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TUESDAY MORNING, JUNE 26, 1934

A. B. GUNNARSON, Head, Department of Manufacture, Chamber of Commerce of the United States, Washington, D. C., *Chairman*

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LEVERETT S LYON holds a Ph D. degree from the University of Chicago, a Bachelor of Law from Chicago-Kent College of Law, and is a member of the Illinois bar. Before becoming connected with the Brookings Institution in Washington, Dr. Lyon served for seven years on the economics and business faculty of the University of Chicago, and for two years as Dean of the School of Commerce and Finance at Washington University, St. Louis He is at present Executive Vice President of the Brookings Institution, from which position he is currently on leave while serving as Deputy Assistant Administrator for Policy on Trade Practices with the National Recovery Administration. Dr. Lyon has written extensively in several fields, his books including *Education for Business*, *Salesmen in Marketing Strategy*, *Making a Living*, *Hand to Mouth Buying*, *Advertising Allowances*, *The Economics of Free Deals*, and (with others) *The A. B. C. of the N. R. A.*

A. P. HAAKE was born in Chicago and received his elementary education there After two years of high school, he worked in Chicago for eight years. He then worked his way through Wisconsin University as an adult-special student, and by carrying extra work completed the last two years of high school and the university course in the regular four years. He is a member of Phi Beta Kappa and of the class honorary societies, also of the forensic honorary, Delta Sigma Rho. Dr. Haake was editor of the college daily in his last year of school. After graduation, he taught eight years at Wisconsin University in the Department of Economics. In 1922 and 1923 he was Head of the Economics Department at Rutgers College. He then went with MacManus, Incorporated, an advertising agency in Detroit, as Head of the Bureau of Industrial Research. Subsequent to that he became Director of Research for the Simmons Company (1925), and later became Assistant to the President, in charge of sales, advertising and service. In 1928 he left Simmons to take his present position as Managing Director of the National Association of Furniture Manufacturers, Inc.

C. G. FRANTZ, President of the Apex Electrical Manufacturing Company, is a native Ohioan; a graduate in law of Baldwin Wallace University; a director of the Cleveland Chamber of Commerce; and a member of the Electric Vacuum Cleaner, Washer and Ironer Code Authority. For many years he has been Secretary of the Vacuum Cleaner Manufacturers Association. The company with which Mr. Frantz is associated was the first in its industry to sign the President's Re-Employment Agreement on August 1, 1933, and since that time Mr. Frantz has devoted a large part of his time to matters relating to the codes.

THE NATIONAL INDUSTRIAL RECOVERY ACT

The first session of the Fifteenth International Cost Conference of the National Association of Cost Accountants was called to order in the Grand Ballroom of the Cleveland Hotel, Cleveland, Ohio, at ten o'clock on Tuesday morning, June 26, 1934, by Colonel Arthur H. Carter, President of the Association.

PRESIDENT CARTER: Gentlemen, I have great pleasure in declaring the Conference in session. Perhaps never before in the history of this organization have we met to discuss events which have transpired since our last annual convention that have greater importance, not only to us but to our country, than those we are about to discuss.

The seriousness of the situation cannot be over-emphasized. I hope the discussion will develop both sides, with all the points for and all the points against, and that we may leave here better contented, in mind at least, that we have aired the subject thoroughly.

I do not believe there is any industrialist, any accountant—certainly any cost accountant—who has not been confronted with most difficult questions this last year. I know of no organization that is better equipped than ours to meet in common purpose, to work out some foundation upon which we may proceed in the next year with more satisfaction.

Our program has been arranged by one for whom we all have great admiration, and I am sure he is going to present to you during the next few days a most interesting series of talks. I have great pleasure in introducing Mr. Bill Marsh of Pittsburgh.

WILLIAM MARSH: Thank you. It is the privilege of the Chairman of the Program Committee to say nothing. All the Chairman has to do is to see that the speakers are here, which I shall try to do.

As the subject of this convention, the National Recovery Act, was naturally set up for us, we shall try in the next two or three days to give you a picture of N. R. A. from every standpoint.

In this particular convention we deviated just a little from the usual procedure, because on Thursday we do not have a set program. We are then going to give all the youth an opportunity to produce that session, an open forum. I hope that everyone will take advantage of that opportunity and be here on Thursday morning and tell us what he thinks of the N. R. A.

Today we are going to have the subject discussed, first, from the standpoint of the N. R. A. itself, and then from the standpoint of trade associations, and lastly from the standpoint of industry.

The Chairman for this morning's session is Mr. Arthur Gunnarson. Possibly all of you know Arthur Gunnarson. If you do not, you will in a minute. He is the first President of the Washington Chapter, and he has been reelected for this coming year. Arthur is with the Chamber of Commerce of the United States, and in that capacity has been a very, very great help to us.

While I am on my feet, I want to take this opportunity of thanking all the members of the Program Committee. Mr. Gunnarson will be Chairman today. Tomorrow Howard Knapp will be Chairman. On Thursday Charlie Reitell will be Chairman.

Also, I want to thank those of you who have helped me in formulating this program. I did not have an opportunity to reply to all the suggestions and the letters that were sent to me, but I am now doing that publicly.

Without saying any more, I take pleasure in introducing to you Mr. Arthur Gunnarson, President of the Washington Chapter, who will be Chairman of today's session.

CHAIRMAN GUNNARSON: Twelve months ago the national convention of this Association was being held at the time Congress was considering the National Industrial Recovery Act. On the day preceding the passage of the Act, the afternoon session of the convention was devoted to a discussion of the Act and its possible effects upon industry.

Obviously, the attention of the convention was focused on problems of costs. Questions arose as to the extent to which costs would be increased as a result of placing the Act in effect in the various industries and trades. As accountants concerned with placing before management data which would accurately reflect changes in costs which would occur as a result of complying with the Act, and desiring further to be fully informed concerning the responsibilities and opportunities under the Act, the members of this Association participated energetically in that discussion.

A year has passed. The National Industrial Recovery Act, being an emergency measure, was given a life of two years. Half of that period has expired. Probably no legislation in American history has left such a deep imprint upon American citizens in such a short space of time as this Act. To every crossroad and every hamlet has penetrated information about N. R. A. Codes, Blue Eagles, and other phases of that program.

This result has not been unanticipated. The President, in a statement issued on June 16, 1933, when he signed the Act, said, "History probably will record the National Industrial Recovery Act as the most important and far-reaching legislation ever enacted by the American Congress. It represents a supreme effort to stabilize for all time the many factors which make for the prosperity of the Nation and the preservation of American standards. Its goal is the assurance of a reasonable profit to industry and living wages for labor, with the elimination of the piratical methods and practices which have not only harassed honest business but also contributed to the ills of labor."

On the same day, the President declared that the Act was a challenge to all elements of our population. Industry, he said, had demanded the right to act in unison to correct the abuses of competition. It now had that right. Labor, under the Act, had been granted a new charter of rights which would be used to improve the status of workers. The Administration, the President stated, faced new responsibilities in protecting the public as a result of provisions of the Act which relaxed some of the safeguards of the anti-trust statutes in order to keep free the individual initiative of business. Finally, the whole people of the United States had a responsibility of supporting this program without making it necessary to use forceful methods.

A further declaration might have been made to the effect that the Act placed upon accountants a serious responsibility to justify themselves as members of an honorable profession sincerely concerned with advancing the science and art of accounting, particularly in the field of costs. The constantly increasing attention which has been given by N. R. A. and by the various codified industries to the problems of costs and their relationship to various phases of management should furnish ample evidence of the prominent place the accountant has held in this recovery program.

As I have indicated, the organization here represented devoted one afternoon of its convention last year to the implications of the pending legislation. Today we are again assembled in convention. The National Industrial Recovery Act is not merely an incident in our deliberations today but is practically the whole substance of our program. It is our intention to review the Act in relation to its effects upon the business community.

Mr. Marsh has indicated that in drafting the program we have tried to give the various interests involved an opportunity to be presented This morning we intend to establish a broad, general background as a basis for subsequent discussion.

It is only natural that we should turn to the National Recovery Administration for a representative to present an official point of view. Our speaker this morning comes as a representative of General Hugh S. Johnson, the Administrator for Industrial Recovery. He is the Chairman of the N. R. A. Policy Committee on Trade Practices. He has had a wide experience in dealing with problems of industry and in addition to his present public functions is also the Executive Vice President of the Brookings Institution of Washington. He has made frequent contributions to discussions of current economic questions.

Dr. Leverett S. Lyon, our first speaker, will open the discussion by presenting the point of view of the National Recovery Administration with respect to the Recovery Program. I take pleasure in introducing Dr. Lyon.

THE LARGER SIGNIFICANCE OF THE N. R. A.

LEVERETT S. LYON

Deputy Assistant Administrator for Policy,
National Recovery Administration, Washington, D C.

I FEEL often, when I am called upon to speak—but more particularly in this instance—a little in the situation in which Mark Twain is said to have found himself on a certain occasion, when he came down from his hotel room and walked into the lobby. A friend approached him and said, "Well, it is nice to see you this morning! Won't you step into the bar and have a drink?"

To this Mark Twain is said to have replied: "No, I can't do that for three reasons. In the first place, I once made a very, very solemn promise that I would never, never take a drink. My second reason is, it is really a little early in the morning to drink. And the third reason is, I have just had a couple of drinks."

I am not indicating that I am in the situation in which Mark Twain found himself, but only that there are at least that many reasons perhaps why I should not be making this address.

The first and most important is suggested in the remarks of our Chairman, who said that I was here as a personal representative of General Johnson. It goes without saying that nobody can really represent General Johnson.

In addition to that—and I let this go for all the other reasons—you are going to have so much more said about some of the subjects in which you are particularly interested, as to the effects of the N. R. A. upon your particular profession and its work, that I feel there might be a great deal of gain by letting you get immediately into the discussion for and against the cost protection provisions and other items in which I know you have a keen and, quite naturally, a very strong interest.

It is my privilege to open for this body its discussions of the National Recovery Administration. Speakers on this subject typically follow one or the other of two lines. On the one hand they feel called upon to extol or defend the N. R. A. and, upon the other, to assail or criticize it. No doubt before your meetings are over, either among speakers from the outside who address you or from the varying viewpoints of your own group, you will have plenty of the for-and-against variety of discussion.

