SOME PROBABLE ECONOMIC EFFECTS OF THE WAR

Prof. Irving Fisher, of Yale, Says If We Keep Our Heads We Shall Be the Only Great Nation Whose Economic Relations Have Not Even Been Strained.

By Professor Irving Fisher, Yale University.

WHEN the future historian chronicles the facts of the present great world struggle and attempts to analyze its causes and effects, the economic losses, gains, shiftings and dislocations will form an important part of the story. It is, of course, quite impossible at this time to know, in any detail, what all the economic results will be. Much will depend on how long the war lasts, how many people and how much property are destroyed, what financial devices are resorted to in order to finance it and which side is finally victorious.

The most palpable and the most fundamental effects will be a partial stoppage of earnings in the nations directly concerned, i. e., a reduction in the "real income" which consists of enjoyable goods. All the other important results follow from this.

The cost, however reckoned, is sure to be stupendous. Prof. Richet is quoted as reckoning it at $50,000,000 a day. This is probably more than half the total income of all the inhabitants of the warring countries. The highest estimates of the total income of the United Kingdom, France and Germany, estimates of Bowley, Laverge and Bucher respectively, total up less than $70,000,000 a day. Russia and Austria are poor countries per capita, and would scarcely bring the grand total to $100,000,000 a day. Moreover, the loss of real income to Europe is, I imagine, in reality, much greater than Richet's estimate, chiefly because he takes little account of the indirect costs, which may well be the greatest of all. The cost to the fiscal departments of government is probably only a small part of the total cost which the people will have to bear. The killing and disabling of the men engaged will cut off the financial support of European families to the tune of hundreds of millions of dollars per year. The physical destruction of capital through the devastation of crops, the burning and demolishing of merchant ships and buildings, the crippling of industry through the sudden withdrawal of labor, raw materials, the introduction of new trade risks, and the cutting off of transportation, both internal and foreign, make up a sum of items which cannot be measured but which may exceed those which can. Last, but not least, is the impairment of that subtle but vital basis of business; commercial credit.

In short, the central effect is a vast impairment of Europe's current income and of the capital from which her future income will flow. It means a veritable impoverishment of vast populations. The great burden will bear heaviest, of course, on the poor. It will impinge very unequally and will cause a great redistribution of wealth. As always happens, some people, mostly lucky speculators, will come out of the melee wealthier than before. This fact will not serve to lessen the discontent of the masses which their impoverishment is sure to create. Food prices will be high, the earnings of labor will be low; and, after the war, unemployment will be great, due to the impossibility of quick absorption into the industrial system of returned soldiers as well as other maladjustments, which the war is sure to bring.

The victor may secure indemnity for part of the loss, but not for all; he will, in spite of himself, be a net loser. Taxes will be a crushing burden, merely to secure funds with which to pay high interest on vast new war debts, to say nothing of funds with which to purchase new armaments—if again the nations are forced, by lack of international control, to resume the stupendous folly of racing each other in military equipments.

Bankruptcy and Revolution.

It may well be that among the economic consequences of the war there will be some national bankruptcies, and that among the political consequences will be revolutions. High prices, high taxes, low wages and unemployment make an ominous combination. We may be sure that discontent will be profound and widespread. This discontent is pretty sure to lead, especially in the defeated nations where there is no compensating "glory," to strong revolutionary movements just as was the case in Russia after her defeat by Japan. Whether or to what extent these movements, in which "Socialism" in the various meanings of that word is sure to play a part, will succeed, depends on the relative strength of opposing tendencies which cannot yet be measured. One possible if not probable result may be, as I suggested in The Journal several weeks ago, some international device to secure disarmament and to safeguard peace.

Though part of the losses to Europe will be permanent, her chief loss will be coterminous with the war. She will, therefore, seek ways and means to fill in this immediate hole in her income in order to "get by." To do this she must borrow; that is she must secure her present bread and butter from us and other nations and arrange to repay later out of the fruits of peace. She can stint herself, but not enough to meet the situation. She must borrow. And in one way and another she will satisfy this necessity by borrowing in the United States.

