1923

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Recommended Citation

Haskins & Sells Bulletin, Vol. 06, no. 06 (1923 June), p. 42-46

liabilities and, as well, any contingent ones which may be in the offing. There is proper classification. The integrity of groupings has been preserved and all relationships made clear. Full description and truthful titles leave no question as to what they represent. And last, but not least, the surplus is differentiated as to its origin so as to show particularly that which has arisen from revaluation. Less weeping, in general, would result from more unemotional balance sheets.

This Business of Business Cycles

JEVONS, an eminent English economist who lived from 1835 to 1882, is probably best known to the present generation, in this country, at least, as the propounder of the theory of sun spots. Jevons' general reasoning tended strongly to bring economics into relation with physical science, and he advanced the theory that there is a connection between commercial crises and sun spots. The reasoning was somewhat involved and had to do with the diminution of the heat from the sun and its effect on crops. In short, given sun spots of sufficient size, Jevons contended that panics are bound to ensue.

Looking back over the history of the United States for the past one hundred years, there are a number of crises which stand out. While they are sometimes referred to as panics it does not seem necessary to differentiate between panics and crises, if, indeed, there is any substantial difference. The outstanding periods of depression began, respectively, in 1837, 1873, 1893, 1907, and 1921. They are of some interest in examining the question of business cycles, because, with one exception, they have well defined points in common, and it is not unlikely, in the case of the exception, that sufficient investigation would reveal the presence of causes which are common to the other instances. Some of the panics synchronize with the occurrence of sun spots and crop failures; others show no relation to these phenomena.

The panic of 1837, as it is usually called, followed a marked period of territorial and business expansion, with excessive extension of credit and speculation in public lands. The panic was precipitated by the suspension of specie payments, resulting in great financial disturbance, and was accompanied by crop failures. There is no evidence available apparently to show that sun spots appeared at that time.

In 1873, due to over-expansion in railway construction, increase in the demand for iron, over-expansion in the iron industry, industrial expansion generally, inflation of prices, came another so-called panic. This depression is usually attributed to the fact that railroad development and construction, particularly through the west, was too far ahead of the transportation needs of the country, and as a result the roads with new extensions were unable to earn sufficient to meet the interest on the investment. There were no crop failures. There were no sun spots, but the depression was deep and far-reaching.

Just twenty years later another panic occurred which lacked, generally speaking, the ear-marks of its predecessors, with respect to over-expansion and speculation. The panic of 1893 is traceable more clearly to lack of confidence in the ability or intention of the federal government to redeem government obligations in gold and maintain a parity between gold and silver. In this year there were both sun spots and crop failures.

The next panic occurred in 1907, and

may be charged principally to a group of bankers who were pyramiding bank stocks. At that time trust companies were not members of the Clearing House, and were obliged to clear through banks which belonged to the Clearing House Association. The immediate cause of the panic was the refusal of one of the largest New York City banks to accept and put through the clearings of a prominent trust company. A financial crash ensued, and while business throughout the country generally was in a satisfactory condition, money became exceedingly tight, and it was necessary to resort to Clearing House exchanges and certificates, in order to keep the wheels of business moving. This depression was known as a money panic, and so far as may be learned there were no sun spots attending or preceding it.

The depression of 1921 is so recent as to have come within the practical experience of everyone in the present generation, but a word or two regarding it may not be out of order. High prices, brought about by the demands of war and for a long time a demand in excess of supply, gave rise to over-expansion in plant facilities and over-production generally after the close of the war. The things which sent prices tumbling were a decrease in demand which had been anticipated as a natural outcome of the readjustment process expected of Europe in its rehabilitation, and a buyers' strike in this country in protest against the excessive prices which had developed out of the war period. During this year sun spots appeared which were the largest on record, but at the same time there were bumper crops. It will be noted that this depression occurred just fourteen years after the panic of 1907, which is in accordance with some theories as to recurrence of depressions. It will also be noted that the panic of 1893 was just twenty years after the panic of 1873, which is also in accordance with another theory regarding recurrence.

The history just recited seems to prove nothing with respect to regularity or synchrony. In two instances during the past hundred years have depressions occurred in accordance with theoretical lapses. In two instances have depressions been accompanied by crop failures. In two cases have sun spots appeared in the same year with panics, but only on one occasion have sun spots and crop failures coincided. Further, in the year 1921, when the depression was unprecedented in depth and sun spots were the largest in years, the crops were bountiful. There is, however, one feature which is applicable to all cases cited, except possibly that of 1893, namely, that depressions followed over-expansion of one kind or another. First came speculation in public lands; next, over-development of railway construction; then, speculation in bank stocks, and, last, over-expansion of investment in war facilities and munitions, and the other necessities and luxuries which follow the trail of war conditions.

