Factors in Maintenance of Present Price Level

Commodity Price Level Cannot Recede to old Pre-War Level—Economist Declares It a New Price Revolution.

We have had occasion to express the opinion that the present price level, with local or temporary fluctuations, would remain for several years and have urged upon the business interests of British Columbia to make their commitments for the future on the basis that prices would not fall appreciably. Dr. Irving Fisher, professor of political economy in Yale University, has recently addressed the Chamber of Commerce, New York, on The New Price Revolution, giving scientific expression to the high price thesis. As a guide to future action we think his remarks, a summary of which is presented, is worthy of the close attention of our business men. Although writing from the American point of view, his words have equal applicability to Canadian business:

Almost everything one buys somehow costs twice as much as before the war, and labor is twice as dear. Now, as a matter of fact, when we investigate almost any individual one of the so-called high prices for industrial products we are likely to find that individually it is not high; that is, it is too high relatively to the rest. Our quarrel is with the general level of prices.

Variations in the general price level may be compared to the tides of the sea, while inividual prices may be compared to waves. Individual prices may vary from this general level of prices for specific reasons peculiar to individual industries, just as the height and depth of waves vary from the general level established by the tide. The causes controlling the general price level are as distinct from those controlling individual prices as the causes controlling the tides are distinct from those controlling individual waves.

All prices have risen, but some have risen more, some less, than the average for particular reasons affecting each industry. In some cases an improved organization of both employers and employee has enabled them to combine against the public and take full advantage of the price advance. The war brought about an abnormal demand for certain products like copper and steel, and they advanced faster than the average. The abnormal demand having disappeared, these prices are being adjusted downward.

The fundamental practical question confronting business men is whether the general level of prices is going to fall. In my opinion, it is not going to fall much, if at all. We are on a permanently higher price level, and the sooner the business men of the country take this view and adjust themselves to it the sooner will they save themselves and the nation from the misfortune which will come if we persist in our present false hope.

The general level of prices is dependent upon the volume and rapidity of turnover of the circulating medium in relation to the business to be transacted thereby. If the number of dollars circulated by cash and by cheque doubles while the number of goods and services exchanged thereby remains constant, prices will about double.

The great price changes in history have come about in just this manner. The "price revolution" of the sixteenth century came upon Europe as a result of the great influx of gold and silver from the mines of the new world. Europe was flooded with new money. More counters were used than before in effecting exchanges and prices became "high." People talked then of temporary "inflation," just as they talk it now. But it was not temporary; it was a new price level.

A similar increase in prices all over the world occurred between 1896 and 1914, following the discovery of the rich gold fields of South Africa, Cripple Creek and Alaska, the invention of the cyanide process in mining, and the vast extension of the use of bank credit.

Circulating credit—that is, bank deposits subject to cheque and bank notes—is a multiple of the banking reserve behind these deposits and notes; and the essence of this reserve is gold. Our present monetary system is an inverted pyramid, gold being the small base and bank notes and deposits being the large superstructure. The superstructure grows even faster than the base. The deposits are the important elements. They are transferred by cheque from one individual to another; that is, the circulation of cheques is really the circulation of deposits.

Thus any increase in the country's gold supply has a multiplied effect. The possible extent of that effect is dependent upon (1) the amount of gold available, and (2) the gold reserve requirements, determining the volume of credit that can be put into circulation based upon the gold. Over a billion dollars in gold has come into this country from abroad since 1914, and a large amount has disappeared from domestic circulation. The gold from both these sources has found its way into the United States treasury and into bank reserves. On June 30, 1918, the portion of the gold reserve of the federal reserve banking system which supported national bank deposits and federal reserve notes, was more than three times as large as the gold reserves under the old national banking system on June 30, 1914—$1,786,000,000, compared to $592,000,000. During the same period credit instruments (demand deposits and notes) increased about twofold—from $6,100,000,000 to $11,700,000,000. This increase of credit instruments is typical of the banking situation for the country as a whole and largely explains the present high level of prices. The increase of gold has been so great, however, that the base has grown faster than the superstructure—which is contrary to the normal tendency. The ratio of gold to credit has risen from 9.6 per cent. to 15.3 per cent. The legal reserve requirements of the present system are such for 1918 there is an excess of gold above these requirements of more than $700,000,000. The reserve required by law to support the $11,700,000,000. The $700,000,000 of free gold could support an additional superstructure 70 per cent. as large as the existing one, which indicates that for the banking of the country as a whole a potential future expension of 50 per cent. is a conservative estimate.

Many people, referring to this inflation in the circulating medium, and assuming that is temporary, are waiting for this inflation to subside. When we speak of inflation we mean more circulating medium than is needed to transact the business of the country on a given price level. But what price level? Some people mean the price level of 1913-14. Our currency is certainly inflated in terms of the prices of that period, just as the currency in 1914 was inflated with respect to the prices of 1896, but our currency is not inflated at the present time relative to the new level of prices in the world which the war has brought. The country's volume of money will have to be judged in terms of this new price level, not in terms of a price level that is past. To speak of the present "inflation" as temporary is to assume the very thing about which we are contending—to assume that the normal prices are those of 1914.

Let us examine the factors upon which any future price movements must depend.

1. Gold will not return to circulation—No great effect in the direction of falling prices can be expected from any return of gold and other lawful money into daily circulation. Such a reversion would be contrary to monetary experience everywhere. When people have learned to leave their gold and silver in the banks and use paper money and cheques instead, they find the additional convenience so great that they will never fully return to the old practice.

2. No great outflow of gold through international trade—It should be noted that many of the former reasons