I am not opposed to for-and-against discussions. They constitute one fruitful way of getting the issues of a controversial subject into the light, even though the light may be accompanied by an unnecessary amount of heat. As Justice Brandeis once observed, there are few ways of getting at the issues in a question that are better than a well contested law suit. So I suppose it is necessary in considering an innovation in public affairs to have a very considerable amount of taking sides, of making cases for and against.

Nevertheless, I shall leave to others the role of proponent and opponent, so far as your meeting is concerned, and in my remarks follow rather the suggestion made by Daniel Webster when, in opening his masterly reply to Hayne, he pointed out the wisdom, when controversy had been strong, of taking account of position, of determining one's whereabouts, of making certain of one's bearings. I shall ask you, therefore, to withdraw your thinking from the arena of controversy and to take a position of some perspective; to consider what the N. R. A. is as an institution in American life. Such a general and detached consideration is the more significant in view of the fact that the N. R. A. has just now completed its first year of activity and is beginning upon the second year authorized by the National Industrial Recovery Act.

Now that it has had a year of life, there is no one, I think, who can fairly deny that the National Industrial Recovery Act has proved itself to be one of the most momentous pieces of legislation ever enacted by this nation; that its administration, the various forms of which one could hardly have forecast from the law itself, has been carried forward with an energy and ingenuity seldom, if ever, equalled in peace-time. Nor can one doubt that the public's interest and attention have been caught and retained by it as by few enterprises in which this government has ever engaged. Agricultural allotments, radical changes in banking legislation, even the abandonment of the gold standard, have hardly taken the headlines in public interest from the N. R. A.

It will not be inappropriate therefore to cast our thought back to those circumstances which brought the Recovery Act into existence, to remind ourselves of the current of ideas and events which lie behind it.

The law was the outgrowth of a certain desperate situation of depression and a series of ideas, desires, hopes, and purposes which have a long history. While it was devised to meet immediate needs, it was built upon economic, institutional, and idealogical foundations of the past. Although we are traditionally a nation in which the idea of independent enterprise is deeply rooted, the protective tariff, the Interstate Commerce Commission, public utility commissions, labor laws, trade practice conference agreements under the Federal Trade Commission, and the corporate bodies of war time—I do not mean to imply that all of these are equally important or equally useful—had all established patterns of thought, in terms of which it was easy to conceive of new regulation of individual freedom. We had also long been familiar with the idea of associative action. To the working man this meant typically unionism, to the farmer cooperation. To the business man it meant some sort of trade association. The Recovery Act drew heavily upon this notion of associative action, and its administration has drawn even more heavily upon it.

During the few years which preceded the passage of the law it had been repeatedly suggested that there were a series of matters to which the national government could desirably give greater attention. One of these was the idea of technological unemployment. Since the days of the industrial revolution it had been realized that the introduction of machinery had caused, at least temporarily, unemployment. But the rapid technological advance of recent years, striking examples of displacement of men by machinery, and the advancing rationalization of American industry between 1922 and 1929 had given the idea of technological unemployment a new interest and had made large numbers of persons susceptible to proposals which seemed to show a way of spreading the available work. A second widespread belief found expression in the word "overproduction." Many persons had come to believe that there existed an excess of producing capacity, that society had somehow found itself in the position of being able to produce more than it could consume and that this was an important element in the continuance of the depression. Related to this was the idea referred to as under-consumption, more often called a lack of mass purchasing power. This in turn was believed to come primarily from the inadequacy of wages to purchase the output made possible by mass production methods. During the depression this idea—not uncommon before—was reenforced by the absence of purchasing power in the hands of the unemployed and the loss of purchasing power of those whose wages had been cut. From this there developed a wide popular belief that the way out of the depression was through an increase in mass purchasing power.

Of a more general character was a third concept—so-called economic planning. Under this broad phase were included numerous proposals to increase the amount of collective economic control. While the specific plans proposed by planners were almost as many as the number of those proposing them, they had the common ground of distrusting individual enterprise as a guiding principle in economic life.

Finally, and of great importance in the whole matter, was the widespread view that much competition is predatory. This view, held in more prosperous days chiefly by business men in regard to the actions of their competitors, was extended by a growing number of business failures and the price and wage reductions which always accompany depression. The notion of predatory competition was thus expanded into a doctrine, accepted by many, that the degree of competition to which we are ordinarily accustomed is in itself an evil, perhaps a cause of the depression and a factor in its continuance. The prevalence of this point of view gave support to proposals to modify the anti-trust laws in quarters which heretofore had supported these laws as a bulwark against monopoly.

These underlying strains of thought were those to which there were brought in the spring of 1933 a series of proposals—some having to do with the limitations of hours of work, some with repeal of anti-trust laws, some with economic planning, some with the hope of direct relief from the depression. From such specific proposals and in the light of such a background of thinking there was formulated the National Industrial Recovery Act.

Let us turn to view the law and its administration. To my way of thinking the N. R. A., always accepted as a gigantic experiment in economics, is equally a gigantic experiment in government. On the economic side it may be said that the Act was designed essentially with the belief that it could hasten the process of economic recovery. In addition it was designed to spread work, to improve the relationship between employers and employes, to put government in a new relationship to business enterprise. In its administration these ends have never been overlooked, but the law has been administered as well to provide us with what is in effect almost a national minimum wage and practically to abolish child labor. The greatest interest from an economic point of view attaches to the N. R. A. as a way out of the depression. Here the central method has been to increase directly the purchasing power of wage-earners through a prescription of minimum weekly and hourly wages. This has been accomplished so far as practicable by the protection of wage differentials above the minimum. The N. R. A. has thus in a sense become the instrument through which a controvertible economic issue may move to be resolved. If through its efforts there should be furnished proof satisfactory to all observers that the road to plenty lies through some plan of general wage increases, of work spreading, and shorter hours, the N. R. A. will have solved the most serious problem concerning economists and statesmen—the problem of the business cycle.

If we turn to consider the N. R. A. in its governmental aspects, it is quite as striking, quite as significant as when studied from an economic point of view. The N. R. A. is providing the long-talked-of opportunity of self-government in industry. The essence of the plan is that business groups, through their associations, shall set up codes for their own control and that these codes, when signed by the Administrator and the President, shall have the effect of law.

On the administrative side this task has been difficult and the quantitative accomplishments little short of astounding. The problems have been innumerable. The effectiveness of their solution cannot, I suppose, be fully stated until the Supreme Court shall have acted on some of the issues sure to come into controversy.

Consider, however, in a little more detail, what I mean by referring to the N. R. A. as a governmental enterprise. In the making of codes, industries take the initiative. This presented at once the problem of representation. When is an industry properly represented? For the several hundred codes this question had to be answered in each instance. In the creation of codes—each a piece of legislation for an industry—scores of special problems have arisen. While the general pattern is the same, the emphasis in each one differs from the others. Industry has its interests, labor its interests. Yet industry and labor are in themselves abstractions. Within each there are varying points of view. It has been necessary to face the questions of where labor is represented and who may speak for it. Nor are industrialists of a single mind as to what is desirable for industry in general, or their own industries in particular.

Even if we assume that representation is satisfactory and a code has been made, the problem of administration before the N. R A. is no less difficult than the problem of administration in government where ever we find it. The question of representation on the code authorities has had its day. The classification of industries according to the codes under which they shall operate is a puzzling problem. The selection and continuance in office of honest and efficient code administrators will be no less difficult than the selection of honest and efficient public officials in any other form of government. These are but examples of the tasks of the N. R. A. as a governmental agency.

When we take all of these things together with other problems of government which are implicit in the N. R. A. organization, we have a picture of business attempting self-government under the supervision of federal administration This is a great opportunity for business and one to which you as professional men can make a contribution. Business has for years expressed the wish for greater self-government. Those who have been skeptical of such government have based their skepticism on the fear that self-government in business would mean collusion in business, that it would mean attempts unduly to raise prices, that it would mean attempts to fortify in their present position those who now possess the ownership or control of social resources. In short, they felt that the plea for self-government in business was in large part a plea for self-government in the interests of business.

Through the N. R. A. business now has the opportunity to demonstrate what it really means by its desire for self-government. It has the opportunity to show whether the fears of the skeptics were well founded, or whether it can express its self-government in terms which can be socially justified. The professional accountants of this country, acting as they do as advisers to business men, can play a helpful role both to the N. R. A. and to business in the advice and counsel which they offer their clients. Those who truly wish to see the experiment of government in business succeed will find that their advice is running in those terms which will bring credit and not disrepute upon this momentous undertaking. If their advice is of the sort which will induce business groups to strive for advantage or position, or the exploitation of opportunity which cannot be socially justified, it will tend to discredit the whole N. R. A. experiment.

In this connection may I make a few observations concerning a matter which affects the N. R. A. in both its economic and governmental aspects. It is likewise a matter which is of importance to you as professional accountants. It has to do with the N. R. A. in relationship to profits and prices. In a capitalistic society, that is, a business society such as ours, profits are the mainspring. When profits are to be made, business men expand their activities. Thus employment is increased; thus production increases; thus an advancing standard of living is made possible. It is unnecessary to say to this group that profits are the difference between costs and income. But it does sometimes seem necessary to point out, even to an accountant, that the difference between a cost and a price does not necessarily represent a profit. The reason is that one may have prices at which goods do not sell. Profits have meaning only when they represent the difference between all costs and prices at which enough goods are moving to cover those costs with something left over. It is easy for any of us, even at times for an accountant, to make ourselves believe that if there is a nominal difference between the cost of a specific article and the price which we put upon that article, a profit is assured. It is this belief that has led manufacturers at times to compute all their costs, add a profit, fix their prices, and wait for business which did not come.

But how else, you may ask, is a profit to be assured? There is I believe only one way. That way is to have a knowledge of the price at which products of different types will sell, then to determine costs; and if they cannot be produced at a profit at these prices, not to produce them. This is the great service which the cost accounting profession can provide and has provided for American business. Only by knowing costs can one know when it is worth while to manufacture, or to buy and sell. Only by knowing costs can one tell the possible profit in an enterprise, or the possible profit as between different types of products. But when the accountant leads a business man to believe that a knowledge of costs with prices built thereon will assure him a profit, he is leading him into trouble, rather than proving a helpful and constructive guide.