Most of the strange and unprecedented phenomena which we have witnessed in the last month, in rapid succession, are due to this pressing necessity of the belligerent peoples to cash in now and trust to good fortune to pay later. As soon as the war became even probable, Europe tried to cash in on our securities. The pressure for our gold pushed it toward Europe faster than it could move. Exchange jumped to the gold shipping point of $4.89 per £ and did not stop. In some cases it reached $7. This was partly due to the desire to get our gold and bolster up a credit structure tottering before the deadly blow of war; but it was also partly due to the need of ready money for supplies of all kinds. This need applies not only to the governments, but to the individual people. To obtain this ready money they threw back on us the securities they had purchased of us in former years. They wanted us to take back these titles to future income and give them instead titles to present income. Had they secured our gold their next step would have been to spend part of it for supplies and this would have caused any foreign dealers to whom they applied to place orders with us. The gold then might have turned the exchanges and have been brought back to us in return for our wheat and other products.

This double transaction is in essence one, a barter of present income in the form of our wheat to Europe for future income in the form of investment securities. It was interfered with by the refusal of the insurance companies to insure the gold and by the closing of stock exchanges against the inundating flood of securities. The first difficulty, as to transporting gold, has been largely removed by arranging for drafts against stocks of it kept on both sides of the Atlantic. This will save the need of sending it on risky voyages back and forth, and any final net balances can be liquidated after the war. The second obstacle, the closure of the stock exchanges, is more formidable but cannot completely or permanently prevent the transactions which so many people on both sides are anxious to consummate. Curb markets and limited cash sales on the exchanges themselves are doing some of this business, and, sooner or later, much more will be done, whether the exchanges are open or not. Europe needs our wheat and cannot pay for it except with securities, partly because her own industry is paralyzed, partly because ocean transportation is difficult.

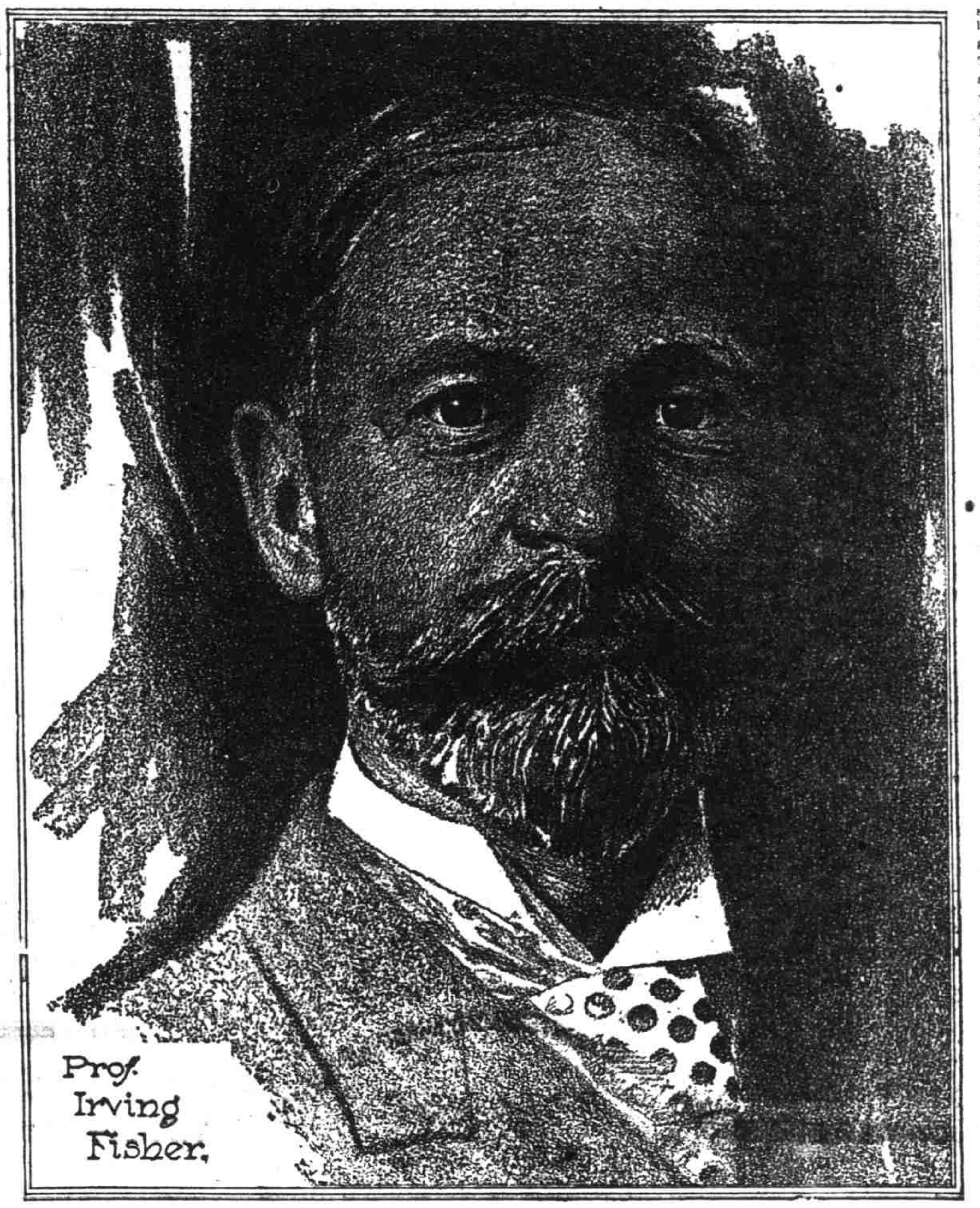
What Dumping Securities Means.

