

**TRANSACTIONS OF SOCIETY OF ACTUARIES
1962 VOL. 14 PT 2**

PANEL DISCUSSION

ECONOMIC OUTLOOK FOR THIS DECADE—A DISCUSSION
WITH EMPHASIS ON POINTS OF PARTICULAR IN-
TEREST TO THE ACTUARIAL PROFESSION

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GENERAL PRICE LEVEL¹

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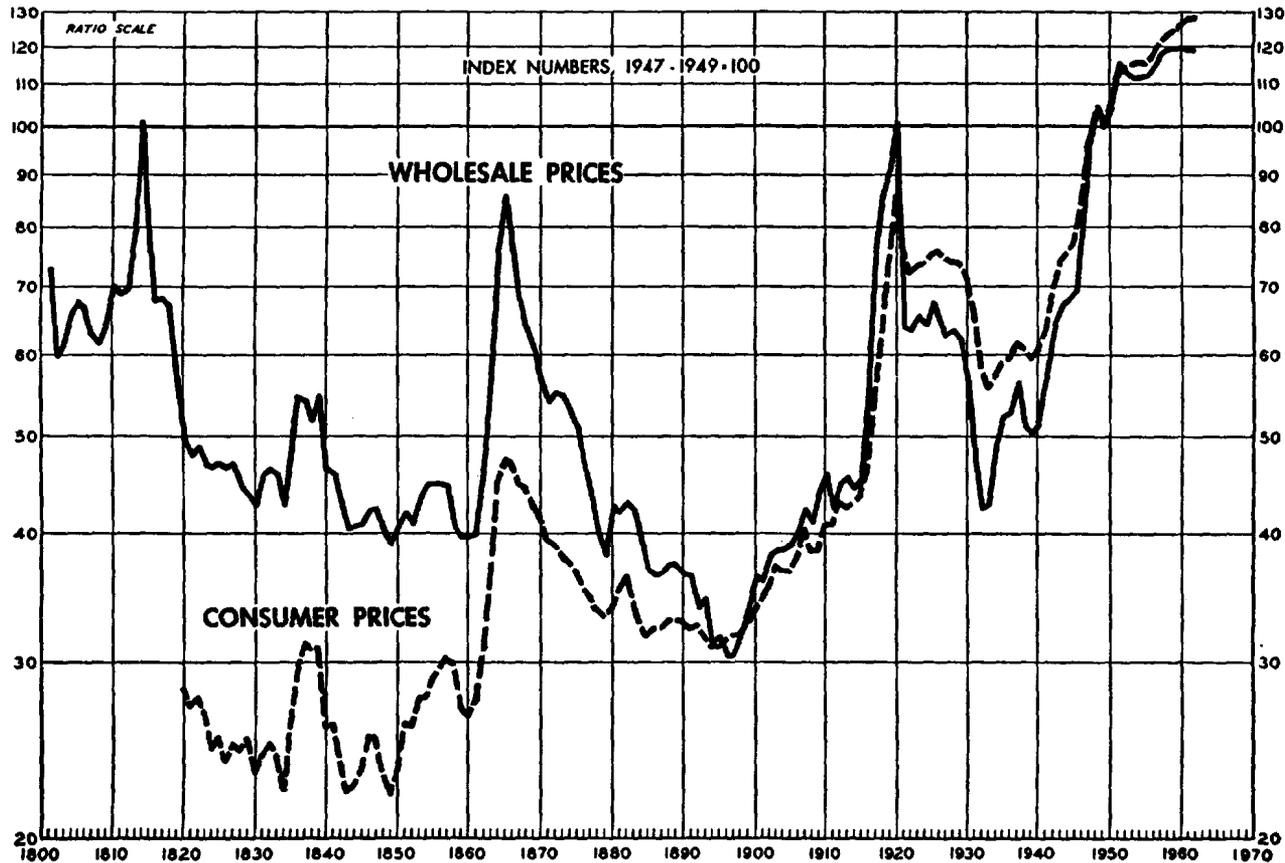
About two years ago in a speech before the Senior Executives in Mortgage Banking, I ventured the conclusion that businessmen would be well advised to re-examine the warrant for the then-prevailing belief of "the inevitability of future inflation upon which some of their longer-range thinking may be based." I entitled that analysis "Inflation in the 1960's?"² With the first one thousand days of that decade already behind us, it is comforting to find that time has not done too much violence to the reservations implicit in the title I selected. Indeed, with a quarter of the "Golden Sixties" a matter of history, price weaknesses currently are a matter of growing concern to an ever widening circle of industries. In fact, so illustrious a viewer of the world economic scene as Per Jacobsson, of the International Monetary Fund, in recent months not only has discounted the threat of further inflation but also has raised the prospect of cumulative deflation.