From a social point of view the outcome is the same. Profits, as I have said, are the mainspring of a business system. When the accountant helps the business man to know where profits are to be made, he guides him in a direction which will lead toward greater employment and greater national output. When he guides him in the direction of merely maintaining his prices so that there is a *nominal* profit between the costs of individual units and the nominal selling prices, he is taking him into doubtful if not dangerous territory. The extent to which adventuring into this second area may be wise is one in which you are too technically competent for me to advise you. But I may quote from one of your own professional brothers, Colonel Montgomery, who has said, "In a competitive system there is some connection between cost and prices but . . . unfortunately no one has invented a system under which there can be any certainty that you can sell your products for more than they cost."*

Nor will I try to point out to you the difficulties of knowing what costs are—the differences between the costs which must be considered by the man who rents his plant, and who has a large funded debt, and the man who owns his plant and whose capital structure consists of common stock alone. If I may again quote one of your own brotherhood: "We will never have a standard cost formula which will protect prices. . . . It requires the use of insoluble problems. You can only protect your prices by proper management of your materials and tools and by turning out goods of quality and usefulness and in such reasonable quantity as will not destroy your chances for profit."†

You will see much in common between these observations and the recently announced new price policies of the N. R. A. These policies undertake to move positively and constructively in the direction of open prices, to eliminate those elements of secrecy which are justly called unfair. They are not designed by some magic formula of price maintenance to guarantee profits, but they are designed to give full publicity to all the facts to those who must make decisions. The proposed plan makes it possible for an industry, if it chooses, to file prices with an impartial agency which, when filed, are to be made available to sellers and buyers generally. Provisions are made for preventing so-called price raids, and yet conditions are retained which enable companies whose alertness or knowledge of costs tells them promptly that prices should be changed, to profit by their alertness and their wisdom. Only in emergencies is protection given by price-fixing. The new policy recognizes that price maintenance is at best difficult to achieve without (a) the possibility of monopoly, or (b) the necessity for government control, both of which are distasteful to the American people The policy provides definitely, however, for fixed prices when there is a real emergency that adversely affects small enterprises, wages, or labor conditions, or tends toward monopolies.

* From an address of Robert H. Montgomery, Lybrand, Ross and Montgomery, 22nd Annual Meeting, Chamber of Commerce of the United States, May 1–4, 1934, Washington, D. C.

† Ibid.

The recently stated price policy also states a clear position on cost accounting. It is declared that N. R. A. will encourage proper cost accounting and accounting provisions in codes. The philosophy of the cost accounting provision is that American business is entitled to know, but must be left freedom of judgment as to the action which shall be taken on the basis of knowledge. New codes may provide that the code authority shall cause to be formulated methods of cost finding and accounting capable of use by all members of the industry. These, when approved by the Administrator, shall be made available to all members of the industry. Such methods and principles as are formulated, however, are not to be made compulsory.

May I conclude by briefly summarizing what I have already said. The N. R. A. is now one year old. It is a gigantic undertaking striving to accomplish in the fields of economics, sociology, and government a program elaborate enough, we would ordinarily have believed, to occupy a decade, if not half a century. As a sociological enterprise, its practical elimination of child labor is perhaps its most significant achievement. As an economic undertaking its most significant contribution will, I believe, prove to be the light which it will throw on the question whether by the direct, prompt and general increases of wages we can bring ourselves out of those recurring periods of depression which have been a characteristic of business for the last century or more. In terms of its governmental significance, we will look upon the N. R. A. as a great test of what self-government in business means to its advocates and what actually results from government thus attempted. In all of these matters you, as professional accountants, can have only the keenest of interest. You can play a useful part in the progress of the N. R. A. by the guidance which you can give your clients in bringing out of this experiment something better in economics and government than we have known before.

CHAIRMAN GUNNARSON: As professional men, interested particularly in one subject or in one field, it is well that we stop occasionally to survey broadly the general field in which our specialized interests lie. I believe that Dr. Lyon has given us such a broad background in reviewing for us some of the underlying philosophy of N. R. A. Before we proceed further, I want to express our deep appreciation to Dr. Lyon for his presentation. We hope that in subsequent discussion some points that may require further clarification will be brought out.

The second approach to our subject this morning involves consideration of problems which have received considerable attention as a consequence of the Act. Under the Industrial Recovery Act certain machinery is set up with respect to the formulation and administration of codes for various industries. Even before the N. R. A., there existed a form of business organization known as the trade association. A trade association is a voluntary organization of business men in the same or related fields of business banded together for the purpose of considering problems of mutual interest. Subsequent to the adoption of the Recovery Act, and under the codes that have been approved in compliance with that Act, we have set up a system of Code Authorities, which are administrative bodies for the industries which have codes. In many cases, the trade association functions as the code administrative agency.

The trade association field is a broad one. It contains many capable men who represent their respective industries in the capacity of executive managers of trade associations. These men have played a prominent part in assisting to formulate policies at Washington with regard to the administration of the Recovery Act.

One of the first men who appeared on the scene, even before the Act was passed, is with us this morning. A few days after the Act became law he had issued a suggested code for an industry as a guide to others who were concerned about drafting codes of their own. This model code was drafted along the lines of the one that he had suggested for his own industry. He has had wide experience in various fields of business. He has been a professor of economics During recent years he has been the Executive Manager of the National Furniture Manufacturers Association.

I take a great deal of pleasure in introducing Dr. A. P. Haake of Chicago.

THE NATIONAL INDUSTRIAL RECOVERY ACT FROM THE STANDPOINT OF THE TRADE ASSOCIATIONS AND CODE AUTHORITIES

A. P. Haake

Managing Director, National Association of Furniture Manufacturers, Inc , Chicago, Illinois

I WANTED to come to this meeting. And yet, being here, I feel a little bit like the colored gentleman I heard about on the radio last night.

For the first time in many, many months I have actually written a speech. I think this must be in deference to the fact that I am talking to cost accountants. I have several of them on my staff and I know that if you catch them young enough you can make good business men out of them. You always have to be careful in what you say to them. So I thought it worth while to write down what I had to say

It was a quarter of six this morning on the club car of the New York Central that I finished typing the last page. I was in the berth for one hour, and I feel now like this gentleman the Negro told about.

He asked a friend of his why it was that when he stood on his hands the blood rushed to his head, but when he stood on his feet it did not rush to his feet. His friend said, "The answer is very simple. Your feet are not empty."

I am frankly more than pleased that I have had the opportunity of listening to Dr. Lyon. I think if I had heard his speech before I wrote mine, mine might have been a better speech. I am particularly glad it was Dr. Lyon, because I will be quite frank in saying, in his presence and in your presence, that I do not think he is quite a typical N. R. A. representative. There are college professors and college professors, just as there are business men and business men. I feel personally honored to appear on the same platform with Dr. Lyon.

The problem which was responsible for the National Industrial Recovery program was largely political but primarily economic. It certainly was aggravated by politics and distorted by the campaign of 1932, but the problem itself grew out of the crash in 1929 and the culmination of the tremendous level reached by the expiring period of prosperity.

Its outward and immediate symptom is unemployment. In perhaps the most serious dislocation we have ever suffered, we can point to the marvellous patience displayed by the unemployed of all classes during the past four years as one of the finest tributes ever paid to American character and national stability. The problem became acute in 1932, and has continued with no great improvement down to the present time. Much of the absorption of labor already accomplished has been at an excessive cost to government and at best is a palliative that cannot go on indefinitely.

There are two aspects to the problem. There is the problem of relief, so that families may be kept from starving to death, and the more fundamental problem of effecting recovery from the depression and securing employment through the re-establishment of private enterprise.

Public Relief

Public relief is essential, of course, for we may not permit people to starve. The alternative to starvation for unrelieved distress is historically disastrous. We even recognize that at times it is necessary to have relief as an introduction to temporarily postponed economic recovery, for a patient may sink so low that he must be kept alive with hypodermic injections while the doctors are working to cure him.

However, even in the application of relief measures we must be on guard against going too far, so far as to raise new difficulties and lead to final impoverishment of the nation. True health for the nation can be restored only through renewed economic activity, and relief must not be mistaken for recovery, nor may the cost of relief mount so high that the meeting of resulting obligations later leads to worse conditions than those from which we seek to escape. Only for a limited time may a considerable portion of the population be cared for at the expense of the rest. Finally, with an irreducible minimum of unemployables we must make every livelihood pay its own way.

Since I am concerned with the problem of recovery, I shall make no effort to evaluate the various relief measures, beyond expressing the fear that they may already be reaching to dangerous lengths, and to challenge our administration to lay heavier emphasis on the problem of economic recovery even though that involve some political sacrifice.

Recovery

To secure recovery we must have resumption of business on such a scale that private enterprise is renewed and becomes profitable. Dictators may flourish in other countries, whatever form the dictatorship may take, due to the mass of people being not so well or generally educated, or desperate for other reasons, but even those dictatorships show signs of proving futile and finally unsuccessful, whereas in our country free schools and wide-spread education for several generations have developed a public psychology which would not long endure a real dictatorship of permanent socialism as the solution to the problem.

The net of the situation is that our government cannot possibly absorb the approximately 9,000,000 still unemployed, without seriously endangering the very life of our country Recovery *must* come through reabsorption of workers by industry and trade. The opportunity to work must come from the production and/or distribution of wealth. The work must be self-supporting through the creation or moving of wealth, and through gradual and continued improvement in the standard of living. I recognize the fact that the banking situation, speculation and numerous other factors had their full part in bringing about the sad situation, but the nub of the problem is unemployment.

Approximately half of our 9,000,000 unemployed are in what are called the durable goods industries. These include capital goods such as machinery, buildings and other equipment used in producing other goods, and those goods which are not consumed except after a period of use. They represent the goods whose consumption can be postponed easily when there is only enough income to keep body and soul together. Almost half of this half is employed in the construction industries. Most of the other half of the unemployed is normally in the services and trades. This unemployment grows largely out of decreased employment in the durable goods industries.

