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AFTER-WAR ADJUSTMENT: THE PRESENT PRICE OUTLOOK

An address by

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The perplexity in which the business mind of the country was left at the time of the armistice by the confused price situation resulting from the war has been much relieved by what has taken place in the last six months and particularly in the last three months. It would be premature to say that the situation has clarified itself sufficiently to speak of the price outlook with confidence. Certain factors, however, which are destined to exercise a very considerable influence upon the trend of prices in the future, are coming to be discernible and it is worth while, because of the decisive bearing which the price situation has upon business and employment, to undertake at this time to examine them.

The expectation that prices would drop and go on dropping was expressed by competent students at the time of the armistice and was shared by many business men. Such had been our experience after the Civil War. Indeed, some, who had in mind that experience, feared that the decline of prices might proceed so rapidly as to be disturbing. Prices dropped some 30 per cent in the first six months of the year 1865. This fact suggested that at least a considerable decline might not unreasonably be expected in the United States following the close of the great war. Such, moreover, had been a very common feature of the after-math of other great wars.

There seemed to be justification, therefore, for the expectation that prices in Europe and the United States would begin to fall with the turn of the year 1918. The only question was how rapid would be the decline and how long continued. The operation of natural economic forces and particularly the devotion of the productive energy and resources of different countries to peace industries was expected to do much to relieve shortages which were in part responsible for the momentous price changes induced by the war. The fact that fifty million men or more were to be released from armies and from war work led to the belief that there would be a quick resumption of industrial activity in Europe and increased production of goods and resulting declines in values and prices. This conclusion also seemed to be the logical consequence of the general acceptance of the view that the price situation, which had developed throughout the world as a result of war conditions, was highly artificial and highly inflated.

Whatever differences of opinion may have existed during the war as to the cause or causes of the revolutionary advance of prices experienced, it is now coming to be more and more clearly recognized and frankly admitted that the chief factor in the price revolution is to be attributed to the enormous increase in the volume of circulating credit, bank notes and government currency put out in the past four and a half years.

The situation in the United States is coming to be so well understood that no extended reference to it is necessary. It is well known that in our five Liberty Loan Campaigns the Treasury has been obliged to borrow from the community and issue government obligations more rapidly than the comparative rate of savings by the people could support, with the result that a considerable part (perhaps as much as seven billions of dollars) of the several issues of bonds made by the Government have had to be financed by an expansion of banking credit and, to a lesser degree, of banking currency.

It is coming to be recognized that our banking and financial situation can never be as healthy and strong as it should be until the banks are relieved of the burden of carrying such large investments, either for themselves or for their customers, in Liberty Bond operations. This means that such parts of the community as have not yet done their full part in absorbing and digesting the government issues, must by one method or another be induced or made to save and pay up, or buy. Those who believed that this process would be rapid, and they were many, and that the Government would soon disappear from the market as a competitor for current loan funds, expected as a natural consequence that the volume of our circulating bank credit and currency would shrink and that with the shrinkage would come a lowering of the price level.

Other countries, it was thought, would move along the same general course as the United States, though of necessity more slowly because of their continuing financial difficulties. A reduction in the volume of circulating media of one kind or another was, however, regarded as such an essential part of good financial policy in the process of post-war readjustment that this reduction was taken almost as a certainty.

The feeling of caution and hesitation, which characterized the temper of the American business community at the close of the war, was the natural outgrowth of this expectation of the probable future course of prices. It is well known that this view was shared by an important agency of the Government, which was set up for the special purpose of assisting the expected downward course of prices by gradual and orderly price revisions. By mediating the transition from war prices to peace prices, the Industrial Board of the Department of Commerce undertook to bring about the resumption of industry and its adjustment to anticipated conditions more quickly than if left to the unassisted working of natural economics forces. Price stabilization was expected to bring buyers in to the market, particularly for basic materials required in construction work and thus to accelerate the process of industrial readjustment and improve the employment situation. The abandonment of this policy by the voluntary retirement of the Industrial Board and other steps that have been taken toward decontrol of industry have left the process of readjustment pretty much to the unimpeded action of the market.

The movement since the armistice is interesting. For the first month or two there was little or no change; with the opening of the year 1919, prices moved downward, though slowly; toward the end of March the downward trend halted and with the beginning of April there is a noticeable upward trend - most marked in the retail trades and those manufacturing trades which are closely auxiliary to the leading retail trades (such as the textiles, clothing, boot and shoe trades), but with some evidence recently that it might develop into a more general forward movement. At the moment, prices are close to the war level and, in many instances, moving forward.