I propose here to take a second look at price trends, starting with a long look first at the past decades to see what can be learned therefrom. Chart I summarizes price behavior in the United States over the past one hundred and fifty years or more. These indexes have been painfully pieced together by scholars long after the time period to which they refer and

¹ The assistance of J. Frank Gaston, the Conference Board's Director of Information Service, is most gratefully acknowledged.

² Reprinted in *The Conference Board Business Record*, March, 1961.

CHART 1
A CENTURY AND A HALF OF PRICES



are subject to many of the deficiencies of attempting to convert records established for one purpose to an entirely different one. However, they represent the best that exists today in showing the main outlines of price movements in the United States.

Since 1800 we have experienced a series of decided long swings in prices, particularly in wholesale prices. In all instances the price peaks have been associated with past wars. Price peaks were reached, for example, in 1814, 1865, and 1920. Though clearly these peaks in wholesale prices have been associated with wars, they have come usually in the postwar period. The record since 1945 is thus a notable exception to the characteristic behavior of prices in the past. Wholesale prices continued to climb rather sharply, at least through 1951, and then moderately thereafter. No clear peak as yet has appeared in this index.

Consumer prices, at least since 1860, have followed approximately the configuration shown by the wholesale price index. Some deviations do occur, of course, but these do not appear to be very great. The two indexes do differ, however, if one extends the period of comparison from 1820. During this period the wholesale price index does not seem to show any decided long-term upward or downward trend despite the decided cycles already noted. Consumer prices, on the other hand, seem definitely to show a long-term upward drift—a phenomenon that has been noted by many in the past, but one which cannot be completely explained at least by reference to available statistics.

Some of the explanation may be found simply in the inadequacy of the statistical record that is available to us or to the different composition of the two series. For example, farm products are more important in the wholesale price index, while the prices of processed foods are more important in the consumer price index. Consumers have tended to supply their needs increasingly through market purchases rather than home production. By favoring foods with a greater degree of fabrication, an upward tilt may thus have been transmitted to the consumer price index. While this is a possible explanation, it clearly cannot be conclusive. Research by the Conference Board suggests that the percentage of processed goods has increased in both indexes although to a slightly greater extent in the consumer price index (Table 1).

Another factor of some importance is the complete exclusion of services from the wholesale price index and their gradual inclusion in the consumer price index. Before 1919, rent was the only service item included in the consumer price index. Since that time, services have been reflected to an increasing extent with each subsequent revision. Prices of services, which presumably have not shared in the upward trend of productivity

increases for the economy as a whole, have had the effect of making the consumer price index rise somewhat more rapidly than it would otherwise. This shift to the services has been particularly pronounced postwar.

Also of some importance is the change in the cost of distribution. Over the last hundred years there has been a tendency for the value added by retailers to increase and that of wholesalers to decline slightly.³ In 1869, value added by retailers constituted 23 per cent of the price of all commodities sold to the consumer. This percentage steadily increased until it

TABLE 1*
ESTIMATED PROPORTION OF RAW AND PROCESSED GOODS IN
WHOLESALE AND CONSUMER PRICE INDEXES FROM 1801

	TOTAL NUMBER OF GOODS IN INDEX		PER CENT OF PROCESSED GOODS†	
	WPI	CPI	WPI	CPI
1801-25‡	79	17	58	65
1825-40‡	63	17	59	65
1840-59	85	42	78	71
1860-89§	223	53	82	74
1890-1913	252	94	78	80
1935	784	198	74	88
1954	1,900	300	81	92

* Source: *The Conference Board Business Record*, September, 1959, p. 436.

† Includes services in consumer price index.

‡ Consumer price index period 1820-40

§ Consumer price index period 1860-79 (1880-89 based on ten food items only).

|| Proportion represented by sum of weights of processed goods.

came to approximately 30 by 1948. The value added by wholesalers, on the other hand, was 9.5 per cent in 1869 and 7.7 per cent in 1948.

One final factor—consumption taxes—has also played some part, although an uncertain one, in the more rapid upward movement of consumer prices. The imposition of sales and excise taxes have undoubtedly affected consumer prices to a greater extent than wholesale prices.

I turn next from this historic price background to an examination of the broad factors that have been operating to restrain price increase thus far in the sixties.

First and foremost is the change in the economic environment I have elsewhere labeled as the “emergence of the ‘middle’ years.” In the mid-fifties, I first began to advance the thesis that the backlog of deferred demand carried forward from the depressed thirties and the war years

³ While these categories are not identical with the wholesale and consumer concepts used in the price index, they clearly have a bearing on them.

was rapidly being exhausted. The shortage of productive capacity, an inheritance of these unhappy years, had also been made good. It was this explosive combination of inadequate capacity to supply goods and services and pent-up demand which produced the hyperstimulated, lush, hot-house atmosphere of the late forties and early fifties. This excess of demand over supply was a major contributor to inflationary pressures, reinforced as it was by the huge bulge in money supply and savings during World War II. With the withdrawal of these explosive, expansionary forces, I suggested business in general would enter upon a prolonged period of adjustment or transition to more "normal" and less exhilarating market conditions.