Less than 600,000 are unemployed in the consumption goods industries. These have suffered less and recovered more rapidly because life must go on and cannot go on without consumers' goods, food, clothing and the like. Additional employment in this group of industries waits on increased purchasing power which will result from increased employment in the durable goods industries.

The problem thus reduces itself fundamentally to employment in the durable goods industries. Practically all of these durable goods industries are already under codes, and if the codes were to accomplish their avowed purpose our problem would be solved to a large extent.

So business made a bargain with government. In exchange for limited hours and minimum wages business was to receive a measure of immunity from the anti-trust laws. That is not the way the bargain was written, but that is what the bargain meant. The recalcitrant minorities were to be made to behave.

There was nothing new in the idea of coercing recalcitrant minorities, that fringe of so-called business men who through their disregard of decency or through their ignorance made it difficult and even impossible for fair competitors to do business. Trade associations were dealing with this problem seriously several years ago, but saw no way of controlling these disturbers unless the fear of federal prosecution were removed.

One of the most interesting and distressing chapters in association history has been written around the efforts to stabilize business and do away with unfair competition through the former federal trade practice conference. A great deal of early enthusiasm led to final disillusionment. The rules lacked "teeth" and at best were admonitory. The idea of a two-year moratorium on predatory competition was presented to President Hoover more than two years ago by a committee of seventy representative business men. Legislative conditions at that time made passage impossible. Perhaps business and government both had not yet become sufficiently frightened to accept the necessary interference and limitations involved in such a program.

We finally got it under the N. R. A., at a price!

Anyone who has labored in the writing and passing of a code knows what I mean when I say "at a price." But we were willing and glad to pay the price for something that had "teeth."

Point of View of the Association Executive

Here let me state briefly the point of view of the association executive. It is primarily that of the business man who sees recovery, not in new deals that may become raw deals, but in renewed business activity first and increased purchasing power in consequence.

Within our industries we want fair play, a fair field for all, discouragement for the cheater and rewards for him who plays the game in the common interest of all, including his own. We think in terms of an industry, not in terms of an individual. We lean away from unrestricted competition and in the direction of a strengthened group which has the will and the power to protect itself against stupid and unfair competition. We strive through group consciousness and the psychology of team play to lift the entire level of business ethics.

We are interested in labor as an economic factor in the process of wealth production and distribution. We want fair play for the worker because the employe is also our customer. We count ourselves among labor and, believing that the laborer is worthy of his hire, also believe his remuneration should be based on individual merit, with a minimum to provide for bare subsistence, not to hold back the deserving in behalf of the inefficient or unfit. We hold the same attitude toward business units.

N. R. A. Welcomed

It follows that we could easily welcome a set-up under which we would be given power to enforce decency in business competition, and to do something more effective than simply plead with the fellow who thumbs his nose at rules of fair play.

We welcomed cost protection provisions, although we had widely varying ideas as to the form and method of cost protection; we welcomed fair trade practice rules, and a codification of the best thought in the industry as to the elimination of bad practices. We welcomed especially the "teeth" which were written into the law. You do not know—perhaps you do, I do—that many members were dragged into the trade associations because they were promised that at last here was something that had teeth.

We welcomed minimum wages and maximum hours, as helping to restore purchasing power and as a stabilizer for competition.

In short, to the average trade association secretary, having gone through a period of membership starvation, the National Industrial Recovery Act appeared as a gift from the gods. At last we were to be properly recognized; we were to have a definite and approved program, and, as our President Roosevelt put it in a conference with a committee of association executives, "We are going to stop demoralization of your industries by the ten per cent of industry who refuse to play fair." That meant "teeth."

That was a year ago!

Today many of us are disappointed and disillusioned some more than others. We still believe in the objectives of N. R. A.; we can stomach even some of the alphabet soup; we are trying to administer, even now, the codes we grew gray hair to get, still hoping that our powers will be sufficiently clarified and that the administration will stay put long enough to get results before the Act expires.

What Is the Matter?

The fault is not all in one place. Some of it is due to human selfishness and stupidity and some is inherent in the very immensity of the task undertaken. I have thought that we were something like the man who was told to take one pill each day for thirty days to cure an illness, and who sagely figured it out that if one pill a day for thirty days would cure him, why then four pills a day for one week would cure him so much quicker. He took four a day and at the end of the week was no longer ill. They buried him. Perhaps we have tried to do too much in too short a time.

Business men themselves are not without fault. They came for codes as children come for panaceas, cure-alls that can be taken in a single dose, a substitution of laws and penalties for ordinary sound business judgment and self-discipline. Here was the opportunity to wipe the slate clear of all difficulties by the simple process of writing a rule against each difficulty. I know, when a fellow is up against the last ditch, when he has no answer and he can not say what should be done, he says, "Well anyhow they ought to pass a law against it!" And that is what the N. R. A. meant to a lot of business men: "All we have to do is to make a list of all our difficulties and write into the code a rule against every difficulty, and somehow God and General Johnson and the secretary of the association are going to make the thing work."

I received letters asking us, for example, to write into the code—we are a manufacturers' organization—a rule that dealers may not send telegrams collect to manufacturers. I do not mind telling you, if every rule that was proposed had gone into our code there would have been hundreds of rules. Some of them would have been a little different, but not a lot.

Labor must take its share of the blame. Men were told that they must organize or they could not get the benefit of N. R. A. And the trade unions grew even more rapidly than did trade associations. Labor has more votes than has business management, and some of us have felt that the administration deliberately encouraged labor in its activities, resulting in strikes and shut-downs at the very time when we needed *increased* rather than *decreased* activity in business. And disillusioned labor is no less bitter than many disillusioned business executives.

In the writing of codes labor imposed some ridiculous conditions. I am mindful of the occasion when I tried to convince a labor representative in N. R. A. that averaging of hours was necessary in our industry. He would not agree because he had worked out a theory that all business had to do to run on a steady forty-hour weekly schedule was to regularize its sales. I had discovered that theory myself, some fourteen years before, but the labor professor had not yet discovered that in order to regularize sales it may be necessary to regularize the house-cleaning habits of women, the seasons of moving, the temperature and the weather, all of which have not yet been brought under the control of man and the first of which in my opinion is a hopeless task. But he insisted and he almost had his way.

I visited some years ago with Henry Dennison of Framingham, Massachusetts, and went to the Plympton Press with Harry Kendall, and saw how they had laid out their sales budget and could regulate their whole production, but in our industry the only way one could get the production and sales together would be to get women to regulate their habits of house-cleaning, to control the weather, and moving habits. You might control the weather, but do not start out to control the house-cleaning habits of women!

I speak with some feeling on that point because, being able to buy furniture fairly cheap, my wife buys it once in a while. I buy it cheaper than you do, but not much cheaper. The manufacturer sells it below his cost and I pay his cost. The dealer sells it below cost. So theoretically *you ought* to get it at the price of the material and half the price of the labor. There were natural conflicts of interest among groups as well as among individuals, and the whole experience of code writing is a beautiful expression of the age-old search for "the easy way out."

Association executives contributed their share of selfishness and stupidity. There are too many codes, and but for the physical labor involved in getting codes through the administration there would be many more. Men seized the opportunity to set up groups or to intrench themselves with illogical groups regardless of natural competitive lines of cleavage. The sudden opportunity found many association secretaries unprepared to meet the challenge to their skill and ability, and some share of the blame must be laid at their door for the resulting mess in many quarters. When an association secretary gets a separate code for pipe nipples or something like that—when the manufacturer puts three turns to a spindle instead of four—or he gets a code for a breakfast table that has a porcelain top instead of a wood top, believe me, some one is having a glorious party trying to administer those codes.

When we got into difficulty, I did an unkind thing. I asked an assistant deputy administrator questions I knew he could not answer. He could worry until doomsday but he could never get the answer. It is not there. One of these days some one may discover that the answer is to kick out the code.

Any one of these details may seem trivial to the casual observer, but in the aggregate they have irritated business to the breaking point and are bearing their full harvest of ridiculous inconsistencies. The net effect has been harmful out of proportion to the possible benefits to labor. The labor men were trying to protect the price of labor, and they were arguing with business men who also would grab every bit they could. I was one of them. Naturally they did their best to get a fair deal. That was the game. That is the tragedy of it. Instead of men sitting down as reasonable and intelligent beings to work out a problem of getting codes developed, they got into controversies and bargaining.

A more serious aspect of the program has been the faulty philosophy on which the program has apparently been built. It reminds one of the reasoning of the man who saw another man out in the rain with an umbrella over his head, and came to the conclusion that the way to make it rain was to go out with an umbrella over his head.

We have seen the co-existence of prosperity and high wages, and with deliciously naive logic it has been argued that the way to get prosperity is first to pay high wages. With equally interesting logic it has been argued that, since high prices and an expanded credit and currency structure usually go together, the way to make prices go higher is to inflate the currency or to devalue the dollar. You are witnessing the futility of that process, but men believed it would work.

Combined with the naive conclusion that raising wages first would bring prosperity, was the theory of spreading work, which latter is not a measure for recovery at all, but purely a relief measure. Yet it is argued seriously, even today, that all we need do is to divide the total hours of work available by the total number of men who want work, hold each man to the number of hours resulting for each, and, presto-chango, the problem is solved! Of course, the rates of pay must go up as the hours go down. Of course, they do not concern themselves with where the money is going to come from. They leave it to the accountants to figure that out.

The effect of this on cost of goods or the problem of where to get the money which must be advanced to meet these costs before the returns from sales come in, has not been considered. That is something for the captains of finance to figure out. All that the theorist feels called upon to do is to figure out the number of hours of work which will put everybody to work, theoretically.

And to make the problem more interesting, business has been told that it should not raise prices while meeting this higher cost of production. Humanity, we are told, must be considered before profits, a resounding phrase which goes well in campaigns because it catches votes, even though it fails to solve any problems. It is lovely to say that humanity comes first, but I notice that humanity is taken care of when the means of doing so are provided first.

The theory on which this is based goes back to the first recognized Socialist, one Rodbertus (I think the fellow would have been forgotten if they had not resurrected him and put his theories to work in the labor policies of the N. R. A.) who wrote in 1837 that depressions are due to falling shares for labor and too great shares for capital, and that therefore the remedy is first to increase wages and later, if at all, profits.

