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THE NEED FOR A FLEXIBLE INDUSTRIAL PRICE POLICY

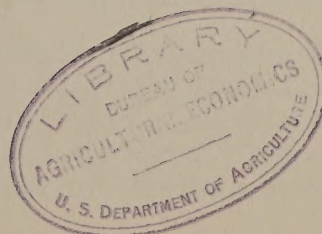
by

Louis H. Bean
Agricultural Adjustment Administration

Prepared for Hearing on Price Provisions of
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THE NEED FOR A FLEXIBLE INDUSTRIAL PRICE POLICY

The purpose of this statement is to call attention to several basic facts which seem to us highly important in a discussion of price policies aimed at furthering industrial recovery. These facts deal chiefly with the lack of balance between the low industrial production level and the relatively stable high output of agriculture, which lack of balance tends to perpetuate an unbalanced relation between industrial and agricultural prices. They indicate rather clearly that from the standpoint of both agriculture and industry the great need is a direct effort at increased industrial output accompanied by reemployment and the avoidance in general of any industrial price policy that tends to maintain price inflexibility at the expense of volume. In this direction lie the broad interests of farmers, workers and business men. Our facts indicate that increased industrial activity is basic to a restoration of the farmers former standard of living; it is the real way to reemployment, and greater incomes for industrial workers; and it is at the same time the most important single factor in restoring profits to industry. Industrial price policies that tend to prevent downward price adjustments with increased volume tend to retard further recovery for these major economic groups.

From the standpoint of agriculture, we have reached a point in the recovery phase of the present business cycle where further progress depends very largely upon an expansion in domestic and foreign demand. In so far as NRA policies affect domestic demand for farm products, they should be such as to increase the purchasing power of farm products and farm income for industrial goods, and thus clear the way for increased production and exchange of both farm and industrial products alike. Policies which aim at clearing away obstacles to increased volume of industrial production rather than policies which aim directly or indirectly at price rigidities are called for if the farmers income is to exchange for a larger volume of industrial goods and if there is to be substantial reemployment, a freer use of goods and services and a rising national income.

The effectiveness of the NRA in promoting reemployment and a rising physical national income depends almost wholly on its ability to increase volume and to lower production costs so as to permit increased consumption. To accomplish this objective, the primary need is for code authorities with definite objectives in terms of increased physical volume and for inter code authorities that can bring about such arrangements in terms of prices of materials, labor and services as will make for increased production and consumption of industrial products.

I. The Farmers Interest in a Flexible Industrial Price Policy.

A given amount of consumer purchasing power available for food products will obviously buy a larger volume at relatively low prices than at relatively high prices. Similarly, a given national income permits a larger volume of industrial consumption at lower prices than at higher prices. There is, however, a broad basic difference between these two groups of products which clearly indicates where

the national interest lies. In the case of the major farm products, a large volume pressed upon a limited market has either a smaller gross value or at least no greater gross value in wholesale and retail distribution, but in practically all cases a smaller net income to producers; while in industrial products, in the aggregate, a larger volume means greater employment, a greater gross income and, furthermore, not only an increase in the national income but also an increase in industrial profits.

The volume of agricultural production available for commercial distribution is not materially out of line with the usual volume of aggregate consumption, although the drought has brought about certain internal maladjustments between feed crops and livestock. These will be corrected in large measure by a return to normal growing conditions in 1935. The agricultural adjustment programs for 1935 practically all involve a larger volume of output than in 1934 in spite of the fact that this may lead to a loss of part of the price gains brought about by the 1935 drought. Under these circumstances, the present agricultural programs of controlled expansion may mean a restoration of part of the former surpluses in wheat, corn, cotton that the 1934 drought helped reduce and thus progress toward restoring a balanced relation between agricultural and industrial prices and incomes would be checked. It is therefore important that NRA price and production policies should be directed specifically to bring about a higher level of industrial production, to support the progress already made in closing up the disparity between farm and other prices and in giving farmers a larger purchasing power for city goods and services.