Many questions are raised by the behavior of prices since the armistice: Is the recent forward trend to be regarded as indicative of the probable future course of prices, or is the advance to be regarded as accidental and temporary and as merely marking an interruption of the expected downward trend? These questions, of course, can not be answered with positiveness. The factors which influence the price situation and to which it is responsive, even under normal conditions are so diverse and frequently so obscure that the resultant is always a matter of great uncertainty. The unexpected is apt to supervene and destroy the validity of even the most carefully considered forecast. As a result of the war, the price situation in all parts of the world has become so vastly complicated that conjecture is perforce a much more hazardous undertaking than usual, particularly if any attempt is made to deduce general conclusions from tendencies discernible only in particular industries or groups of industries, so subtle and exceptional are the influences now at work in different fields of industry.

PRICE SITUATION CLARIFYING

However hazardous the undertaking, it seems nevertheless worth while to direct attention to some of the underlying factors which seem now to be emerging and which seem likely to exercise an important bearing upon the future trend of prices, looking forward:

(1) to a period of some years, during which the general readjustment of the world's industry and trade is being worked out; and,

(2) to a briefer period of a year or more, during which Europe will be in the first stages of her reconstruction.

All business calculations run in terms of prices. Business judgments are for the most part price judgments. Raw materials, labor, fuel, and the other requisites of production are bought at prices; they are converted into goods to be sold at prices. Unless the prices at which the requisites of production are bought and the products are sold are fairly calculable and a satisfactory margin of profit shown between them, the attitude of business will be hesitant. Falling prices are, therefore, obviously to be regarded as an addition to the ordinary hazards of industry. It is therefore a question of vital concern to inquire whether the price situation has clarified itself sufficiently to suggest some expectation of what may be the future price trend.

Until Europe recovers industrially and brings its productive capacity up to what will be normal for its decimated population, no considerable or rapid fall of commodity prices is to be expected. Indeed, until the point is reached where the process of recovery is well under way, a rise of prices rather than a fall is to be expected. Should the eventual outcome show that some have often predicted that the war has given an added impulse to the inventive spirit and to the instinct of thrift, the resulting increase in production and savings would have an important effect in hastening the readjustment of prices. It cannot be too strongly emphasized that it is only as more goods are produced in exchange for the inflated currencies of the world, or more income saved from earnings and used for the purpose of liquidating loans and advances made by the banks, that the financial and credit situation will gradually be improved by the reduction of outstanding bank liabilities and prices respond by a gradual fall. How long it may take the movement, as thus defined, to run its course, no one can predict.

It is a matter of common knowledge that it was fourteen years before the currency disorders growing out of the Civil War were measurably corrected and the greenback dollar brought to a parity with gold. It took Europe fifteen years to effect the restoration of public credit, reorganization of currency and banking, and the readjustment of industry to a stable basis, after the close of the Napoleonic Wars. Considering the vast reach of the present war, which on its economic side has not yet closed, and considering the great destruction of industrial and financial capital, the terrible disorganization of industry, and the impairment of the morale of the working forces of Europe, there seems little reason to expect that the process of reconstruction and readjustment, first the one and then the other, through which Europe is about to pass, will be short or easy. Ten years would seem, on the whole, a short period in which to expect a restoration of economic conditions in Europe to a normal basis and the rectification of the price situation.

The general outlook, therefore, may be said to be for a gradual fall of prices during the next ten years or longer, depending mainly upon how rapidly Europe will recover her productive power and correct her currency disorders by deflating her distended currency.

Those who take a more sanguine view should not overlook the bearing which an artificially forced rapid deflation - should that in any event be practicable - would have upon the debt status of the European Governments. One of the main reasons for believing that deflation and, therefore, price reductions, will not proceed rapidly in Europe is derived from this cause.

The enormous debts, which the war has left European countries, have been contracted in terms of depreciated currencies; by and large commodity prices are double or more than double what they were in Western Europe in 1914. They have increased 100 per cent in the United States; they have increased more in England than in the United States; more in France than in England; more in Italy than in France; in Russia and in the countries that constituted the former Austro-Hungarian Empire, conditions are so chaotic that no basis for comparison is available. If prices could be and were put back to their pre-war level, the effect would be much the same as doubling the debts of the several countries of Europe while maintaining their existing price levels. Such a proceeding would, of necessity, place a burden of taxation virtually so heavy as to force a repudiation of national debts under one guise or another. Even under their existing depreciated currencies, European countries are struggling with the problem of handling their great debts, and their enormously swollen national budgets. This condition alone, if nothing else, would seem to compel the expectation that deflation will be a slow process in Europe and that, as deflation will be gradual, so the fall of prices will be gradual. Many factors will, no doubt, enter into the restoration of the value of the inflated currencies of Europe. But, in the end, it is likely to turn out, as in the United States after the Civil War, that Europe's main reliance in correcting the present condition of inflation will be the natural process of "growing up" to its now excessive and redundant volume of currency.