The facts show Rodbertus was wrong. Every depression has been cured by first making business solvent, then accumulating a fund for expansion, an increase of volume without at first any rise in costs, then increased employment and later, and sometimes delayed over-long, increased wages. But the meat and vegetables have always gone into the pot before the stew could be taken out.

It may not be overlooked that the durable goods industries, upon whose recovery rests the burden of reabsorbing our unemployed workers, are types of business which must have new capital and constant streams of credit, fresh borrowing to keep them going, and require also borrowings on the part of their customers to enable the latter to buy their products in anticipation of increased later income to pay for them. For this there must inescapably be an initial restoration of confidence in the economic future of business sufficient to encourage borrowers to borrow and owners of capital to lend their savings. The necessary condition to both is the emergence of profit.

Until profit appears we cannot be sure of recovery. With the appearance and spreading of profit, recovery takes more rapid strides and employment increases.

The cart is now before the horse. When we get the horse back in front of the cart we really can begin to go places. It is not that I would disturb the minimum wages and maximum hours now in force—they are established—but we would be utterly foolish to rely on mathematics of dividing hours by men to get hours of work for each, when what we need is emergence of profits, restored confidence, a flow of funds back into industry and the consequent ability to increase employment and remuneration.

This point of view, when laid before a member of the Administration, received scant courtesy. (They tell us we wrote the codes. We did not write ours; it was largely written for us. When they got through we could scarcely recognize the thing.) The labor adviser who listened to it as a justification of necessary relaxation in his demands for code provisions, simply acted bored. Why should he take seriously the reasoning of a mere trade association executive when he himself was a real college professor, a doctor of economics, who had read the books and figured out some beautiful theories all by himself? The fact that he had never had to meet a payroll or unravel any complexities of production and distribution in actual business operations where his own money was at stake, was of no consequence. He was one of the anointed and he could make no mistake.

One of the tragedies of the N. R. A. has been to see business men with years of experience behind them sitting in front of some of those "experts" and taking them seriously. Oh, I say that with all respect to the earnestness and the honesty and the good intentions, but honestly I would just as soon let my fourteen-year-old girl run my business—

and it is not an easy business to run—as I would turn over an industry to a man who knows nothing about it. It is tragic.

I may not take the time to discuss the various other measures which have occupied the front pages of newspapers, made George Washington, Thomas Jefferson and others turn over in their graves, and kept business in constant turmoil. Many of the measures were honestly conceived, considering the amateur status of some of their framers they were rather well executed, but they were ill-timed, they lacked the perspective of practical men of affairs, they went too far and have kept us in constant apprehension as to what was coming next, and have frightened millions upon millions of dollars of needed capital out of this country to seek investment elsewhere.

It is true that there was undue speculation, that there was grave misdoing in the selling and handling of securities, that some bankers forgot that they were handling money which belonged to other people, but the remedies were too strenuous and came too thick and fast for our delicate convalescent.

I honor the Senator whose whole life is a battle in behalf of the down-trodden, but that is no justification for a Wagner bill with its propensity for creating mischief in labor relations. The destruction of cotton acreage and the non-planting of wheat, at so much per acre, the killing of pigs so that with fewer pigs we may have more food for all of us coming to market later, and so on, are undoubtedly beautiful theory, but rather devastating in their effects. The going home of Congress came in answer to many a prayer, but its last days' activity reminds one of the small boy who begged to stay up five minutes later, and just before going to bed pulled down a shelf of dishes.

Much of the fault for the present fiasco of codes lies at the door of N. R. A. itself. One could say much pro and con, but, in my judgment the net of the difficulty lies in over-much threatening of "cracking down" and too-oft reiterated promises of "you ain't seen nothing yet," combined with far too little of actual performance in the way of enforcement except for sending a tailor to jail and the like. There is far less need for oratory than there is for enforcement.

Perhaps this is an unavoidable feature of what we call bureaucracy. The boys undoubtedly work hard, are blamed for what goes wrong and given no credit for work well done, and so perhaps seek safety in doing as little deciding as possible. It does seem too bad that in a partnership between government and business one of the partners should run for cover almost every time he is asked to do his share.

You fellows think you work hard. If you want to see a bunch of hard-working fellows, go to Washington and see how some of those men work. It is a marvel to me that General Johnson has not been buried in the last six months, the way he works and the load he carries. I think we are actually committing murder with that gentleman by permitting him to carry the work he carries.

I have heard it said within the organization—I hope I will be quoted when Dr. Lyon goes back—that certain men there belong to the untouchables; you do not dare criticize them because they are in strong with General Johnson. That thing has cost industry "plenty."

Here is an interesting bit of psychology. I talked with a personal friend of mine in the Administration. He is a wonderful fellow. He is steeped in the atmosphere around him. When N. R. A. is being subjected to criticism, does he take the criticisms seriously? Does he try to evaluate them and correct them? Believe me, I have my ear to the ground, and when I find some member causing trouble in the Association, I put him on the Board of Directors. I do not shut him up; I take him very seriously.

But in spite of the difficulties and the growing criticisms, this man's tendency was, almost ostrichlike, to refuse to take the growing criticism seriously. Business must be stupid. Business must be wrong. And when General Johnson made a wonderful speech up in New York, I met this man the next morning, and he said, rather proudly, "Didn't the General hand it to them last night?"

I thought to myself, "Man, if you only realized the tragedy in your remarks! Your utter blindness to the significance of the statement!"

On the other hand, we may be just as blind in our way, and it behooves both of us to listen carefully and take very seriously what the other has to say. But the N. R. A. is committing suicide by the fact that it has refused to take seriously some of the things it should have taken seriously six months ago.

And we are wondering what became of the "teeth"!

Some of us have suspected that such an organization as C. W. A. was not only intended for relief, but also as an incentive for higher wages in industry. While men were getting fifty cents an hour for getting in each other's way in C. W. A. in many cases, industry was able to pay less to many men, and actually lost factory workers who preferred to loaf for fifty cents an hour than work for forty cents an hour. Of course, C. W. A. has brought relief to many thousands, and our difference is with the way in which it has been handled, its reported political flavor and its confusion of relief and recovery.

Now we are to have factories run by the government itself. Someone is going to show industry that men are to be put back to work even if it means taking the business away from industry and giving it to the government, putting men out of work in one place to replace them with government-subsidized employes in other places. Not satisfied with our war experience in handling railroads, we are about to inaugurate government participation and competition with private industry.

The recovery program as a whole might be characterized as long on human sympathy, shrewd in its political tactics and short on the needful understanding of the processes of industry and trade. Our prohibition friends meant well but failed to understand human nature adequately. Our brain trusters mean well but fail to reckon adequately with the practical aspects of business economics. Just as human nature defeated the one, so business facts will defeat the other, and the beautiful theories will eventually return to the classrooms from whence they came.

I have said nothing about our monetary policies and inflation, the disturbing prospect of some day having to pay for the present spending spree. I do not quite trust myself to speak of them. My convictions are too pronounced. While I am gratified that the President has not yet exercised all the powers given him, it is my hope that business may take over the work of recovery before the spending has either led to hopeless inflation or brought us to national bankruptcy.

What Is the Answer?

With characteristic American volatility, for we usually go from one extreme to the other, an increasing number of voices are crying, "Let's stop the whole program before it kills business. It is rewarding the chiselers and penalizing the fellows who play fair. Let's go back to the old proved methods by which this country grew great." But, I am afraid that is not the answer. As unhappy as some labor leaders profess themselves to be with N. R. A , labor will not give it up. There is sufficient intelligence in the ranks of labor to perceive that they have benefited most by N. R. A., as far as it has gone, even though some of them are beginning to realize that it does no good to demand higher wages from an employer who goes broke paying the present wages. The Administration has got hold of a bear by the tail and dare not let go.

Business wants the codes, in spite of all the complaining one hears. Men really want what the codes promise and kick because the promises have not been kept. They still hope they will be kept and they see enough benefit from stabilized hours and wages to hope for more.

The public is strongly in favor of the administration policies as a whole.

The economic facts require closer cooperation in the face of more closely interwoven and mutual interests. The individual has lost the old physical frontier, but in its place has arisen a new frontier, its advancing line made up of the groups who have learned or are learning that the individual must acknowledge the welfare of the group as a condition to his own welfare.

The program is not a complete flop by any means. It is disappointing, of course, and has not been any too intelligently handled, but there is still hope. The answer seems to me to lie rather in this direction:

1. Give us a little rest from experimentation Stop nagging the sick man with nostrums until the sun and fresh air of some profits have given him strength to stand additional experimentation Stop killing him in order to cure him. It reminds me so much of a doctor who for years had yearned to perform certain experiments. He got a poor devil on his back and tied him hand and foot and said, "Brother, I may kill you, but before I am through with you I am going to try out everything I have ever thought of."

2. Let the Administration make a real and sustained effort to enforce codes as they are, instead of jumping like a nervous cat every time someone strokes its whiskers, even when the Darrow Committee reports its half digested findings.

3. Use the teeth that are in the law or take them out. We do not like to be cheated, but we like even less to be kidded.

4. Distinguish more carefully between relief and recovery measures.

5. Get the horse back in front of the cart and encourage profits in business.

6. I hesitate to say this, but Dr. Lyon, you will forgive me—send some of the professors back to college, and I might say, send some of the business men back to the bench.

7. Far more important than even these is it for business men to cease asking God to solve their problems for them, to stop looking on laws as cures for their ills, and to depend upon sound business judgment and business acumen to come back. I know one industry that might well profit by this advice.

8. Let trade associations get on their real jobs. I have said little about code authorities, because they should not be taken too seriously. The real responsibility is that of the trade association and the sooner we stop relying so heavily on codes, as such, and as code authorities as substitutes for providence, the sooner the trade association will demon-

strate its real usefulness. We must go on with fundamental costing work, intelligently gathered and employed statistics, the interchange of necessary information and the encouragement of better practices by selling the soundness of those practices rather than forcing their adoption by law. We want the "teeth" to use on some recalcitrants, but we may be taking them too seriously and we should not wait to make them behave before we ourselves behave.