Few people seem to realize that the dumping of securities on our stores and the efforts of foreign governments, such as France and Switzerland, to borrow money in our markets are at the bottom very much the same thing. They are simply two forms of securing present supplies from America in return for future supplies, the dividends and interest on securities, from Europe.

It does not much matter whether we buy government bonds or other securities. If we buy of French capitalists their holdings in American railway securities we simply provide them with the wherewithal to take the French government loans themselves. They virtually become, without our knowledge, the go-between through which we lend, as it were, to the French government, in spite of ourselves. It is doubtless well, as a matter of policy, to refuse to loan directly to France, but we must not for a moment conclude that France or any other nation will have to finance the war without our aid. We shall not be consciously helping any particular nation, but we shall be actually helping any nation which can trade with us. Evidently England will get more of our help than any other nation because her shores are more accessible. Germany is more isolated. Unless she possesses a larger food stock than commercial statistics indicate she will be pressing for our food supplies, which may reach her indirectly, we selling to Holland and Holland to Germany, also reversely, via Holland or via Austria and Italy, Germany may sell a stream of securities the other end of which we receiev. Whether directly or by devious routes there will inevitably be, so far as I can see, a vast exchange of commodities passing to Europe for securities coming from Europe. In this interchange will be found the dominant economic effect of the war on the United States.

Foreign nations will get their much needed loans on better terms, even if less promptly, by the circuitous process mentioned than if they could borrow directly in our markets; for their own citizens will pay higher prices than we would, even if, to get the money, they have to sell their other investment securities to us at a considerable sacrifice. England has sold treasury bills for $75,000,000 on as low a "basis" as 3¾ per cent.

In this virtual trade of this year's crops for titles to future years' crops, we shall get a high price for the former and pay a low price (in present valuation) for the latter. Investment securities are and will be a drug on the market. In other words, the rate of return to the investor will be high, the rate of interest on long time loans will be high and stay high; that on short time loans may fluctuate greatly. The rise in the rate of interest on long time investments is one of the most vital and far reaching effects of the war. At bottom interest always arises from the exchange of present and future goods. The rate of interest, as I have tried to show in my book of that title, is simply the crystallization, in a market rate, of the impatience of the human race for its bread and butter. War has now produced such impatience in populations of hundreds of millions. It is this impatience which dumps the securities upon us, sends down their price, and sends up the rate of interest. As Byron W. Holt has said, there is no moratorium for hunger. The fall of securities in Europe produces the like fall in this and other countries.



Prof. Irving Fisher.

One of the consequences to America of being forced to play the role of money lender and one of the consequences of the rise in the rate of interest here, or what amounts to the same thing, the fall in the prices of bonds, will be an increased difficulty of financing our own enterprises. Only the most promising enterprises will be able to sell their securities. This means that we shall be neglecting, to some extent, our own enterprises to finance the European war instead.

This general depreciation of investment securities will doubtless lead to many bankruptcies, if not to a genuine crisis. It will also give tempting opportunities to investors. The likelihood of a genuine panic is lessened by the fact that everyone recognizes the real cause of the disturbance and that insolvency is not suspected. According to the best commercial observers, the previous liquidation had been fairly well completed. Unless they are mistaken, disaster will not be likely to follow.