Between March 1933 and May 1934 as a result of the various administration policies, the level of farm prices advanced about 50%, from 55% of prewar to 82% and a rise in prices paid by farmers for processed goods advanced 21%, from 100% of prewar to 121%. Largely as a result of the drought, farm prices have risen about 25% between May and December 1934, while prices paid by farmers have advanced another 4%. In December 1934 farm prices stood at 101% of prewar, prices paid by farmers at 126%, and the relative purchasing power of farm products at 80%. The 25% advance during the last half of 1934 can be maintained during 1935 with increased farm production only through a vigorous increase in the purchasing power of the industrial groups. The NRA can contribute to that increased purchasing power through increasing output and employment at such prices as will permit the increased volume to be consumed. In the absence of such an increase in urban purchasing power, the disparity between farm and other prices could be corrected, in so far as NRA policies are concerned, by policies that would promote a lowering of industrial prices toward the level of farm prices.

The broad industrial groups that are involved in this present disparity between farm and other prices may be readily judged from the following set of price indexes of goods for which farmers spend the major part of their cash income. While these figures show prices paid by farmers, they are generally representative of retail prices to other consumers as well.

Table I. Prices Received and Paid by Farmers.
(1910-1914 = 100)

	Mar <u>1933</u>	May <u>1934</u>	Sept <u>1934</u>
Prices received by Farmers	55	82	102
Prices Paid by Farmers	<u>100</u>	<u>121</u>	<u>126</u>
Fertilizer	91	104	105
Operating expenses (for farm home)	96	107	106
Food	92	107	113
Clothing	102	131	130
Furniture and Furnishings	117	135	137
Farm machinery	135	144	146
Building materials (for house)	126	158	153

It is clear that industrial products from certain industries-- notably building materials, farm machinery, and furniture and furnishings-- are the outstanding cases where prices have been maintained so high that the quantities farmers and other consumers can or will buy are seriously limited.

In addition to the farmers need for a flexible industrial price policy which would mean increased output and employment and a closer approach to parity for farm products, they need also flexibility in the margin between producer and consumer prices. The adjustment programs in certain crops could aim at greater volume if the relatively inflexible costs could be so adjusted that large crops gave farmers some reasonable return instead of losses. The great need in this field can be illustrated with a single commodity, say grapefruit. According to our price analyses, consumers under present conditions will pay at retail about 26 million dollars for 6 million boxes, 32 million dollars for 12 million boxes, and 31 million dollars for 18 million boxes. For the small quantity, harvesting, shipping, and marketing costs amount to about 12 million dollars, for the average crop 27 million dollars; and for the large crop 31 million dollars--the margin per unit remaining practically unchanged except for selling costs. Thus farmers net returns would be 14 million dollars for 6 million boxes, 10 million dollars for 12 million boxes, and no return whatever for 18 million boxes. Price policies for goods and services in the producer-consumer margin which would flex with volume would make it economically possible for crop adjustment programs to aim at volumes above average instead of average or less. In so far as NRA price policies prevent flexibility in the costs that enter the producer-consumer price spread and force farmers to avoid large crops, they are hindering a larger flow of goods from farm to city and from city to farm, or are forcing farmers to take losses on them.

II. Effect of Codes on the Relation of Wholesale Prices of Raw Materials to Prices of Finished Goods

The rapid decline in prices from 1928 and 1929 on was far more marked in raw materials than in finished products. At the bottom of the depression in February, 1933, raw materials had declined to 48.4% of the 1926 level, while finished products had fallen to 65.7% of that level (at wholesale) leaving finished products relatively 36% higher than raw materials.

The rapid increase in price level from February to July, 1933 under the impetus of the expected monetary changes, caused a partial correction of this condition. Raw material prices rose to 61.8 finished products to 72.2, the excess of finished products over raw materials falling to 17.