I believe N. R. A. will, in fact must, adjust itself to these principles, give business a freer hand, attempt less, promise less, give what it promises and accomplish far more.

The code of tomorrow will in my opinion confine itself to hours, wages, costing protection and perhaps a rule against misrepresentation. The mirage of price-fixing might as well be dispelled. It cannot be done artificially for any length of time, and in most industries, cannot be done at all. To accuse our industry, for example, of price-fixing would simply indicate the person who did it knew nothing about the industry or lacked a sense of humor. It is a fool's paradise. Costs can and should be protected, but at a point which constitutes a decent last line of defense against demoralization and reasonably avoids holding the umbrella over the less efficient producers.

We shall always have cycles of business with better and poorer times, until society has become static and is on the way to death. So long as there is progress and life there will be change, and until men become gods they will make mistakes in estimating demand and needs of various kinds. Out of these always will come periodic depressions. And some day, let us hope it may be soon, we shall realize that periods of prosperity are times when business should be taxed to liquidate the debts occasioned by previous governmental and private works to employ the unemployed, and in the time of depression avoid the taxation and other burdens that make recovery the more difficult.

I do not believe we shall have a dictatorship in this country in the sense that Roger Babson is reported to have predicted it. Roger has made some serious errors in his prophecies, in spite of the famous lucky guess of 1929.

Business must be made solvent. For this we need restored confidence, and back of that is the need for faith, self-discipline, recognition of the basic motive of profit.

I said we needed faith. That is one of the finest attributes of our President. Say of him what you will, he lifted our hearts out of the depths of despondency something over a year ago by that magnificent appeal over the radio. I sometimes wonder whether, if we could have stopped with that magnificent appeal and built on that confidence and not gone further, we might not be further out of the morass at the present time. I believe with him that we shall survive, because I believe that he, or his successor, will finally extricate himself from the maze of experimentation now surrounding him, and, with his feet solidly on the ground of fact, will dare to lead us in the direction we must go.

I cannot forego the pleasure of reading to you something published recently:

> The day of large profits is past . . . the advances made in the past fifty years cannot be repeated in the future . . . it is not likely that the tremendous volume of accumulated capital will ever be fully employed or that more will be accumulated . . . prices will tend steadily downward and we shall not again see the high prices we have known . . . there may be intensive development of industry but extensive development is of the past.

In the net this writer sees little hope for the future. He paints a dark picture and holds little hope for returned prosperity or higher standards of living. And the most interesting fact in connection with this prophecy is that it was made in a government report dated 1886, 48 years ago. It is just as true now as it was then. And it proves mistaken on both counts.

We are reaching forward to greater prosperity than mankind has yet known, to higher standards of living than we have even dreamed of.

Tell me there are too many capital goods, too much machinery, too much production! Nonsense! Count the families who still lack the real comforts of life, add up the millions of articles of almost any description that are lacking in homes all over this land, conceive, if you can, of the insatiable character of man's wants, the almost incalculable variety of goods that can be developed to meet those wants, and then look with me to the Hills for strength to believe, to trust in the God who is still in his heaven, and will help us as we help ourselves, to recover, even though we do have a recovery program.

CHAIRMAN GUNNARSON: Dr. Haake, the spontaneity of the response speaks far more effectively than I can on this occasion. It is unnecessary for me to direct the attention of the members of the Association to the undercurrent of serious thought that has permeated your presentation. You have given us much of value to carry back with us to our own jobs. In behalf of the Association, I want to express our sincere thanks and appreciation for your address.

The third approach to the subject before us this morning is that of considering the problems confronting the business executive. We are happy to welcome to our convention a business executive from Cleveland. He has been in the electrical manufacturing industry for many years and he speaks from actual experience with code problems in his industry.

I take great pleasure in introducing Mr. C. G. Frantz, President of the Apex Electrical Manufacturing Company.

THE NATIONAL INDUSTRIAL RECOVERY ACT FROM THE STANDPOINT OF INDUSTRY

C. G. Frantz

President, The Apex Electrical Manufacturing Company, Cleveland, Ohio

I WAS glad the previous speaker created the precedent of reading his talk, because I also felt a bit backward in coming before this group of specialists, shall I say, without my thoughts a bit organized.

Our Mr. Morris—I see him back there—said, "Oh, they are serious-minded fellows! Tell them a few stories. Tell them that the manufacturer is in the same position as the man who was walking through the field with his chum and was chased by a bull. He looked around for a means of escape and saw a great big hole and finally jumped into the hole. His colleague ran to a tree and climbed it. The bull jumped over the hole after him, but of course missed him. As the bull would turn around and come back, the fellow would jump out of the hole and the bull would dive after him again. That kept up, and finally his colleague said, 'My gosh, man, why don't you stay down there in that hole?' He said, 'Stay down, your eye! There's a bear down here!' "

My accepting the opportunity to speak before this distinguished group was conditioned upon the understanding that you would not be disappointed in failing to hear a silvery tongued orator who might entertain you. I believe your greater interest is to hear the plain recitation of the experiences of one who has been closely identified with the N. R. A. activities as they affect industry and to hear of his reactions to such contacts.

I have had the courage to appear before you in this guise as I do feel somewhat qualified to discuss the subject, based not on hearsay, but on personal experience during the entire year of the N. R. A. existence. Of course, any expression of mine must necessarily be based on personal opinion which may, or may not, coincide with your own. However, little benefit would be derived from anything I might say unless it were an honest expression and not designed to please some particular school of thought.

Regulation, such as originally planned and subsequently made effective or now in prospect under the National Recovery Act, indicated either great possibilities or decided handicaps to industry. Labor had of course one point of view; management in some cases an entirely different outlook; the consumer was not articulate; the stockholder was apprehensive. Therefore, it seemed to me that any executive responsible for the welfare of his firm, its stockholders and employes, was obligated not only to be very closely in touch with the developments, but to actually assist in formulating the code procedure in so far as possible, to the end that the greatest good to the several classes he represented might ensue.

In helping to work out codes in several industries with competitors, many of whom up to this time had been more or less strangers, Dr. Johnson's philosophical assertion that all strangers were enemies was very forcibly demonstrated. Those whom I knew least and therefore suspicioned most, proved, upon acquaintance, to be fellows much like myself with the same problems to face. Meeting these men regularly brought mutual respect and growing confidence. This perhaps is one of the most satisfactory results so far from the executive standpoint, and I believe that, were the codes to be eliminated entirely, this benefit would continue.

The governmental side of the picture unfolded as the necessity arose for many trips to Washington, endless conferences, meetings and individual contacts with the officials and their aids, who were charged with the responsibility of preparation, examination or legality of the various codes. Irrespective of their experience or lack of experience, their breadth of view or depth of judgment, one gathered that most of these officials were actuated by patriotic motives and fired by the early zeal of the neophytes of a new cult. If this enthusiasm quickened into better judgment with experience, the later codes were the better for it.

These innumerable Washington contacts were all of great assistance in broadening one's point of view and in gaining a fair insight into the attitudes, as well as an understanding of the intentions, of the men responsible for this new effort. The first reactions were, I believe, almost universally favorable towards the necessity of creating a workable plan to extricate us from the nearly chaotic situation facing industry under a new and untried administration. Therefore the first effort was a wholehearted one. Busy men gave willingly of their time and money in their enthusiastic anticipation of the wonderful things this new N. R. A. was to accomplish. They accepted the many new, and then radical, labor provisions as to regulation of hours, wages and other conditions, in anticipated exchange for the privilege of eliminating many of the vicious trade practices in industry.

Then followed the weary months of organization of industrial trade groups: meetings, hearings, countless revisions, and a constant stream of regulations issued and often almost immediately countermanded, making it exceedingly difficult to obtain results. It seemed a very simple matter to write a set of regulations under which a single industry might be governed and to put it into practice. However, the conflicting interests in the succeeding codes brought to light many difficult situations. This has been met in some instances by securing exemption from certain codes, conditioned upon observing the labor provisions of the code representing the major portion of the business and the fair trade practices of each one of the codes with respect to sale of the various products.

That does not clear up the difficulty, for example, of the trucking, printing, lumber and other codes, where those industries operate under certain labor provisions different from those of an industry where these activities are but a simple department of a business. Complications in this respect and many similar ones have rather dampened the former enthusiasm of the men who first viewed the plan as a plausible and workable one.

Perhaps the project has been oversold—the expectations built too high. At any rate, many individuals are becoming disappointed because the codes do not correct evils which are really problems of management. It has been my observation that a great deal of lost motion and ineffectiveness in the preparation and operation of the codes has resulted from the lack of knowledge of the subject on the part of members of industry. This lack of definite knowledge applies to even a greater degree down further among the employes of the various industrial organizations.

Of course, the problem of meeting the labor program has been a major one and perhaps will continue to be so. For most firms this is a new and radical experience and here again either a lack of knowledge of procedure, or sometimes a too narrow outlook has delayed action to the danger point. For the most part individuals are perfectly willing to follow the letter of the law, nevertheless that this is a difficult problem was evidenced recently by General Johnson's own experience with the N. R. A. union identified with the Administration's activities. Surely, if the theory is to work at all, it should work at headquarters.

Without question, for the most part industry is favorable to the general policy of spreading work by shortening hours and paying living wages as a minimum to employes. It would be a short-sighted and narrow-minded individual who would not see that the very existence of his firm depended upon the prosperity of the workers in industry. I need not tell you that the collective bargaining principle has presented problems even in the labor ranks.

Confident that American labor is both intelligent and fair, it cannot be overlooked that in some industries the labor racketeer has appeared taking prompt advantage where any uncertainty is manifested. This situation has not been lessened in complication by the ambiguities of the famous Paragraph 7 A and the legion of succeeding official interpretations. To what extent these bargaining principles will be expanded or curtailed remains to be seen. If the problem were a simple one it would have been solved long ago. It must be faced, however, and with an understanding on the part of both sides which will not only enable the employe to benefit from this effort, but will inspire confidence in the industrial ranks and furnish an incentive for capital to properly finance industries' activities.

