advance in the price level, even of seemingly mild proportions, comes to have an influence on the utilization of resources, the composition of output, and the directions in which economic expansion occurs. Once the nature of the situation is recognized and accepted, actions to adjust to rising prices may be expected. The motive to save is weakened, or savings are put into forms where reduction in their value will be minimized or eliminated. Thus it is that inflation feeds on itself and eventually becomes an extremely disrupting force. If variations in average prices are mild, however, the resulting sense of economic security permits a high level of purchasing power to be reflected in a high level of consumption and in balanced, orderly growth.

Role of Federal Reserve System

Federal Reserve policies are intended to contribute to sustainable economic growth and stability in the value of the dollar, by minimizing the extent to which money and credit may be used to accentuate economic fluctuations. Under private enterprise, there is no precise mechanism for assuring an automatic adjustment of the money supply and its use for meeting the appropriate needs of business and for fostering orderly growth. Left unaffected by an agency such as the Federal Reserve, the total pool of credit would become excessive in boom times and lead to inflation through the supplying of excessive amounts of short-term credit. In brief, the aggregate demands of credit-worthy bank customers would result in a total that would be inflationary unless restrained.

The apportionment of this credit supply among individual borrowers, in contrast to the governmental influence over the total, is a matter for private lenders operating through free markets. The selection of the particular customer to whom loans are to be made is, and should be, left to the discretion of private institutions. Unless the allocation is left to the operation of free markets, it will be arbitrary and inequitable.

The question of the differential impact of monetary restraints on certain groups of the population involves the larger question of whether the social needs of the community for jobs, schools, roads, and housing are, in fact, in conflict with the maintenance of a sound dollar. Fundamentally, there can be no conflict. No matter how great is our need and desire for more and better schools, roads, housing and other facilities, the simple fact is that they must be fitted into our available capacity and resources. It is a matter of simple arithmetic that we cannot have everything at once.

In boom times, investment must be financed primarily by taxation, or by real savings from current income. A small amount of investment may be financed out of bank credit expansion, but this amount must be kept within the margin of tolerance for a stable dollar. The advantages of sound money certainly outweigh the disadvantages of temporarily postponing some additions to housing or to plant and equipment that cannot be financed out of savings, or to schools and roads that the community is unwilling to finance out of taxes. To protect the purchasing power of the dollar and to foster stable growth in the economy are of supreme importance to those dependent upon jobs, as well as to those dependent upon savings. This means that the well-being of our children and the future strength of the nation call for prudent decisions by both lenders and borrowers, private and public.

Essential partners of monetary policy, however, are fiscal policy and prudent business decisions. By fiscal policy I refer to government tax and spending policies. In a free market economy, growth with stable values requires an intelligent and sophisticated approach to economic problems in the private sectors of the economy. When there is little slack in the labor market and when excess industrial capacity is small, dependence on government policies alone to insure expansion in consumer incomes and buying leads down the path toward persistent inflation.

The Role of the Merchant

The economy of the United States has often been characterized as one of mass production. Production is not an end in itself, however. Rather it is the route to higher standards of material well-being of people, the consumers. To quote Adam Smith, "Consumption is the sole end and purpose of production."

Industrial capacity exists to produce goods for consumption, and mass production has depended upon wider distribution of income and upon mass consumption. That of the average person today is perhaps three-fourths greater than half a century ago. Except for war periods, there have been few occasions when we have been aware of shortages of consumer goods. At times, retailers experience rising prices and delays in delivery of goods on order, but typically the retailer's problem has been to sell. Techniques of marketing have had to be developed to keep pace with the growing production potential. Merchants also perform valuable services in sensing trends in consumer wants, in searching for substitutes for articles that have become too high priced, or that fail otherwise to satisfy the consumer. In a sense, the retailing executive is the consumer's agent, bargaining with producers over price and quality, and even over what to produce. Were retailers less imaginative in the performance of their functions, the country's economic activity, employment, and consumer well-being might be greatly lessened.

The basic point with which I have been dealing is how to achieve equilibrium between high powered productive capacity and high level consumption. The problem is accentuated by our tendency to increase productive capacity by fits and starts; it is also complicated enormously by the undependability of consumption. To quote a distinguished marketing specialist, Professor Orin E. Burley of the Wharton School of Finance and Commerce, "Especially significant is the role of consumption in a surplus economy. In discharging its vital role I assume that a particular store, to be profitable, must not only serve consumers as well or better than competitors, but it must pursue policies that are flexible. This means that the primary goal is the selling of merchandise, not the attainment of speculative inventory profits."

A dynamically changing environment will constantly be creating new marketing institutions just as the department store was once a new and revolutionary force in retailing. The flexibility extends to pricing policies also. It would appear that price flexibility is not only necessary in view of the close margins on which stores operate, but socially desirable. This concept also means that not every department or every commodity group within a department can be equally profitable--in fact, on many items there may be losses.

In exploring the topic "Prices and Consumption" I have recounted the mixed character of current business, the importance of a climate of price stability for the economy to function at its best, then the respective roles of banking and of retailing. Implicit in this recital has been the suggestion that imbalances may have been developing between productive capacity and demand. The exuberance since 1955 has led to an expansion of capacity in many industries at rates that one would not expect to be sustained. It is none too soon to recall the vital importance of balancing protection and risk, caution and daring, the security that stems from liquidity and the expansion that borrowing makes possible.