Following the imposition of the NRA codes, however, during the latter half of 1933, the prices of industrial and other finished products were generally advanced, and distributors' margins were in many cases advanced, while raw materials increased little if at all. By November, 1933 raw materials had increased to only 62.4, while finished products had increased to 75.2, widening the disparity of finished products over raw materials to 21%.

During 1934 the extreme reductions in crop production due to the drought have pushed up the price of raw materials very greatly. Even so, the prices of raw materials in November 1934 were still but 72.2% of 1926. Meanwhile finished products likewise had advanced, although not so greatly, to a level of 79.3, leaving the disparity of finished products over raw materials still 9.5% in spite of the very great shortages of farm products resulting from the drought.

Unless something is done to change the forces which are holding industrial prices and marketing charges out of line with the prices of raw materials, normal crops in the coming crop year would force down the prices of raw materials and leave the disparity of finished products over raw materials again so high as to place a serious brake upon economic recovery. It is evident that real recovery from the depression can come only if a balance is restored between prices of various commodities. To date the price policy which in fact has been followed by NRA codes has tended to intensify these prices disparities rather than to correct them.

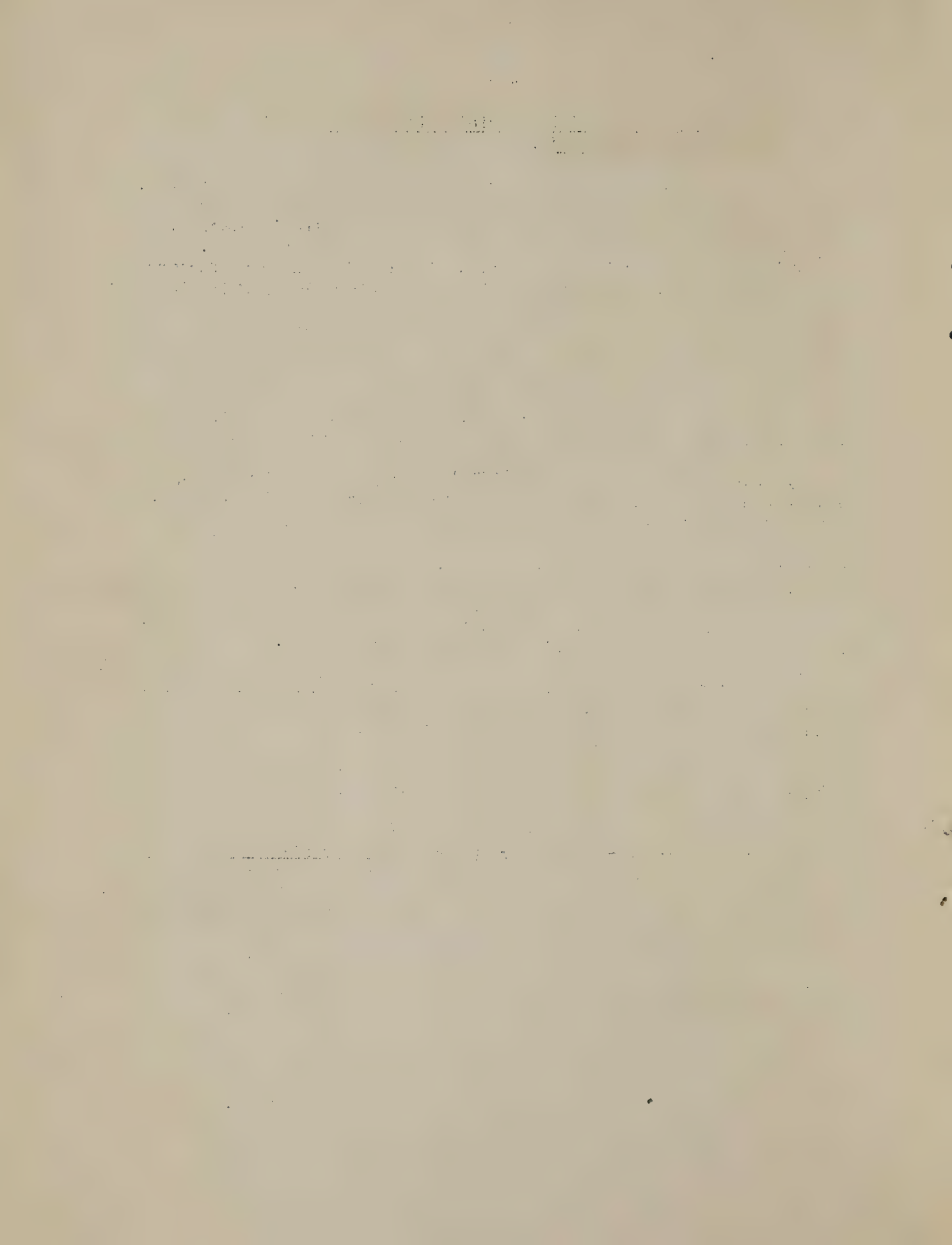
III. The Agricultural and Industrial Price and Production Disparities during 1934.