It has been my own experience that, generally speaking, the employe's attitude is a reasonable one if he has full understanding of the conditions existing under which his firm may be operating. Surely, in this particular problem, which deals with the very life and well-being of the individual, politics has no place. It is the obligation of everyone who deals with the problem, to do so with the broadest possible consideration.

I said before that no thinking person could fail to realize the importance of providing at least a living wage for workers. When it is considered that five-sixths of all goods and services are bought by people whose incomes are less than $2,000 annually, the one-sixth purchases of the so-called "wealthy class" are relatively unimportant. Entirely aside from the humanitarian aspect, I feel that the worker earning a living wage is certainly a far better prospective customer than the unfortunate on the charity rolls.

American business men have rebelled rather decidedly against being ordered about by people who lack experience in the operation of business and whose "Top Sergeant" implications overlook the fact that industry has not the flexibility to enable it to follow the issuance and countermanding of orders upon a moment's notice.

Clearly, the present industrial attitude is one of watchful waiting, having been immensely annoyed by miscellaneous regulations which involve too great an expenditure of time and money. The natural result is likely to be a reluctance to follow so blindly.

A new and encouraging trend is a recent right-about-face in code regulations which concerns price-fixing policy. Other than labor provisions, price-fixing has had the greatest interest and has seemingly offered an opportunity industry wanted to recover quickly its rising costs resulting from code compliance. In some of the basic industries and even under certain circumstances, regulation of selling prices through one medium or the other might be justified, but as a general rule I believe the far-sighted business man has avoided what appears to me an uneconomic and impractical bit of legislation, which certainly has no place in business. It is indeed a far cry from the anti-trust laws to the provisions in a code which not only encourage but often establish a definite scale of prices. In some cases these prices are based upon definite costs, and in others more or less upon an arbitrary schedule. In theory a practice of this kind may appear logical, but in practice it results in an artificial regulation of prices which to my way of thinking nullifies the effect of the natural law of supply and demand, encourages inefficiency, and destroys initiative.

Industrial history is replete with instances of the prompt substitution of one material for another where an inordinate price increase literally compels the change in order to maintain proper cost levels. Public resentment against too rapid a rise in prices is prompt and decisive. My own experience has been largely built up around merchandising efforts, and I am convinced that to maintain and further encourage the volume markets, the price question is most important—reaching down to the very fundamentals of recovery.

Again referring to my own business—an electric washing machine sells today for one-quarter the price at which it sold a few years ago. While margins have become narrower and it is far more difficult to operate profitably, it can be done by continually lowering costs through improved methods, materials, and distribution. These price reductions have opened a far-widening market to the point where unit volume is greater today than ever before in the history of the industry.

It would be most gratifying to immediately pass the increase in cost of labor, materials, and operations to the consumer, but it strikes me as being a much sounder practice to absorb as large a portion of this increased cost as possible so as to encourage continued buying, and thus avoid the almost inevitable shrinkage in purchases by resorting to the popular but questionable practice at the present time of rapidly increasing prices through artificial regulating.

The several codes with which I have been closely identified have studiously avoided these price-fixing regulations, except to the extent of prohibiting sales to be made below cost based on standard cost accounting practice, this being the clause rather generally accepted by the majority of the codes.

If I am not mistaken, it is this clause which will be of more interest to the members of this group than any other in the various codes. Entirely aside from the benefits which industry might obtain through the proper use of this section in the elimination of unfair competition, it will, I am confident, mark an epoch in business management which will have lasting effect. Seldom indeed do you find an individual willing to sell below cost. The trouble is that we do not know our costs accurately, and here at last is the almost universal requirement—that we set up machinery along well planned and uniform lines to determine costs. I well know that your organization appreciates how vital to successful operation is this phase of the regulations.

In considering the results of the new price-fixing policy, we may be assured that there remains a great leveling influence in the labor provisions with the requirement imposed of minimum wages and other conditions which will be reflected rather uniformly in costs of all concerned. Another control to be used when necessary is the so-called Emergency Clause which will at the discretion of industry and the Administration, be called into play by declaring an emergency to exist with respect to ruinous selling prices.

I was pleased to see the Administration turn about recently, taking a very definite stand in price-fixing policy. It is quite evident that codes which have already adopted price-fixing procedure will be not only encouraged, but actually compelled, to revise the provisions. Perhaps this will lead to a certain amount of price-cutting and irregular practices for a time, but in the long run it will make for a much healthier condition.

It is quite common practice among sales people today to quote what they call their "code prices," which of course must either be prices fixed by their code, or which have been legally agreed upon among the members of their industry. The anti-trust laws are still in full force and effect, except as they have been modified by provisions of approved codes, and of course these laws cannot safely be ignored. Here again the lack of understanding on the part of management presents a very outstanding difficulty. I do not mean by this that I view *all* trade practice regulations as unsound and doomed to failure, because, after all, a great many evils can be corrected by close cooperation among the members of an industry; but I do insist that we must deal with fundamentals to avoid so hampering an industry that it cannot operate efficiently.

The elimination of the seven service trades codes by the Administration recently stresses the difficulty, if not impossibility, of regulating price-fixing in those industries.

Your profession is accustomed to deal with facts. Mr. Owen D. Young said that "facts are our scarcest raw material," and further says that "given the facts, management becomes simple." So, another benefit to be derived from N. R. A. activities will be the assembly of facts through the compilation of statistics. These workable figures should be highly valuable and serve as a guide in the conduct of business. Here again as in cost finding and code regulations, simplification and fundamentals are likewise most important, and of course good accountancy requires that these operations be economical and unburdened with indigestible masses of statistics which could serve no useful purpose.

You as professional men in industry have a grave responsibility in giving all possible assistance in improving and coordinating this very significant endeavor. Clearly N. R. A. must succeed as a basic plan and the present success, as well as that of the immediate future, will have considerable bearing on all future trends. Self-government by industry must be successful or face very restricting governmental regulation, which in Italy is termed Fascism, and this obligation must be assumed by both management and labor.

I have no patience with the uncompromising attitude of the man who will not bend or conform because of precedent, personal feelings, time or profits. We must face *all* problems and not only our own. We need not necessarily accept every regulation as being final, but should maintain an attitude of cooperation.

It has been intimated that the essential functionings of N. R. A. will be taken over eventually by the Department of Labor and the Federal Trade Commission. Be that as it may, a continued faith in our government and a closer cooperative spirit among the members of industry —in which your influential organization can play an impressive part— must find a solution to this problem and thus avoid a repetition of the devastating experience of the past five years.

CHAIRMAN GUNNARSON: Mr. Frantz has supplemented some of the points of view already expressed, and has presented some further aspects of labor problems arising under codes. We appreciate his message, based as it is upon long business experience and upon actual and intimate contact with the problems of N. R. A. We are deeply grateful for his interest in coming here this morning.

Due to conditions over which we have no control, we cannot enter into any discussion this morning. Dr. Lyon and Dr. Haake must leave for Chicago within a few minutes so that we shall adjourn at once.

Before adjourning, however, I ask your permission for time to read a letter which came to Dr. McLeod this morning. It summarizes more adequately than I could what I had wanted to say at the conclusion of this session. This message comes from one of the organizers, and a life member, of the N. A. C. A. He was a member of the first Board of Directors of the organization.

The letter is from Mr. Henry B. Fernald of the firm of Loomis, Suffern and Fernald of New York, and I shall take this opportunity of reading just a few sentences from it:

> In this time of turmoil and disturbance there seems a willingness to try all kinds of experiments and to welcome any strange and novel theory with little consideration of the wisdom and experience of the past. I think it is a time when we need more than ever to keep our feet firmly on the ground and face the facts of the situation. After all, we are simply faced today with the same need that gave rise to N. A. C. A. in the first place, which was the need for the development of cost accounting to give a true picture of facts and to do this in a most efficient way, to give essential information to those who are trying to handle the administration of a business organization.
>
> We have grown larger. We speak more nearly a common language. We understand better the various methods in which one and another try to meet their situations. But we still have to deal with the same fundamentals of the determination of facts and their interpretation in a sound, simple and efficient manner so that they can be put to practical use.
>
> The Association has gone a long way since the prior convention was held in Cleveland, and there has been material development in our thought on cost accounting and in the harmonizing of our ideas, in which I think the Association has been an important factor.
>
> My best regards to you and the others, and my sincere regrets that I cannot be in Cleveland, as I had hoped to be.

We sincerely appreciate this message from one of the founders of N. A. C. A. He has given us a thought to carry home with us, and an inspiration to continue to build this Association along the sound lines originally conceived by its founders.

We shall now adjourn, with our deep appreciation extended to each of the speakers of this session.

. . . The meeting recessed at twelve-ten o'clock. . . .

SESSION II

FUNDAMENTAL ACCOUNTING PROBLEMS UNDER THE RECOVERY ADMINISTRATION

TUESDAY AFTERNOON, JUNE 26, 1934

A. B. GUNNARSON, *Chairman*

CHARLES R. STEVENSON for the last nine years has been the Senior Partner of the firm of Stevenson, Jordan & Harrison, Management Engineers, and for nine years prior to that he was President of The Stevenson Corporation, of which the present organization is an outgrowth. Previous to that he was engaged in actual management work with two large industrial companies and from 1903 until 1911 was associated as Junior Partner with the firm of Miller, Franklin, and Stevenson. Mr. Stevenson has served in his professional capacity many of the largest industrial organizations in the United States and Canada. He and his firm have also been very active in managing trade associations before and after the National Industrial Recovery Act went into effect Mr. Stevenson is Past President of the National Association of Cost Accountants.

HOWARD C. GREER is a graduate of Northwestern University and a Certified Public Accountant in Illinois and Ohio. Following several years of industrial and public accounting experience he became Chairman of the Department of Accounting and Director of the Bureau of Business Research at Ohio State University. Since 1927 he has been professor of accounting at the University of Chicago and Director of the Department of Accounting and Marketing of the Institute of American Meat Packers. Professor Greer is the author of a number of books and articles on accounting subjects. At present he is Acting Director of the Accounting Research Council.

FUNDAMENTAL ACCOUNTING PROBLEMS UNDER THE RECOVERY ADMINISTRATION

CHAIRMAN GUNNARSON: In organizing today's program we had in mind that in the morning session there would be sketched a broad background with respect to the effects of the Recovery Administration. That this was admirably accomplished, there can be no doubt. This afternoon we want to begin a discussion of some of the more detailed problems which are of immediate interest to accountants.