We repeat that since the necessities of Europe have forced her to buy our food in return for her investments, it is evident that during the war food prices will be high and security prices, especially bonds, will be low. These are the two facts of greatest economic significance to us. To the country as a whole, they defer some of our pleasures till after the war. Uncle Sam will cut down for the present on his eating and drinking, his clothes, shelter and amusements in order to share his rations with Europe. Instead of the pleasures foregone he will invest—not in new enterprises at home, but in old ones—American and possibly European also—purchased of Europe. We can never have our cake and eat it, too. In this case we shall let Europe eat some of it on condition that she in turn shares hers with us after the war. Moreover, we shall trade off a relatively small piece of our present cake for a relatively large piece of Europe's future cake. In other words, Europe will fill up the great breach in her income now impending by inducing us to make a small breach in ours. The result will be that the course of our real income, that is, economic satisfactions or enjoyable consumption, will imitate in some degree that of Europe. This is, reduced to its lowest terms, the chief economic result of the war.

But to many the question is, do we gain or lose, as compared with what might have been the case if there had been no war? I do not think any one can answer that question with certainty. Europe is willing to mortgage its future to us on terms very advantageous to us; but when the future comes, the purchasing power of money will probably be so much lessened as to have absorbed all our advantage. Probably we shall lose slightly, on the whole. But it is not economically impossible that there will be a net gain. In either case the net effect will, I believe, be small.

Of more importance will be the various effects on various classes. Certain people will be greatly benefited by the rise in food prices, and the fall in security prices. The farming classes will profit by the former; the investing classes by the latter. Those who have the good fortune to belong to both classes will grow rich. The farmer who is in a position to save money will both make more money to save and be able to invest it more advantageously after he has saved it. If he lends to his neighbors he will find the market rate of interest high. Even if he buys more land the purchase price will be restrained from the great rise we might expect from the prosperity of farming by the fact that the "number of years purchase," as the phrase is in England, will be small, or, in other words, that the interest basis, which enters into every land price, will be high.

Labor Will Not Suffer Much.

On the other hand, the general consumer of farm products will suffer from another advance in that part of his cost of living, while the debtor classes will suffer from the fall in bonds or rise in interest. Many speculators on the stock exchange, those who have speculated for a rise, are in effect undoubtedly ruined already and many borrowers at banks on collateral security will feel the pinch from the depreciation of their property and the hard terms of renewing their loans.

And the laboring man, who forms the majority, what of him? It seems improbable that he will be greatly affected, that is, on the average. He will have to pay more for his food and food constitutes more than a third of his budget. But some articles he buys will probably fall and he may secure higher wages because of the withdrawal of competing laborers. Some labor may rise, especially in the industries benefited by the war, such as for instance, farming and other food industries, canning, flour mills, sugar, etc., the automobile industry and perhaps ammunition and steel. In other industries thrown out of gear for lack of foreign markets or for lack of foreign raw material, the wage earner may lose in wages and employment. In other words, labor will be dislocated in spots, like the other parts of our industrial machinery.

Important dislocations will be felt in the fields of shipping and banking. One consequence is that American enterprise has now the golden opportunity to capture a good share of each. The outbreak of the war and the simultaneous opening of the Panama canal will tend to divert the course of trade from Europe to South America. Probably our merchant marine can be developed more successfully for this South American trade than it could for the European trade. New York can largely take the place of London as the world's exchange center for Pan-American trade. This opportunity is increased by the possibilities in the new banking act for the establishment of branch banks abroad.

With these opportunities and the rise of interest in Europe, the United States will change to a great degree from a debtor to a creditor nation.

One of the dislocations of the war in the United States will be the cutting off of imports of a large part of our dutiable commodities, and therefore the loss of national revenue. There is an urgent need to compensate for this loss by some other form of tax.

But it is well not to lose perspective, to remember that dislocations are not necessarily losses, that, however, loudly they are proclaimed in news columns, they are small in extent, when considered in relation to our whole trade, that this country of ours is a vast one, and that the rank and file of Americans will be but slightly affected by the war—especially by contrast with our friends, now fighting each other, across the sea.

We are too nearly self supporting to be prostrated. Our foreign trade is and always has been a trifling matter compared with our internal commerce. The internal commerce paid for by money and checks annually in the United States amounts to nearly five hundred billions of dollars, which is more than a hundred times as much as our combined exports and imports.

Almost all of what has been said so far had grown out of the prospect that the prices of foods and other materials needed in Europe will be high, while the prices of securities which Europe does not need and cannot afford, will be low. Other prices will rise or fall according to special circumstances. Like a bombshell, the effect of the war will be to disperse or scatter prices at all angles of rises and falls. The prices of chemicals will be raised. The same article will fall in price in one country and rise in another if the transportation from the former to the latter is interfered with. This is true today of cotton.