I proposed that these years of transition might well be called the "middle years," as demand returned to normal. In my judgment, we are still in this period of economic transition in the early sixties. It is this change in the economic environment that continues not only to dampen the rate of economic growth but also to militate against the easy cost-price pass-throughs of the first postwar decade.

A second factor restraining price increases is the accommodation into the economic system of the large liquid asset holdings of consumers and business alike. The money supply relative to gross national product is no higher now than it was in prosperous years prior to World War II. However, there has been an increase in the velocity of circulation of this money supply. During the war the velocity of circulation dropped as liquid asset holdings increased. In the last ten years there has been exactly the opposite movement. Circulation has increased as the importance of the accumulated liquid assets has declined. This increase in velocity is a factor that could become of increasing importance again if expectations of further regular price increases become widespread.

A third factor that has affected price behavior significantly is the increased margin of excess capacity that has emerged in the 1960's. Throughout the world capacity to produce is steadily outstripping market demand. Somewhat prophetically I stated in my earlier analysis: "This overhang of idle capacity militates against price increases even in the face of rising unit labor costs and shrinking profit margins (e.g., steel)."

Fourth, and finally, intensified foreign competition and the disciplines of our international balance of payments may well be exercising ever greater restraints on price behavior in the coming years. Until a few years ago the international economic position of the United States appeared impregnable.

In a few short years the continually adverse balance of payments has resulted in a disturbing reduction of our gold supply and an increase in

the short-term balances that foreign nations have in this country. The result has been to make the United States more sensitive to international considerations in managing its monetary affairs. Interest rates, for example, if lowered to stimulate the domestic economy may induce foreigners to transfer their balances from New York to other financial centers to take advantage of higher rates. This new environment now hampers the power of the Federal Reserve System in dealing with the movement of prices.

The new trade act just passed by Congress gives the President additional powers to reduce tariffs from their present levels. In general, the President has the authority to reduce tariffs of industrial products by 50 per cent of their present level as well as to reduce to zero tariffs of industrial products, 80 per cent of whose exports are accounted for by the United States and the members of the Common Market. The effect of this power is to expose the United States economy to an increasing extent to the forces of international competition. This factor may play a very important part in the coming years in compelling American businessmen to re-examine their wage-cost-price policies. Since around 1953, as the economies of Europe were re-established and as the tariff levels of the United States were cut successively by the bargaining sessions under GATT, domestic producers have been exposed to ever more intensive international competition. The present act now insures that foreign competition will exercise even greater restraints upon our domestic price level in the next five years.

One major factor that has operated in the past appears to exercise less pressure in the future. That is the push on prices exercised by unit labor cost increases. While increases in hourly wage rates continue to outstrip gains in productivity, these increases have moderated of late. The resulting rise in unit labor costs still tends, however, to push up the prices of finished goods. Tied in with this factor is the tendency of consumers to devote an increasing share of their expenditures to services rather than to goods. Productivity gains cannot be expected to offset wage increases in the service area as readily as in the production of goods, where a technical change can bring about efficiency to a greater degree.

On balance, I see little reason to modify my earlier conclusion that we have won some notable victories on the inflation front, although the threat of renewed inflation is ever present.

To some the prospect of stable or declining prices this suggests is synonymous with recession or contraction. In closing, therefore, I would like to comment just briefly on the thesis that price rises are inevitable in order to insure economic growth. This is a thesis which still has many

adherents, even though economists have done a thorough job of undermining its foundations in recent years. Our own history clearly demonstrates that there is no inevitable intertwining of these two factors (see Table 2). We have had periods of sustained economic growth when prices were steady and even when they are declining. During the decade from 1920 to 1930, for example, we had an increase in gross national product of approximately 30 per cent and a price decline of about 17 per cent. If we confined the comparison to the period 1920-29, economic growth would be even larger—42 per cent—and a price decline of approximately 15 per cent. In the ten years preceding the turn of the century, prices remained quite stable, while gross national product went up nearly 50 per

TABLE 2
COMPARISON OF CHANGES IN CONSUMER
PRICES AND OUTPUT PERCENTAGE CHANGE

Period	"Real" Gross National Product	Consumer Prices
1890-1900.....	+49.6	+ 2.4
1900-1910.....	+46.6	+20.1
1920-30.....	+29.7	-16.7
1920-29.....	+42.4	-14.5
1930-40.....	+27.2	-16.1
1947-57.....	+45.0	+25.9
1952-62*.....	+33.9	+13.5

* Second quarter, 1962, for gross national product; six months' average for consumer price index.

cent. As already noted, in the decade following the end of World War II, prices continued to advance about 26 per cent from 1947 to 1957, as did output by about 45 per cent.