With the price structures in all leading countries more closely interlocked than ever before because of the new community of interest and fortune resulting from the war, no one country, like the United States, can set itself apart and maintain a price structure very far out of line with the world price structure. Price movements in the United States are bound to be affected by the price movements in Europe and no great changes in the price structure of this country are to be expected except as they reflect changes in the world's price structure. With the larger part of the commercial world in a serious condition of inflation and no prospect that the period of economic readjustment will be a short one, the fall of prices, to which many have been looking forward as an inevitable consequence of the war, seems likely to be a slow one; so slow that for most ordinary purposes in making business calculations and in reaching business judgments it may be taken as a negligible factor. While prices, looking forward over a long series of years, may assuredly be expected to show a downward course, the fall of prices from year to year, it is to be repeated, will probably be so small as to make possible losses from the decline a factor of no consequence, except in the case of long period investments of fixed capital upon an extensive scale, when it would probably be a wise precaution to set up special sinking funds to amortize shrinkages of value from this cause.

While the general trend of prices for the next ten or fifteen years may be expected to be downward, the downward movement is not likely to pursue a steady and unbroken course. It will probably be broken by frequent ups and downs in the process of finding a new normal level because the general process of economic readjustment is likely in each important stage of its development to result in some mal-adjustments, which would inevitably produce price disturbances.

The future price trend, in other words, is likely to have much of a fluctuating character and, therefore, to give to the period of readjustment something more of a speculative character than is usual in normal circumstances.

So much as regards the general and more distant price trend. As regards the near future, there is little reason, I think, to expect any marked interruption of present price tendencies in our own and other leading markets, mainly because of the world's urgent need for goods. Europe is in a bad condition in nearly every way - economically, socially, politically, physically and psychologically. The process of disbanding the armies and getting the men back to farm and workshop is proving a difficult and slow one. Idleness since the armistice has worked its effect in industrial demoralization. One of the main problems presented by the transition to peace conditions is the restoration of the economic morale of large sections of the population of Europe. Feeding the hungry and clothing the naked is an obvious and immediate necessity; equally necessary and as important in its general effect is the alimentation of industry in Europe with raw materials and equipment ; farms must be restocked; implements are lacking; the railroads must largely be reconstructed; machinery must be rebuilt or replaced; everywhere there is need of basic materials and tools before Europe can get back to a condition where she can produce goods enough to sustain herself and pay for her imports. It will take time to effect this work of restoration and repair. While no accurate estimate can be made of the needs of the several European countries, enough already is known to make it clear that they are and for some time will continue to be very considerable. Whether it will take one or two years to accomplish the first stage of her reconstruction, it seems certain that until it is accomplished her needs will tax the ability of the non-European world to the utmost to supply foodstuffs and raw materials. It may be expected, therefore, that there will be a very heavy demand upon our markets for a great variety of goods during the first phase of the reconstruction process, provided we are able and willing to finance Europe in its purchases for such a period of time as Europe must have before making final settlement: that is, provided we supply by loans the capital needed in Europe to assist her recovery.

The most important thing now, from every point of view, is that Europe should

go to work. In those parts where they can not work because they lack the tools and materials, they must be helped to work. Where they do not want to work, because demoralized, they must be made to work. Hunger and idleness are one of the greatest menaces in Europe.
They present the immediate objectives of policies of cooperation with the reconstruction needs of Europe.

Momentarily, Europe lacks the means of paying for the food and material that she must get from the outside world. She has no goods to give in exchange for these, at least not in adequate amount; she has no gold which she can spare, nor do we, or other nations in our position, need or want more gold. But with fair prospect that her economic and political morale will be restored, she has what should be acceptable to us in the process of extending economic assistance, towit: credit. The foundations of credit, both national and private, are reputation for integrity or good faith and demonstrated economic capacity, and these, fortunately, still exist in Europe. The prospect, therefore, is that there may be expected a very considerable credit demand for American goods, that is to say a demand both for goods and for the credit with which to buy them during the initial period of European reconstruction. The short-period price trend may, therefore, be reasonably expected to rule high, if our exports to Europe on credit continue on anything like their present scale.