Imagination would indeed be needed to derive any fundamental principles with regard to panics from the experience of this country during the past hundred years. Almost anyone with intelligence would hesitate to predict the recurrence of panics with regularity. It does not require an especially keen sense to enjoy the humor of the sun spots suggestion. But out of past experience has emerged the theory, which appears to be sound, that as night follows day, and there is a succession of dawn, daylight, twilight, and darkness, so business conditions follow the sequence of depression, revival, elevation, and decline. Practical experience of the past five years needs no supplementary argument to prove the existence of a business cycle. Since 1918 we have seen prosperity followed by a decline; a severe depression recently giving place to a period of revival.

Beginning with a period of depression,

plants are idle, inventories are large; demand for goods is lacking; collections are slow; prices are high. There is labor unemployment; wages are low; fixed charges are going on; losses occur, and failures increase. Incident to the revival, prices first fall; demand increases; goods begin to move; plants begin to operate; the demand for labor increases; wages increase; collections improve; fixed charges are felt less; losses decrease and tend to be transformed into profits; failures are fewer. In the period of prosperity there is a demand for goods, steady and increasing; plants operate at capacity; plant enlargements are numerous; imagination, vision, enthusiasm, ambition, or what not, stimulate expansion; borrowings from banks and others increase; additional capital is sought, because prices tending higher and higher require more capital to swing the same volume of business; fixed charges tend to increase; wages increase, but lag behind the general price level; profits are the rule instead of the exception. The prosperity goes to the head. Business men are carried away with their success. They see visions of untold wealth and the power which usually goes with such wealth. Ambition leads to over-production; to the accumulation of excessive inventories at high cost; to the development of a price level which is out of proper relation. Then comes less demand for goods; bank credit contracts, and the decline which comes on calls for the liquidation of inventories; reduction of wages, with the accompanying dissatisfaction; the laying off of laborers; restricted operations; shattering of confidence; a feeling of uncertainty, and business is back again in the valley.

The manufacturer of a certain chemical preparation distributed in large volumes and in which preparation arsenic is the chief constituent, makes prices in the fall and sells his product for delivery beginning during the latter part of February. Arsenic in the condition in which it is used in this product was selling during the summer of 1922 around 7½ cents. The price rose between August, 1922, and March, 1923, from 7½ cents to between 15 and 16 cents. Not all of the output which the plant was capable of producing had been sold by the first of December, when it was apparent that the price of arsenic was increasing rapidly, and that if the margin of profit computed on 7½ cent arsenic was to be maintained, it would be necessary to advance the selling price. Forward purchase contracts made provision for about one-half the capacity output for the season, but there was no prospect of obtaining the remainder necessary to complete the quantity required by the production program at anything like the summer price of 1922. Looking forward to orders not yet booked at December 1, but with confidence that such orders would be booked and have to be filled largely from higher priced raw materials, the manufacturer advanced the price, effective December 1. This step was based on cost calculations which took into consideration the probable price of arsenic around February 1, 1923, shortly after which deliveries would begin on orders for the season, some of which would have to be filled from arsenic purchased at an increase of one hundred per cent. over the price at which some of the supply had been purchased. This man is not a super-scientific business executive. He is just an ordinary business man applying common sense to his own problems, and looking forward instead of backward.

Like everything else, prosperity is somewhat relative. Comparisons, however, show marked improvement in profits now as compared with two years ago, and profits are as good an index as anything else of prosperity. A list of forty representative industrials develops the interesting fact that the net profits for the year 1922 were 131 per cent. greater than those for the year 1921. In the outstanding instance, the concern in question showed an increase of 360 per cent. when the net profits for the two years were compared. Twenty representative railroads do not give such an encouraging result, since the increase in net for the list is only 17 per cent. The average, however, is brought down by three or four roads which suffered during the year 1922 from serious labor difficulties. On the whole the improvement is marked, and the country generally appears to be approaching, if indeed it has not already reached, a period of prosperity.