There has already been a speculative movement to anticipate these changes and arbitrarily to mark some prices up and some prices down. But as this is guess work and will be subject to frequent revision, one of the striking phenomena will doubtless be an increase in the variability of prices. The general level of prices will tend to rise. The rise will probably be greatest in little countries like Belgium, which are in the war zone, and largely dependent on foreign trade. The rise will be less in England and in the United States than on the continent. In fact it is conceivable that in England the hoarding of money and the shock to credit, which is as predominant there as it is here, may actually lower the general level of prices during the war, especially if we could include in the index number the prices of securities, luxuries and articles of English internal trade. If any nation tries the old experiment of paying its bills in irredeemable paper money, that desperate expedient will have the same result that it did with us during the Civil war. Inflation of the currency will expel gold from that country and raise its price level higher than elsewhere.

After the war is over prices will probably not retreat, but will move upward even faster than before. There may then come the familiar "boom" period, which may culminate in a commercial crisis in a few years after the close of the war, as was true after the Crimean war, the American Civil war, and the Franco-Prussian war. The rebound will probably be fastest in England. Statistical price curves of many nations usually show an upward turn when war begins and another when it ends. The war will thus aggravate a rise of prices already in prospect.

It would take considerable space to give, completely, the reasons for these prognostications, but I have tried to justify them in a brief addendum to a book recently issued on "Why Is the Dollar Shrinking?"

The sudden lightning bolt of war produced as one of its first economic effects a general dislocation of credit machinery in Europe and to some extent in this country. We heard at once that letters of credit of travelers in Europe were uncashable. Gold was hoarded everywhere. It is estimated that about $30,000,000 in gold was hoarded in New York in the first week in August. Runs on banks were frequent. Bank reserves were depleted.

The moratorium was resorted to to avoid a general cataclysm of bankruptcies which might have occurred—not from actual insolvency but from mere insufficiency of cash.

To me, one of the most striking phenomena was the promptness and effectiveness of the cooperative actions by which, so far, any business cataclysm has been avoided. The closure of stock exchanges perhaps saved us from general financial panic. Most striking of all is the manner in which the governments of the world have come to the rescue of business. Those of us who were brought up in the old laissez-faire school have to rub our eyes. Had the world been guided by laissez-faire ideas, in this emergency we should in all probability have witnessed by this time the greatest collapse of credit the world has ever seen. Almost all the large and effective measures to meet the many emergencies arising were taken by governments. The moratorium must be counted among the governmental acts which, so far at least, have saved the day for business credits. In England, the government permitted suspension of the bank act (not of the bank as many Americans seem to imagine).

Improvised Accounting Methods.

The Bank of England has been enabled to rediscount a great mass of acceptances by the guarantee of the British government against loss in so doing. These in the end will amount to several hundred millions of dollars. Emergency notes were issued by governmental authority on both sides of the Atlantic, and in the arrangements made for special gold funds in Canada and in France the governments of England and France played the important parts. Thus have been improvised methods of international accounting by which the transportation of gold balances may be deferred and largely dispensed with. Our own government has cooperated in the currency exchange and credit situation in many ways. It made provision for sending gold to Europe for our stranded countrymen. It promptly revised the banking and shipping laws.

Whether further instability will be found to need such bolstering we cannot be sure. The present outlook is that business conditions are fairly sound and stable. In which direction across the Atlantic the title to gold will tend to change cannot as yet be foreseen. It will depend largely on how much Europe wants our products and how large a sacrifice she is willing to make in selling us her securities. It will also depend on possible issues of paper money. Fortunately we are the happy possessors of over $1,500,000,000 in gold, and it is inconceivable that any large part of this should flow out—unless we should be so insensate as to inflate the currency.

If we keep our heads we shall at the end of the war be in the proud position of being the only great nation whose economic resources have not even been strained.

SCARE ABOUT FOOD SUPPLY NEEDLESS

But It Would Be a Good Thing If Americans Learned Not to Waste Foodstuffs.

By a Veteran Grain Man.

THE whole country has been placed in a state of nervous anxiety about its food supply, and the high prices which it may have to pay in the future for its food owing to the European war. Household after household has laid in stocks of flour, sugar, etc., in fear that much higher prices would have to be paid in the near future. Those who usually buy 25 pounds of flour at a time have, when able and sufficiently scared, bought a barrel or several barrels.

