Factors in Adjustment of Scale of Prices

Recession in Prices Due More to Psychological Than Economic Causes—Effect on Decline in Commodity Prices—Problems of Producer and Position of Consumer.

In discussing high prices in relation to the producer and consumer, at the fifty-third meeting of the Economic Club of New York, Thursday, May 27, 1920, at the Hotel Astor, New York City, Francis H. Sisson, Vice-President of the Guaranty Trust Company of New York, said in part as follows:—

"A wave of price-cutting is sweeping over the country. It is the most interesting economic phenomenon of the day —an event long heralded and waited for by the public. And yet, curiously enough, the public is only tardily awakening to a realization of the fact that it is not only the beneficiary but also the creator of the movement. Merchants generally frankly explain that they are reducing the prices of certain commodities because the public is refusing to buy at high prices. In brief, the movement is largely psychological, rather than economic, in character.

"And it will be well to bear that distinction in mind in endeavoring to analyze and foresee the trend of commodity prices. The reductions in prices that are being made today are not due to over-production; for there is, in fact, under-production in many essential lines which is likely to continue for some time. Consequently, it would seem advisable to avoid a hasty conclusion that the present movement forecasts a universal and drastic drop in commodity prices. It may be, and very probably is, merely an oscillation of the economic pendulum as it begins to swing from the height it reached during and as a result of the war, although it seems certain that we have definitely passed the peak of high prices.

"Our problem is not to force a price recession as rapidly and as precipitately as possible, but rather to bring about a gradual readjustment with a view to stabilization. There is quite as much danger from too accelerated and extreme price reduction as there is from too high prices and all their attendant evils. Above all, we should remember that a permanent lower price level can be obtained only as the resultant of many forces, some of which seemingly are unrelated, but all, nevertheless, working, directly or indirectly, toward a common objective, namely, a general economic readjustment.

"The present recession in prices is concentrating the attention of both producers and consumers upon the probable effects upon themselves of such a decline. The nature of the effects which may be felt will depend upon the distribution of the declines throughout the whole range of commodities as well as upon the extent and the rapidity with which the declines are brought about.

"Our price level has attained its unprecedented height as a consequence of world-wide scarcity of goods and of extraordinary extravagance on the part of the American buying public.

"Production under conditions of general shortage moves up unevenly and overtakes the demand, now in this line, now in that. It is natural that high priced goods, luxuries in particular, should soonest show a definite downward turn of prices. This is what we are apparently witnessing at present. Furs and silk, for example, have recently declined to considerably lower levels. The slump in raw silk prices in New York, chiefly in consequence of the big drop in Japanese prices, was preceded by some months of gradual weakening. Clothing and shoes are other examples of goods for which there is a weakening demand at prevailing prices, an expression of the growing impatience with high living costs. The extraordinary demands of foreign markets, like those at home, are overtaken piece-meal, in accordance with the varying fortunes of foreign producers in the resumption of normal activity, which means that the export prices will be variously affected.

"The tightening of the purse strings in the matter of credit and the accompanying discrimination in some measure between essential and non-essential lines of production in the granting of loans, moreover, is also making for uneven pressure on the price scales.

"It would be phenomenal if, in such a prospective readjustment of prices, there should not be a number of not merely sustained individual prices, but of actually higher prices.

"The effects of a broad downward swing in commodity prices upon producers vary not merely with the distribution of the changes—their spread over the general list of commodities—but with their rapidity as well. The more rapidly lower prices are reached, the greater difficulty is experienced by manufacturers and others in turning their commitments with a maximum of gain or a minimum of loss. A price recession of a given extent, which would result in sweeping losses if sudden, might, if gradually reached over a longer period, be successfully withstood. There are those who do not believe it is possible to bring about a real and necessary readjustment in prices without passing through a period of marked business depression, attended by a heavy record of failures. It is argued that our banking machinery, while functioning smoothly in the process of expanding credit, is still incapable of effectively and at the same time gradually contracting credit. The fact, however, that as yet our Federal Reserve System has not been tested by the necessities of a period of general and sustained contraction is not proof of its inability to function well under such conditions. But there are reasons to believe that the system will demonstrate its ability to lead in an orderly contraction, a readjustment not ushered in by a general collapse of credit. In other words, it is possible to apply the necessary restrictions gradually rather than suddenly to the credit structure, thereby accomplishing an easy and gradual reduction in the price level.

"The chief problem of producers under conditions of a declining market for their goods is, of course, the difficulty of confining costs of production within the limits of the sale value of their products. Generally speaking, cost of production moves in harmony with the value of the goods produced. Wages, however, which are unprecedentedly high now and often the largest single item in the cost of production, usually respond less promptly to variations in commodity prices. In other words, wages nearly always lag behind commodity prices in their movement either up or down. Accordingly, it is to be expected that wages will not fall as rapidly as prices. This may be expected to retard the decline of prices through the influence of wages on cost of production. While the maintenance of high wages may thus increase the difficulties of producers in a period of declining prices, on the other hand, the preservation of the buying power of the wage-earning classes would powerfully reinforce the demand for almost all classes of manufactures and be an additional factor making for gradual rather than sudden price recessions.

"The distribution of the losses, in consequence of falling prices, and contraction of profits, all along the line is the result of numerous influences. It is an axiom in economics that the price of a commodity already produced is not directly determined by its cost of production, including the expenses incurred in distributing the commodity. The goods may or may not find a market at a price to cover this cost of production. If they do not find a market, the loss may fall anywhere among the distributors or producers, the incidence of the loss depending in part upon the methods and practices in vogue in the process of producing the goods and placing them with the consumer. If, for example, a producer sells his product in advance upon the basis of known costs, he is presumably immune against loss, so long as the purchaser adheres to his contract; while on the contrary, if the assembling or production is undertaken for