In summary, I feel that we can count as a major achievement the avoidance of the sharp price contractions that have inevitably followed the past inflations associated with wars. For a variety of reasons, we have instead witnessed a period when prices have continued to increase, sometimes quite perversely. This postwar upward movement of prices now has apparently lost its zip. The decade from 1952 to 1962 saw consumer prices rise by not quite 14 per cent, approximately half the rate of increase in the overlapping decade 1947-57. This more moderate rate of increase is apparently a world-wide phenomenon, at least among the major industrial countries, as can be seen from Table 3, the contents of which are embodied in Chart II.

Discontented as we are with the current rates of economic growth (which, incidentally, do not compare so unfavorably with past periods),

CHART II

CONSUMER PRICE CHANGES, SELECTED COUNTRIES (Annual Percentage Change from Preceding Year)

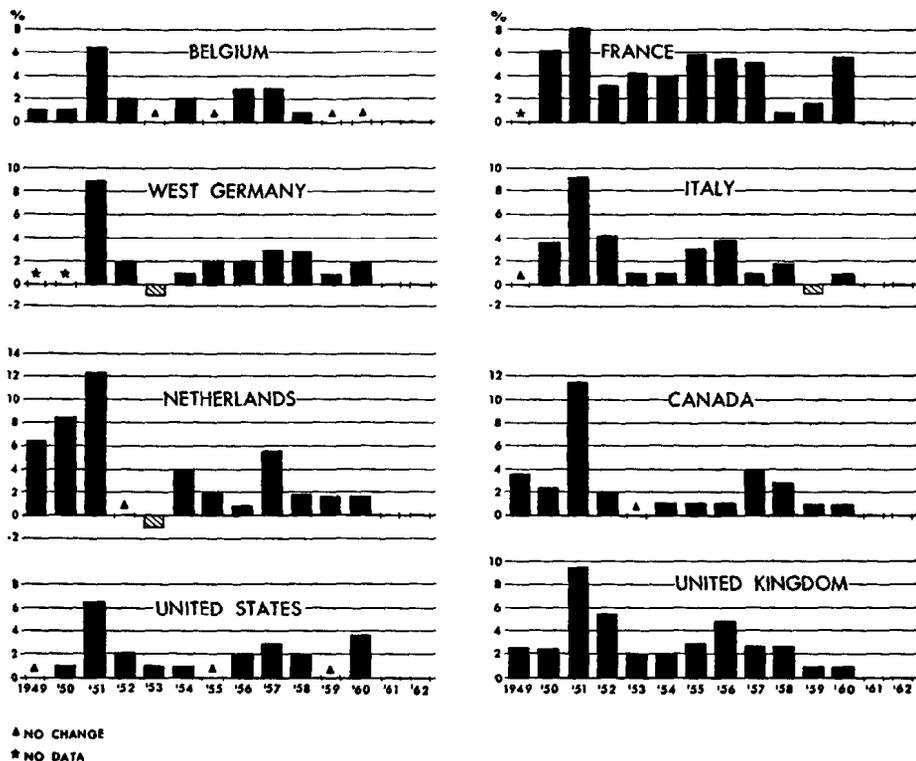


TABLE 3*

PERCENTAGE CHANGES IN IMPLICIT INDEX OF PRICES UNDERLYING PRIVATE CONSUMPTION EXPENDITURES

Period	United States	Canada	Belgium	France	West Germany	Italy	Netherlands	United Kingdom
1948-49	0.0	3.6	1.1	0.0	6.4	2.5
1949-50	1.1	2.3	1.1	6.2	3.6	8.4	2.4
1950-51	6.6	11.4	6.5	8.1	8.8	9.2	12.2	9.4
1951-52	2.1	2.0	2.0	3.2	2.0	4.2	0.0	5.4
1952-53	1.0	0.0	0.0	4.2	-1.0	1.0	-1.0	2.0
1953-54	1.0	1.0	2.0	4.0	1.0	1.0	4.0	2.0
1954-55	0.0	1.0	0.0	5.8	2.0	3.0	1.9	2.9
1955-56	2.0	1.0	2.9	5.5	1.9	3.8	0.9	4.8
1956-57	2.9	3.9	2.9	5.2	2.9	0.9	5.6	2.7
1957-58	1.9	2.8	0.9	0.8	2.8	1.8	1.8	2.7
1958-59	0.0	0.9	0.0	1.6	0.9	-0.9	1.7	0.9
1959-60	3.7	0.9	0.0	5.6	1.8	0.9	1.7	0.9

* Source: Organization for European Cooperation and Development.