A review of the broad production and price facts for 1934, with comparisons with previous years reveals clearly the nature of the broad price policy that the NRA should promote in place of the recent efforts to sustain prices at the expense of volume. Table 2 shows that agricultural production (defined here as factory production in industries using agricultural materials) was in 1934 85% of the 1929 level while non-agricultural production was 58% of the 1929 level. The volume of processed farm products was down 15% but of industrial products, 42%. The price situation was just the reverse. Farm product prices were 39% lower than in 1929 and industrial prices only 14% lower. The production of industrial goods in 1934 in relation to the production of agricultural was about 35% less, and this fact naturally shows up in an exchange value of farm products for industrial products in 1934, 30% lower than in 1929. From this it should be obvious that the pre-depression balance between agricultural and industrial prices could be substantially restored by further increasing the volume of industrial production in relation to farm production.

Table 2. Agricultural and Industrial Production and Prices (1929 = 100)

Year	Production		Prices		Ratio of Industrial to Agr. Production 5/	Ratio of Agr. to Industrial Prices 6/
	Agricul- tural 1/	Non- Agr. 2/	Agricul- tural 3/	Non- Agr. 4/		
1927	98	84	95	102	86	93
1928	95	93	101	101	98	101
1929	100	100	100	100	100	100
1930	87	77	84	96	89	90
1931	88	58	62	83	66	76
1932	82	41	46	79	50	58
1933	93	52	49	78	57	63
1934	85	58	61	86	65	70

- 1/ Factory Production in industries using agricultural raw materials.
- 2/ " " " " " non-agricultural raw materials.
- 3/ Wholesale prices of farm products.
- 4/ " " " all commodities other than farm, food and textile products.
- 5/ Col. 2 divided by Col. 1.
- 6/ Col. 3 divided by Col. 4.



IV. Increased industrial volume at lower industrial prices has in the past proved effective in restoring general prosperity.

The suggestion that the general interests of the country are best served by a flexible rather than by a rigid industrial price policy is in line with the facts as to recoveries from former business depressions, the progress during prosperity periods and the long-time relationships between agricultural and industrial prices.

During the period between 1923 and 1929 it was clearly demonstrated that the combination of (1) a rising agricultural price level with stable agricultural production, and (2) a gradually declining industrial price level with expanding industrial volume, made for general prosperity. Data of the National Bureau of Economic Research for 2,046 manufacturing corporations show that between 1923 and 1929 their physical volume increased nearly 50%, their wholesale prices decreased 8% and profits rose more than 50%. It has been argued by some that greater price flexibility in that period than that represented by a drop of 8% between 1923 and 1929 might have helped to prevent the subsequent major depression. Whether or not certain prices in that period were too rigid, the fact nevertheless remains that the industrial prosperity of that period was on the whole one of expanding production, sagging industrial prices and profits in line with volume

The facts of this depression also reveal that the chief concern over price policy should be that of greater flexibility in the interest of volume. In Table 3 it is shown that the third quarter net earning of 163 industrial corporations rose between 1927 and 1929 with increased industrial production and declined sharply as industrial volume was cut in half by 1932. Between the third quarter of 1932 and that of 1933 industrial production advanced nearly 50%, industrial prices about 6%, and profits changed from a loss of 21 million dollars to a gain of 128 million dollars.