This has produced an unusual and sudden demand of large extent, which naturally has reacted on the grocer and miller and has thus created an abnormal fear lest this demand last through the crop year.

The farmer also, in many sections, has a most exaggerated idea of the high price he is sure to obtain for his wheat and other grain. This idea causes him to hold back his supplies when able to do so, but most farmers are obliged to sell great quantities of their grain soon after harvest in order to meet their necessities, which grain has to be stored in warehouses at central cities, and carried by those engaged in the grain business and by the banks.

This great warehousing of grain acts as a balance wheel to keep the machinery of supply and demand of grain in equilibrium, as the balance wheel in a great mill enables the mill power to produce smooth action of the machinery, or the ballast in a boat keeps the boat right side up.

We need these great reserves of storage grain to be carried by men in the grain trade as a protection to the country for its grain supplies. A great country must have great grain storage reserves, the same as a great bank must have great reserves in cash resources.

We have harvested a wheat crop of over 900,000,000 bushels, which will give us 300,000,000 for export, or 100,000,000 more than our largest actual exports in any previous year. In the early part of July we were wondering how we could get rid of it at any fair price, but today we are wondering if we can keep the price within reasonable bounds, as the public mind has become hysterically excited. To be sure, in 1866-7, just after the Civil war, we sold wheat at $3.30 per bushel, and corn at $1.81, in paper money, but we had no reserves in the country to speak of.

The crop of corn gathered in 1913 was a small one, and hence now at the end of the year we are seeing very high prices for corn.

The present crop to be gathered this fall, which begins to come on the market in December, is expected to show at least 2,650,000,000 bushels, or 200,000,000 bushels more than last year. While this is not a large crop, the saving, which the farmer can readily make through care in feed, should make it equal, in results, a crop of 2,750,000,000, owing to the high prices which it commands.

The waste going on upon farms in our feed crops is every year enormous, owing to the cattle and hogs being carelessly fed, and immense quantities of grain are trampled under their feet and scattered carelessly over the ground. The farmer this year will be very careful to save every bushel of grain possible, and in the aggregate this saving will reach many millions of bushels.

The oat crop for this season will amount to 1,150,000,000 bushels, and is what might be called a fair average crop. It unquestionably will command good prices, as the European countries will want immense amounts for their armies.

Potatoes are showing better results than last year, and the probabilities are that their keeping qualities will be good. The general results of minor crops this year have been fairly satisfactory.

There is no necessity for the American people to become excited for their food supply; much of the sensational talk is of a highly inflammatory and deceptive nature. If the American people can be brought to exercise care in the use of their food and to cease the immense wastage which is constantly going on year after year through wasteful habits, at least 20 per cent of our present consumption in the food supplies of our country can be saved. This is an immense total, but we have acquired such wasteful habits of high living, that we have added an immense total to the cost of living.

We, as a people, are equal to seeing an essential fact when clearly demonstrated to us, but we are not so quick to remedy the evil until forced to it by compulsion, if it requires the entire change of our habits of living. The people seem to be awake at the present moment to the situation, and they will probably meet it not only as a necessity, but in a spirit of readiness and adaptability.

We are creatures of habit, and if we have acquired wasteful habits we stick to these methods. Much is being done by the government, as well as the railroads, in showing the farmer how he may increase the production of his crops by practical demonstrations along the lines of railroad in many sections of the country. We need to be shown in some practical way how we can serve to the best advantage the food supplies which are produced.

In Europe we are having the greatest lesson the world ever saw in the stoppage of free and quick means of intercommunication between thickly inhabited places in present day civilization, which will in one week produce results in loss of supplies that would seem incredible while the means of ready transportation were at hand. We ask—where have the supplies gone? They have simply been stopped because we are denied the material means to move those supplies, and have paralyzed the mind with fears so that it will not act with the necessary confidence to meet the demands.

The American people should take this lesson to heart. If we have crippled the readiness and flexibility of the will of our people to do things we have dried up the sources which produce the thousand and one means of livelihood, even if we say nothing about its crippling our food supply. It seems cruel to prey upon the minds of the people at such a time as this, when we need the most calm and sane presentation of facts, with the stimulus of mere temporary excitement, which only exhausts our resources and our capacity to see without the glasses of distorted fears.