

ADDRESS

THE ECONOMIC AND FINANCIAL OUTLOOK
AND THE CASUALTY BUSINESS

BY

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General economic and financial conditions affect casualty insurance in several ways. The rate of business activity will govern to a considerable degree the total volume of such protection that is required. Changes in the general commodity price level will influence the amount of protection that will be needed by the assured in many particular instances. Certainly, any runaway rise in commodity prices would change both the type of protection required and the method of operation of casualty companies. Finally, investments of casualty companies are influenced in substantial measure by the trend of long-time interest rates and broad movements of bond and stock prices, and these in turn are sensitive to monetary and business influences.

A broad appraisal of recent economic and monetary developments, and especially of the current situation, requires that we look back twenty years. The year 1914 witnessed the foundation of the Casualty Actuarial Society, which has been a significant force for good. The same year saw the beginning of the World War, which changed the course of our civilization and effected profound and disastrous dislocations in our economic life. Production of certain types of goods required for war and incidental purposes was enormously expanded. There was a great expansion of debts, especially government debts. A major rise in prices was forced as new money and new credit was issued to permit the governments to buy what they needed to prosecute the conflict.

After the war, we should have had a protracted depression in order to correct the dislocations caused by the conflict. We should have had a deflation of credit, a decline in prices and a readjustment of the relative status of wartime and peacetime industries. But the world at large sought to escape the necessity for such a necessarily painful readjustment. Central banks of

the leading nations co-operated to expand credit anew, to encourage creation of additional indebtedness, to maintain purchasing power, business activity and prices. As a result, a post-war boom developed during the decade of the twenties, which not only delayed the inevitable economic and financial readjustment, but made it far more severe when it came.

A building boom to make up for construction delayed during the war period, the huge volume of business incident to the popularization of the automobile with the resultant need for a national network of roads, and a vast foreign trade based in large part upon billions of dollars of foreign loans; these were the factors which gave us our prosperity in the decade following the war. It was all financed through a vast expansion of indebtedness, represented by bank credit and other types of debt. Bank credit alone increased by an average of some \$1,500,000,000 annually during this period. This vast mass of new indebtedness, however, which spurred on the boom, also insured a subsequent very severe collapse.

During the past five years, we have thus had to reap two major crops of wild oats. We have harvested the crop sown during the war, and the even bigger crop sown in the subsequent era of inflationary credit expansion.

The Roosevelt Administration, on entering office in March, 1933, embarked upon a program of economic changes through legislation which was quite revolutionary in several important respects. Like most revolutions, however, it has tended to become far milder in actual practice than appeared at first. Where is the commodity dollar, which we were promised a scant year ago? Where is the regimentation of industry under the N.R.A. and the Blue Eagle which loomed so large in our national life until this spring? They are gone the way of the snows of yesteryear.

If we should now turn to an appraisal of economic and financial prospects for the future, we find that it is necessary to distinguish between long-term and short-term trends. From the long range point of view, there is every reason to be hopeful, even quite optimistic, for the industrial future of America. We have an unsurpassed technical equipment, a wealth of natural resources and a skilled population, which together should assure a resumption of our economic expansion. Recent surveys have

clearly indicated that even at the peak of the credit boom which culminated in 1929, the average standard of living in this country was surprisingly low. The furnishing of modern housing alone to the bulk of the population would, it is estimated, generate a volume of business far beyond the 1929 peak in the construction and related industries. Unless unsound governmental policies interfere, therefore, the main upward trend in the physical volume of production should re-assert itself in time.

For the near future, however, such an upturn in the physical volume of production faces certain obstacles. Whereas the light manufacturing industries and the volume of retail distribution have recovered substantially from the low levels of 1932 and the first quarter of 1933, and in some cases are again approaching their previous peaks, the capital goods industries remain very severely depressed. Building construction, railroad and public utility maintenance and expansion and such industries as steel and copper production, which depend on construction and the public utilities, are generally operating at a small fraction of the 1929 peak levels. Failure to deflate their costs in proportion to the general decline in the price level and national income, inept governmental policies, continued disorganization of the capital market, and uncertainties created by industrial disputes largely widen the lag between heavy and consumer goods industries which at the moment is perhaps the outstanding characteristic of the business situation. As a forecast for the long run, further industrial recovery and expansion for this country seems assured. For the near future, however, the maladjusted business situation created by the depression of the heavy industries may prove relatively protracted.