Even more significant are the changes between the third quarter of 1933 and that of 1934. Volume declined 18%, prices increased another 6%, but profits declined from 128 million dollars to 78 million dollars. Efforts to maintain volume rather than prices would have given a much farther advance toward general recovery.

NRA policies that tend to prevent industrial prices from being gradually adjusted downward with volume, work contrary to the basic trends in the relation of agricultural to industrial prices. In a country that is becoming more and more industrialized, where industrial production for unlimited demand expands much more rapidly than agricultural production for demand closely related to population growth, it is natural for agricultural product prices to gain in relative purchasing power. This has been the longtime trend for over a hundred years and must continue in that direction if industrial activity is to regain its 1929 level.

Table 3. Industrial Production, Corporation Profits and Prices.
(Third quarter of each year)

	<u>Production 1/</u> <u>Per cent</u>	<u>Net Income 2/</u> <u>Million dollars</u>	<u>Prices 3/</u> <u>Per cent</u>
1927	104	258	93.6
1928	110	343	92.8
1929	122	393	91.6
1930	91	204	83.8
1931	78	97	74.0
1932	61	- 21	70.1
1933	90	128	74.1
1934	74	78	78.3

1/ Federal Reserve Board, 1923-25 = 100.

2/ 163 Corporations, Federal Reserve Bank of New York.

3/ Prices of products other than farm and food, Bureau of Labor Statistics, 1926 = 100.

This basic relationship can be illustrated by reference to production and prices for selected years during the past half century. Between 1881 and 1909 crop production in the United States more than doubled and was nearly three times as high in 1929 than in 1881. During the same period, production of total basic commodities increased by more than five fold. Taking 1926-1930 production levels as 100, the ratio of industrial production to crops was 57 in 1881, 76 in 1892, 73 in 1901, 81 in 1909 and 96 in 1929. This mounting volume of industrial products reflected itself in a relatively lower level of industrial prices and therefore an increasing purchasing power of unit farm products. In these same years, the ratios of agricultural to industrial prices at wholesale (taking 1910-1914 as 100) were 82, 92, 85, 102 and 108. In a country where per capita production is increasing and standards of living are rising, it is inevitable that industrial production thus outrun agricultural production; for higher standards of living always mean much greater increases in expenditures for other goods and services than in expenditures for food and clothing. If this upward trend is to continue, industrial production must increase faster than agricultural, and industrial prices must decline relative to farm prices, or farm prices must trend upward faster than industrial prices.

(Note that as relative industrial volume was lower in 1901 than in 1892, the relative purchasing power of farm products was also lower).

In relation to that upward growth in the purchasing power of unit farm products, the present level (November 1934) is about 20% too low, and would be even lower were it not for the price effects of the 1934 drought.

V. Implications of a Flexible Industrial Price Policy.

The foregoing facts support the general conclusion that the production price policy for industry should in general be the opposite of that for agriculture. In the latter, production programs are being aimed at restoring balance as between the several branches of agriculture, restraining production of export crops until foreign markets can be regained, and restoring the purchasing power of farm products and of farm income. In general, the agricultural production programs aim at maintained production for adequate domestic consumption, and are not drastically limiting supplies even though prices and, in some cases, higher returns might be attained were farmers to reduce their production more nearly in line with the low volume of industrial production and domestic purchasing power.

The appropriate industrial policy, it is generally agreed, should be that of increased output, but to attain this it is necessary to turn from efforts to maintain prices to devising ways and means for increasing output and consumption. Unlike increased agricultural production which has a lower value if it exceeds the current level of demand, generally increased industrial production actually creates added national income. For example, an expansion in automobile production from the present volume is quite possible if the general level of automobile prices could be reduced. That larger volume at lower prices would set in motion activity in a host of allied industries which would immediately result in a rise in the national income and purchasing power.