We are now exporting a net excess of goods over what we are receiving as imports at a rate of well over three thousand millions of dollars a year. Assuming that the value of our annual output of goods of all kinds and descriptions amounts, under present conditions, to sixty billions of dollars or more, the exportation of a net excess of three thousand millions means a loan to Europe of capital goods to the extent of five per cent of our total annual production. On its purely economic side, the question whether we can indefinitely go on doing this reduces itself to a question of productive capacity. On the financial side, it reduces itself to the question of our willingness to save and add to the capital supply of America available for use in Europe after the needs of our own industry have been reasonably provided. Beyond that the question is a technical one; it is that of devising the best form of machinery for mobilising such capital as can be spared for the purpose for the use of Europe.

Complete and accurate data are not available for estimating the extent to which the productive capacity of the United States has increased in recent years, much less have we any satisfactory indication of the increase in the capital or saving capacity of the United States. There is, however, statistical foundation for an estimate of 16 per cent increase in the productive capacity of the United States in the past five years, measuring the increase not in its money value but, far more significantly, in its physical volume, to warrant the use of this ratio in estimating the financial capacity of the United States. Accepting 35 billions as an approximate estimate of the money value of the products of American industry before the beginning of the European War, an increase of 16 per cent in the physical productivity of industry would yield an increase of 5.6 billions of dollars in the money value of the nation's productivity. But figured, as the increase should be, on the basis of the 1918-19 price level, which is 100 per cent higher than the 1914 level, the increase would amount to 11.2 billions. It is most noteworthy that this increase in the economic productivity of the United States has taken place without the usual addition to our working forces from immigration.

The period has been one of emigration, rather than of immigration. The estimated 11.2 billions is, therefore, to be regarded as pretty much a purely economic surplus, after making deduction of course for the expense of taking care of the natural increase in our population, which has occurred in this interval of time and which is estimated at some four millions. In other words, this increase in our production is due to the fact that the industries of the nation have been working at a high pitch of intensity under the impulse that was given by war conditions and that a larger percentage of the nation, than before the war, entered the ranks of its productive workers.

Bearing in mind that the capital which Europe needs and will seek to obtain from us by borrowing will consist of goods which are the product of American labor, it is obvious that the process of accommodating Europe will involve either the continued high activity of American industry or a reduction in the amount of goods available for American consumption. In either event, must there by saving. Nationally, the question is whether we shall undertake to finance Europe by savings out of a reduced volume of production or out of a sustained volume of production. In the latter event, the problem of making reasonable advances of capital to Europe should present no great difficulty economically. The problem will then be to convert an adequate amount of the potential savings of the nation into actual savings. In the former event, however, the question would present almost insurmountable difficulties and the attempt to undertake any excessive financing for Europe would probably in the end result in the forced growth of the savings fund of the nation by a further inflation of credit and a further increase in the cost of living.

No more pressing financial problem confronts the United States than the setting up and putting in motion the machinery for determining the extent to which we can safely undertake to finance reconstruction in Europe. Fundamentally the problem is one of keeping the industrial activity of the nation stimulated and, equally important, keeping the savings spirit of the country from weakening. The people must everywhere be made to appreciate that in the present condition of the European world, it is our urgent duty to keep up our newly acquired saving habit. Beyond that a sufficient portion of the community must be educated to an interest in the purchase of European obligations or American obligations based upon European collateral. More than this, some competent agency, which will merit the confidence of the American people - public in character but preferably not governmental - must be set up for seeing to it that the apportionment of such capital as may be yielded by the savings of the nation shall be made wisely, with due regard for the economic needs of American industry and the American consumer, as well as the needs of European industry and the European consumer. The opportunity to make financial and traders' profits out of the needs of Europe by the sale to Europe of goods and materials on long-term securities floated in the American market is such that great care must be taken that such operations are constantly kept within the limits of national economic prudence, both in our own interest and in Europe's interest. It might therefore be advisable to set up a Committee on Financial Facilities for Europe composed of a membership - following the analogy of the Federal Reserve organization - one-third representing financial interests, one-third commercial interests and one-third to be selected by the Federal Reserve Board representing the general public interest. But whether this or some other method is adopted, it is of primary importance that a national and representative character should be given to any movement for the mobilization of our financial and economic resources for Europe's use. The matter is one of too grave consequence to be left to the determination of private interest alone. The situation offers so many temptations, that abuse of the credit facilities of the Federal Reserve System would be almost certain to result with a further and disastrous inflation of credit as a consequence. No method of providing for the financing of Europe that does not contain careful safeguards against this contingency can be regarded as satisfactory. What Europe needs is capital. The Federal Reserve Banks are not investment institutions; they deal in credit, not capital. The attempt, under any disguise, to use their facilities as a substitute for capital would be fatal to the Federal Reserve System and injurious to the public at large.

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