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Disinflation

A U.S. 'going out of business' sale

by Leif Johnson

On April 24, the *New York Times* devoted its lead headline to the announcement that the Consumer Price Index had fallen for the first time in 25 years—since 1965, to be exact. The drop was small, about 0.3 percent, and only for one month, but the trend toward lower inflation has been noticeable for some time. Paul Volcker's anti-inflation strategy, the media burbled, is working.

The rejoicing will be short-lived. The reason for the temporary deflation is a combined collapse of farm prices and the heaviest sell-off of consumer and producer inventory the nation has ever witnessed. As in the 1930s, the decline in prices is strictly due to the depression. The American economy is having a going-out-of-business sale. With a total unemployment rate of 23 percent of Americans willing and able to work in March 1982, the ability of consumers to purchase goods has plunged dramatically. Therefore prices took a small dip.

Farm-price collapse

The most dramatic shift in prices was in foods. Wholesale prices of foodstuffs have been declining since last May, when they stood at an index number of 260.9 compared to the 1967 base of 100. By December wholesale food prices for foodstuffs had sunk to 234.1, a decline of 10.3 percent. Since a year ago, prices paid to farmers have begun to crumble. Corn, then at $3.30 per bushel, had tumbled precipitously to a low of $2.43 by November 1981. Wheat, at $4.06 per bushel in April, had dropped to $3.80 by December, then to $3.60 in March 1982. Soybeans, one of the most important cash crops for farmers, fell from $7.60 in April to $6.00 by December, and then to $5.88 in March 1982.

The 10 percent decline in foodstuffs wholesale prices did not result in a 10 percent decline in food prices for the consumer. The decline to the consumer was less than 1 percent, the rest of the "savings" being absorbed between the farmer and the buyer—and most of that was absorbed not by the "middleman," but by bankers, insurers, and other financial entities.

The consumer who rejoices over the slight drop in food prices is like the housewife who exults over the local grocery store going bankrupt so she can buy his stock at cut-rate prices. The farmer is being hit with a dual problem. He is receiving today on average exactly what he was receiving for his crops and livestock in 1979. But since 1979 his costs of production have gone up 25.5 percent. That is why he cannot buy tractors and other necessary equipment and why 3,000 farms every week hit the auction block. At the same time, consumer spending for food, declining since 1979, dropped sharply since August 1981.

According to the U.S. Department of Agriculture's *Farmline*, a monthly reporting bulletin, Americans are consuming only 15 percent more red meat than the Polish population per capita, and are consuming 33 percent less milk and milk products than the Poles. But Americans are consuming twice as many chickens, because they are relatively cheap.

In one of the more honest speeches made recently by a Governor of the Federal Reserve System, Henry C. Wallich told an audience at Rockford College, Illinois on April 7 that it is Fed policy to reduce American food consumption.

Inventory liquidation

The American farmer is not the only businessman being driven out of his profession. In the first quarter of this year, the economy witnessed the largest inventory liquidation in postwar history. Forty billion dollars worth of inventory, or about $17 billion in 1977 constant dollars, was sold to meet short-term financial obligations after two years of usurious interest rates. Merchants and producers sold at whatever they could get to raise cash. That meant that prices showed a lower inflation rate or even dropped.

The largest inventory liquidation took place in auto: $7.9 billion in auto inventories and $1.3 billion in truck inventories were sold. Even with this enormous manufacturing liquidation, the ratio of inventories to sales remains at nearly the January post-World War II peak; American businesses will continue to be sacrificed until low-interest credit is made available to rebuild the economy.

If interest rates were suddenly lowered across the board, Volcker's so-called inflation-fighting strategy would only have guaranteed that the structural inflation built into the U.S. economy over the medium to long term would become immediately visible. The effect of Volcker's tight credit policies has been to shut down productive industry. That means the overhead of the total economy is increasing while the productive farm and manufacturing sector is shrinking, feeding a tendency for prices to rise if credit is simply loosened. Only if the U.S. Treasury directs a program of low-interest credit to investment in productive industry and agriculture can an economic recovery be assured.

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