Inter-code policy making essential.

Thus far NRA codes have been written and code authorities have administered them largely without much regard to the effects of policies under one code on the welfare of related industries. Each individual segment of an industry covered by a given code has thus been led to reason. "If we reduce our price (or our margin), that will have little effect on the final retail price, and volume will not be particularly increased. Let us instead keep our prices high so that we will be assured of some profits even if the volume of production (or sales) continue exceedingly small."

In the automobile case, for example, automobile manufacturers could not by themselves stand the reduced prices necessary to sell a greatly increased production. But manufacturers of steel, glass, tires and sales agencies, all would have lower overhead costs from the resulting increased volume and could afford lower prices for the greater output. If some means were available to secure concerted action to reduce prices and distribution charges and increase volume, as a joint action by all agencies directly or indirectly involved in the manufacture and sale of automobiles, prices could be lowered, many more cars sold, thousands of men put back in productive work, and industrial profits increased, all at the same time.

The building industry offers many similar situations where concerted action for lower prices and selling costs and larger output, taken by all the agencies and labor groups contributing at any stage to the production of a finished house, would make possible exceedingly important increases in volume of activity.

What is needed, then, is some way of coordinating the policy-making decisions now scattered through many codes, so as to insure that price and production policies are established from the point of view of their effect upon the activity and welfare of the community as a whole, rather than solely from the point of view of the narrow self-interest of each small segment of each industry.

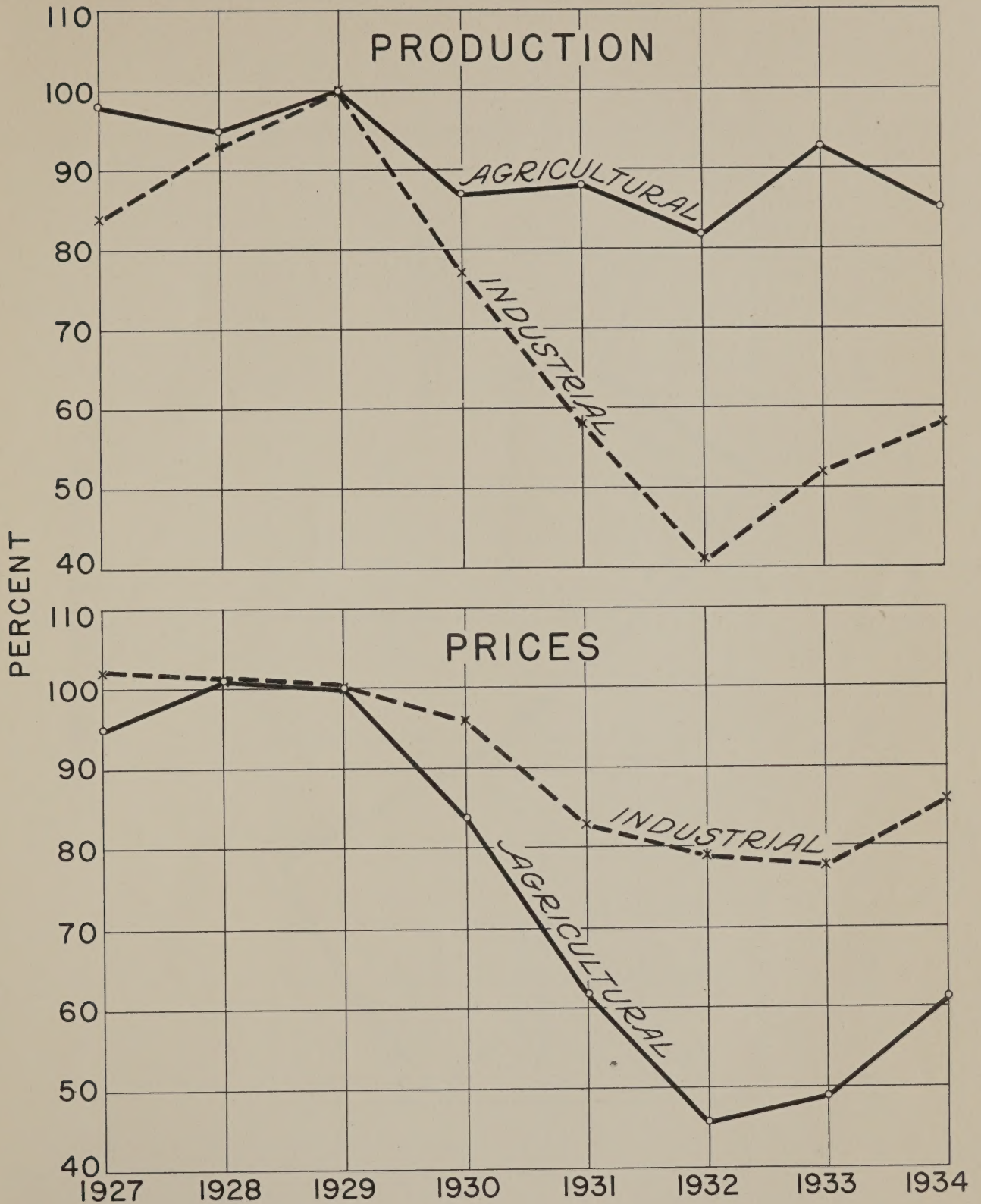
There are many different ways in which this coordination of fundamental key policies could be obtained: (1) by coordinating committees, bringing together the key NRA administrators and the code authorities and labor representatives, for each group of codes related to a particular final product or products (as autos or houses; or (2) by inter-code authorities, with similar jurisdiction as suggested above, but with definite legal responsibility for approving individual code policies before they become effective; or (3) by a governmental planning agency cooperating with the code authorities and labor representatives in developing coordinated plans, and backed by administrative support in seeing that policies of individual codes and code authorities complied with those plans.