The larger volume of business which is indicated for the future will probably be done, however, at a stable or declining commodity price level. In fact, there is a hopeful revulsion of feeling evident in popular circles, both here and abroad, towards monetary manipulation. The great excess productive capacity for many types of goods that now exists and the ability of so many of our industries to expand their productive capacity further whenever necessary make any shortage of most types of goods which we produce in this country all but unthinkable, unless there is an artificial curtailment of supply by government intervention or agreement among producers.

For a time, under the old N.R.A. it appeared as if each industry would be given the power by government to effect such an artificial interference of supply. That is now a thing of the past, and the mere mention of that phase of the N.R.A. is sufficient to bring smiles to those who remember the roaring days of General Johnson and the experiment in a "controlled economy" which he launched with so much vigor but little more than a year ago. We in the United States have certainly tried hard enough to generate an inflationary rise in prices, utilizing about every known device to effect this result. The small and probably temporary success achieved in this direction should give pause to those who continue to favor a general price rise as the open road to business recovery. Far more significant, however, is a tendency for the relationship between prices of raw materials and prices of manufactured goods to re-adjust their inter-relationship. The mal-adjustment between these two great groups of commodity prices has been a major cause of the protracted character of the depression, and if these major groups of prices are brought into more satisfactory relationship between each other, a much greater contribution will be made to lasting and stable business improvement than a forced artificial general price rise can ever accomplish.

While there is very good reason to believe, therefore, that a resumption of the expansion of our industrial output and the rise in our standard of living will be witnessed when the current series of re-adjustments has been completed, there remains a very serious source of concern to those seeking to appraise future business prospects. There is a danger that future business expansion will be accompanied by the same kind of credit and debt inflation that was witnessed during our last boom. In fact, the bane of modern economic civilization appears to be the inability of our leading countries to enjoy a period of expansion in the volume of production without a corresponding sharp increase in the volume of debt. Whenever this debt expansion stops, and creditors insist upon some re-payment, the deflationary forces are let loose which generate recurrent depressions.

Just now, as a reaction to the extremely painful and severe decline of the past five years, steps have been taken by our government and by the Federal Reserve Banks which lay the basis for a greater orgy of debt expansion than the world has ever seen before, short of a currency debauch such as occurred in several

European countries after the World War. The devaluation of the dollar has resulted in the increase in the gold stocks of the United States to an unprecedented total of more than \$8,000,000,000. Of this total the treasury possesses some \$2,700,000,000 of free gold, held in its own cash fund and in the Exchange Stabilization Fund. Whenever this gold is deposited with the Federal Reserve Banks, and the resulting deposits are spent, they will add a corresponding sum to the total of about \$2,000,000,000 in excess reserves which member banks already have with the Federal Reserve Banks. A basis could thus be laid, in the light of existing bank legal reserve requirements, for an increase of approximately \$50,000,000,000 in outstanding commercial bank credit. Many things must happen, doubtless, before there will be demand from those regarded as entitled to credit for such a huge sum. However, the basis has been laid, and if there is not governmental intervention of the restrictive type at the time when credit expansion begins anew, we may merely see repeated, perhaps even on a grander scale, the temporary prosperity and the sequel of deflation and depression through which the world went during the fifteen years that followed the outbreak of the World War.

It is to the interest of the casualty insurance business and its customers, and of all others who are injured by economic instability with its alternating cycles of depressions and booms, that any new expansion of debts, and especially of bank credit, shall be restricted and controlled as much as possible in the period ahead, when the hampering influences now at work no longer influence the activities of bankers and business men.