Notwithstanding this general condition, there is heard here and there the question as to whether or not things have begun to let down a bit and if certain signs noted signify the beginning of a decline. Some lines do show a slackening in demand and slightly more sales pressure is needed to keep up the volume. It is possible that the great activity in building operations evident in certain parts of the country has drawn potential individual purchasers away from the lines which they would naturally follow. Obviously the man who depends on a salary will, if he decides to build a house, be less likely to buy a new automobile. This factor in the aggregate may or may not be responsible for the apparent tightening in demand for goods. The whole situation is so complex that the present tendencies may possibly signify the beginning of a downward general movement from the period of prosperity, but the chances are that they will show, figuratively speaking, simply a saw-tooth in the general curve.

While everyone may be willing to accept the theory of business cycles and recognize that they are comprised of certain periods, indefinite though the periods may be as to extent, the particular one which concerns everyone is that of prosperity. Given a period of prosperity the factors which break it are prices which are too high, overproduction, excessive inventories at high cost, and a decrease in the demand for goods. The apparent way to avoid or postpone the decline, therefore, would seem to be consideration and control of these factors. As a means to this end a greater study of those statistics which relate to general business conditions and activities would seem to be indicated. There are today many business men who compile and study statistics relating to their own business. There are not enough of those who extend the idea to embrace a consideration of their own problems in their relation to the statistics for the country as a whole. With this added information, it would appear that there is some opportunity for the exercise of control over production and the relation of inventories. With the marginal price in sight, it seems natural that the business man who desires to maintain his volume should resort to the expedient of reducing prices somewhat. Sporadic effort of this kind might have little effect, but the combined forces of a herd have much to do with the direction in which the herd travels.

Ten years ago a suggestion of this kind might have sounded like flying in the face of good business theory. Today the first notable step of this kind has been taken in a considerable discontinuance of building operations and projects. There is no quicker way to break prices than to shut off demand; there is no quicker way to induce buying than to reduce prices. It does not seem too much to hope that some scheme may be developed for stabilizing prices and otherwise regulating the factors which start a decline from a period of prosperity. The depression of 1921 was not a panic, principally because a panic was anticipated and discounted. Much was learned from that depression and the period of recovery which followed. With a proper fund of information and some concerted action directed possibly by some government department, such as the Department of Commerce, the present period of prosperity might, it would seem, be considerably extended.

Judgment Guiding Financial Statements
(Continued)

SOME of the complications predicted in connection with capital stock having no par value are already beginning to arise. One case which presents some of these complications has to do with a corporation, the charter of which provided for both preferred and common shares without par value. The preferred carries a cumulative provision with respect to dividends. In the event of liquidation or dissolution this stock has an expressed value of $100 per share.

There are three times as many common shares as preferred authorized and three of the five directors are elected by the common shareholders. This provision remains operative as long as the preferred dividends are paid; or at least in the event of default in the payment of three consecutive semi-annual dividends on the preferred shares, the holders of the preferred shares may elect for the unexpired term three directors to replace those representing the common stock. The whole board is subsequently elected by the preferred shareholders and continued until all arrears in dividends on the preferred stock have been paid up.

The corporation was organized for the purpose of acquiring the property of a certain bankrupt corporation and to offer an opportunity to the stockholders of that corporation to participate in a new attempt to carry on the business which had been unsuccessful. The practical purpose of the plan was to effect a reorganization, although it was brought about by the establishment of an entirely new company. For purposes of identification the two corporations may be referred to as the predecessor and successor corporations.

Under the terms of an agreement between the successor corporation and certain shareholders of the predecessor or bankrupt corporation the latter were offered the opportunity of exchanging their shares for those of the new corporation "dollar for dollar." This was the basis specified in the agreement, but as subsequent developments will show, was not strictly adhered to. The shareholders in the defunct corporation were, however, allowed to value their shares, for purposes of exchange, at cost. And it should be added that their shares were of the common class and without par value.

The new company stock was valued for exchange purposes at ninety dollars per share in the case of the preferred and seven-fifty per share in the case of the common. Further, it was stipulated that the privilege of exchange should only be extended to shareholders of the predecessor corporation who would pay in an assessment of $2.25 per share of old stock. These funds were put into the hands of a committee representing the new corporation, with instructions to purchase from such funds the plant property of the bankrupt corporation. And it was provided further that these funds should be regarded in fact as advances from the old stockholders and be returned to them out of the so-expressed first profits made by the new corporation.

It so happened that twenty dollars per share was the cost placed on the old stock for exchange purposes. Where exchanges could not be effected otherwise cash was collected by the new company to equalize.