But regardless of the form of organization, it is essential that means be found by which the NRA organization of industry can be made to work so that production is increased; costs are lowered without reducing payrolls; selling margins and prices are reduced so that there is a market for the increased output; and unemployed workers are absorbed on a steadily increasing cycle of expansion. Only in some such way can our potential productive power be put to work to produce the things so many of us need so badly; or can we permanently restore the productive power and the buying power of the city workers, so that they can again afford to buy the full and adequate production which farmers are eager to produce and sell.

The alternative policy would be to go back to deflation and ruthless competition, to equalize all prices downwards, and so again after a new period of chaos and suffering make full production possible. Even then we would face the probability of only short-lived prosperity followed by another debacle.

Each day that ten million workers, in city unemployed and excess workers on farms, go without real work, the labor of 80 million man-hours is lost for all time. That is the greatest

waste of the entire depression. We must work out the necessary readjustments in our economic machine, in our balances of wages, prices, and production, necessary to turn loose this flood of manpower to producing the things they and we need and want--if the depression is ever to be really solved.

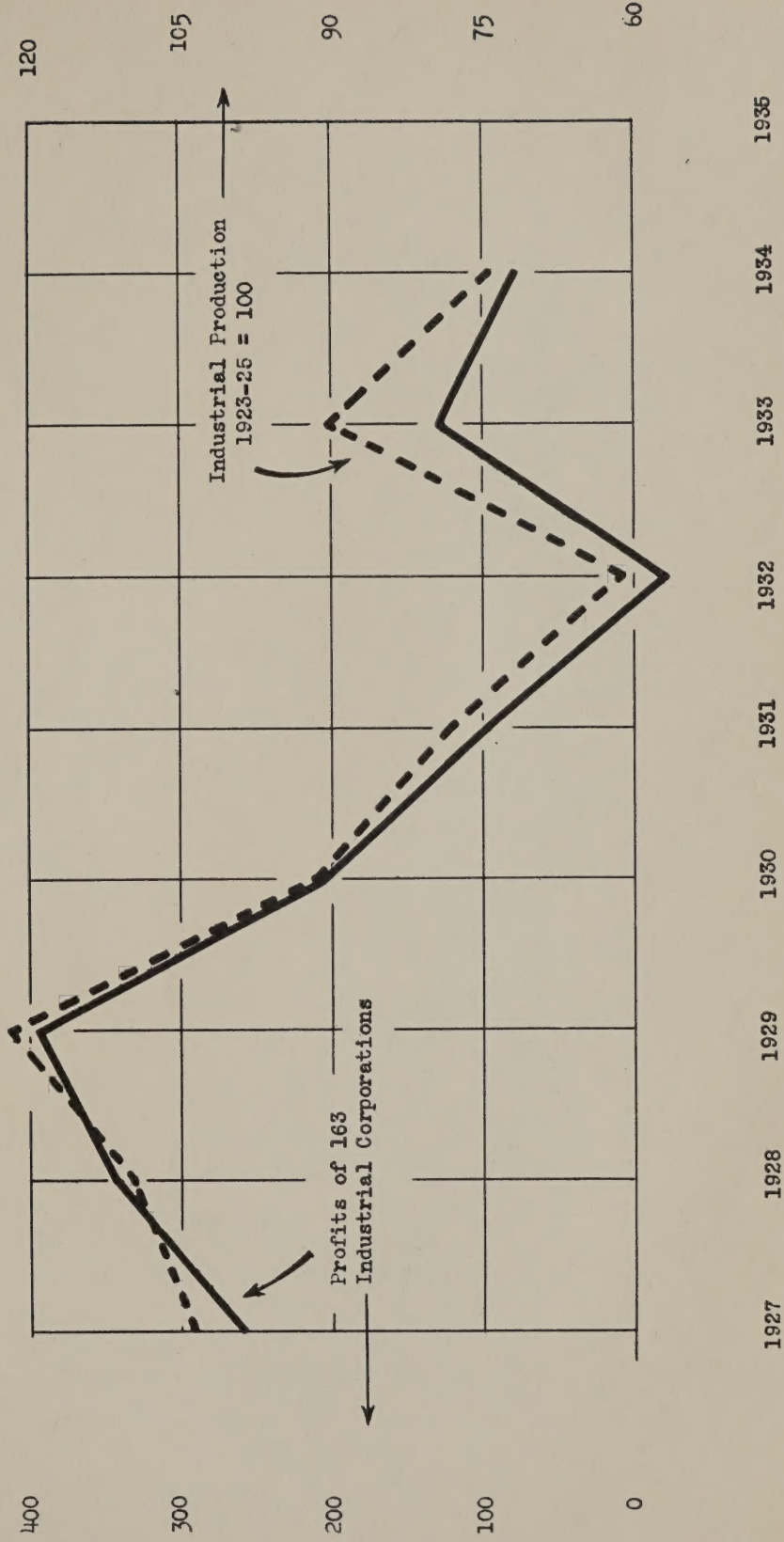


The volume of agricultural products processed in our domestic factories has remained on a level approximately 15% below the 1929 level throughout this depression but industrial production declined nearly 60% below the 1929 level in 1932 and during 1934 averaged more than 40% below. Just the opposite situation exists in prices. Industrial prices in 1934 averaged approximately 15% below the 1929 level but agricultural prices which in 1932 averaged about 55% below the 1929 level were still nearly 40% below the 1929 level during 1934. An increase in industrial production and employment would of course create a larger domestic purchasing power and this would in turn further raise the level of agricultural prices. In that way the disparity between agricultural and industrial prices would be further considerably reduced.

INDUSTRIAL PRODUCTION AND PROFITS

1927-1934

Dollars
(millions)



Third Quarter, July-September