The subject of the session is "Fundamental Accounting Problems Under the Recovery Administration." Both of the papers to be presented will be along somewhat similar lines, although the points of view will probably be different.

It is not necessary to go through any formalities this afternoon in presenting our speakers. They are both members of the Association and have been so for a long time. Our first speaker is one of the old guards of the Association. He has been president of the organization, has served on the Board of the National Directors, and has had a wide experience in industrial fields. He has spoken before most of our chapters and all of you know him.

I now take pleasure in turning the meeting over to our friend, Mr. Charles R. Stevenson, who will discuss the subject "Price Control and Allotment of Business."

PRICE CONTROL AND ALLOTMENT OF BUSINESS

CHARLES R. STEVENSON
Senior Partner, Stevenson, Jordan and Harrison,
New York, New York

WHENEVER I get back to talk before an N. A. C. A. convention, I always feel like a fireman who has been out visiting when he gets back to the old home firehouse, because this is my place of departure and I always like to come back and be with you men I have worked with and been with so many years.

I am just a little handicapped this afternoon in speaking after the speakers we heard this morning, because in the very nature of the subject I was asked to discuss I can not help repeating some of the things that were said probably more ably, and certainly much more humorously than I am able to say them this afternoon, particularly by Dr. Haake.

Many of the things Dr. Haake said, particularly in regard to the detailed work of the Administration in Washington, I agree with but probably would not have had the courage to say quite as frankly as he did.

However, I disagree with some of the basic conclusions that both Dr. Haake and Mr. Frantz, and to some extent Dr. Lyon, presented to you this morning. I am going to try to present a rather different point of view this afternoon.

It seems to me when I get through talking, if I have done my job as I hope to be able to do it, I will have reduced this question to a clear-cut issue, and the clear-cut issue will be whether it is desirable for business in this country to operate on a price-control basis, which means price-fixing, or whether it is better to adopt the other principle as outlined and supported by Dr. Haake and Mr. Frantz this morning, that there should be no attempt at price-fixing in business.

With the permission of the Chairman, I am going to suggest that after I have finished talking and Mr. Greer has finished talking—and I believe he will take the opposite side than myself—and we have had some pretty good discussion from the floor so all of us can express our thoughts, that it would be interesting if we might have the sense of the meeting and get some idea how sentiment is in a group of men. I suppose there are probably 700 or 800 of us here in this room. I would say it is a group of men who are thinking about these things and are familiar with them, far above the average intelligence of the American voting public. I think we would all be interested to know what the majority opinion of a group of men like this would be. At least I would, and I am going to ask your permission to do that after we have finished the discussion.

Gentlemen, following the example the speakers set this morning, I have also, contrary to my general way of speaking, reduced what I have to say to writing, because I think when we come to talk on subjects that are as important as these questions that are now up for determination and decision in this country, questions that are going to affect our future, the future of our children, I do not think we want very much loose thinking or very much loose talking about it. I think we want to reduce what we have to say to writing and in as definite a form as possible. It is in that spirit that I have done this. So you will bear with me as I read what I have to say on this subject.

Seven years ago I discussed at the annual convention of our association, held in Chicago, the problem of selling below cost. I imagine that several of you, who are in attendance here today, were in attendance at our meetings seven years ago and will remember the discussion which I have in mind.

For the benefit of those of you who did not attend that session, let me say that through the Research Department of our association we sent out a questionnaire to several thousand companies engaged in various lines of business in an endeavor to ascertain whether or not they sold below cost, why they sold below cost if they did so, and whether or not they thought it was a good business policy.

The returns from our questionnaire showed conclusively that about eighty per cent of the companies replying, and we had several thousand replies, admitted regretfully that they were from time to time forced to sell below cost to meet the tactics of competitors who resorted to selling below cost in an effort to secure an excessive percentage of the available business. About twenty per cent of the replies indicated that the companies making the replies believed in selling below cost as a deliberate policy, believing it advisable to make whatever sacrifices were necessary to keep their plants operating at as near a capacity rate as possible. The eighty per cent of the companies who did not like to sell below cost took the stand that it was an indefensible business practice and that the adoption of the selling-below-cost policy generally resulted in losses rather than profits.

After thoroughly discussing the facts brought out by our questionnaire and after a good deal of discussion from the floor, I think our session went on record to the effect that it was contrary to sound business policy to sell below cost except to meet prices which had been initiated by a competitor. In other words, seven years ago we were discussing the basic elements of price-control which have been and still are the main basis of controversy in connection with the operation of the National Industrial Recovery Act.

While the National Industrial Recovery Act was introduced and passed as an emergency measure to aid in bringing about recovery from the depression which started in 1929, the provisions for industrial control which were embodied in the Act have been crystallizing in the minds of a good many of us for several years. As a matter of fact, a committee representing the leading trade associations of the country presented a very similar plan to President Hoover in the winter of 1932.

It came about very logically then, when the Roosevelt Administration came into power in March of 1933 with the clear-cut determination to increase the purchasing power of the mass of our people through reducing the hours of labor and increasing wages for both the minimum and higher paid employes, that industry accepted very readily what was, to all effect and purpose, a bargain. Industry undertook to meet the wishes of the Administration in regard to reduced hours and higher wages, and, in return for this concession, industry was promised the right to enter into enforceable agreements which would bring about stability of price and profitable operation. In other words, both the Administration and industry recognized that the time-honored principle of unrestricted competition had broken down and that during the emergency period, at any rate, a system of controlled competition would have to be tried.

The past year has been a disappointing one to those of us who believed that the National Industrial Recovery Act meant what it said. Before discussing the reasons for this disappointment and the conditions which have gradually developed in connection with industry control as the Act has been administered, let us go back and discuss the conditions which led a good many of us to believe that the industrial system, which we had been using successfully for one hundred and fifty years, had broken down and that a new method of conducting the business of the country was in order.

The one-hundred-fifty-year period ending in 1929 covered the growth of our nation from a group of agricultural communities spread along the Atlantic seacoast with a total population of less than 4,000,000 people to a nation reaching from the Atlantic to the Pacific and from Canada to Mexico with a population of 120,000,000 people. It covered the transition from the handcraft age to the machine age, with the development of enormous amounts of available energy from our coal, oil, and water powers.

At the same time that we were developing our own country, we were able to supply large quantities, first, of raw materials, second, of manufactured goods, and, third, of productive machinery to the other countries of the world. Never in the history of the world had there been such an opportunity for the development of individual initiative and enterprise. Abundance of opportunity existed for every man. If an individual could not make good in his own community, all he had to do was to move further west to the frontier, where free land and the opportunity to wrest a living from the soil awaited him. It was a period of development, of growth, of new inventions, and, notwithstanding several temporary setbacks, our people as a whole grew and prospered.

And, yet, like all good things, this period gradually came to an end. We pushed our frontier to the coast of the Pacific. We absorbed all of the free land. We increased the productive capacity of the individual fifteen or twenty times. We found ourselves able to produce much more food than we could eat, much more clothing than we could wear. In other words, we passed from an era of scarcity to an era of plenty.

The system was beginning to creak in 1914. It received fresh impetus from the war, which led us, under the delusion that we would somehow be paid for what we shipped out of our country, to still further increase our production and our productive capacity. The war over, we proceeded to spend the money which we thought we had made in a still further development of our productive facilities, and we enjoyed the unprecedented prosperity beginning with 1922 and ending in the crash of 1929.

We came pretty nearly solving the problem of the successful operation of the capitalistic system in 1929. If the men who had been employed in building our excessive productive plant and capital structure had been transferred, when they completed their work and were thrown out of employment, into the production of consumer goods through a general shortening of the hours of labor, and if hourly wages had been increased so that the same amount of money which had been flowing into the pockets of the mass of our people had been maintained, we should have been able to continue for a very considerable length of time the prosperity which we then enjoyed. I am inclined to believe, however, that even if we had had intelligence enough to do this, the inherent evils of uncontrolled competition, where excessive productive capacities exist, would have forced us to exercise the controls which were contemplated when we adopted the National Recovery Act, and which I believe we have to continue to make effective if we are going to continue to operate industry through private ownership.

In the period from 1922 to 1929 the evil effects of unrestricted competition were beginning to be severely felt in a good many industries, and, while satisfactory profits, and perhaps excessive profits, were made by some companies, the return on the total capital invested in industry was far from satisfactory.

As a matter of fact, we did not actually operate under the system of unrestricted competition in the period from 1922 to 1929, notwithstanding the fact that the Sherman and Clayton Acts were on our statute books and that, theoretically, we were supposed to do so. Practically, under the Harding, Coolidge, and Hoover administrations industry enjoyed, to all intents and purposes, a moratorium from the Sherman Act, and, through the more or less effective trade associations which were developed in most of our industries, competition was, to a very considerable extent, controlled. The Department of Justice acted with great restraint and intelligence and only enforced the Sherman Act against those industries which violated the laws in a flagrant and unreasonable manner.

Naturally, the efforts which were made to control prices during this period had to be carried on with the utmost caution, and great care had to be taken not to violate the provisions of the anti-trust acts in a flagrant way. Everything that was done had to be done through voluntary action, as definite agreements could not be entered into, penalties could not be set up, and the will of the majority in each industry could not be enforced on the minority. It is, I think, a splendid tribute to the innate fairness and intelligence of the American business man and industrialist that, notwithstanding all of these handicaps, so much was accomplished along the lines of regulating and controlling production and preventing prices from declining to destructive levels.

In all industries certain minorities existed who were unwilling to subordinate what they believed to be their own interest to the interest of the industry as a whole. These unintelligent and unsocial minorities gradually drove prices lower, and, as prices were driven lower, in an effort to maintain a profit margin, costs had to be reduced. Unfortunately, the effort to reduce costs usually took the form of reducing wages, which, in turn, reduced the purchasing power of the country.

In many industries it was found impossible to secure any intelligent self-restraint, and in these industries the full effect of unrestricted competition rapidly became apparent, with the result that wages in many of our industries were driven to unsocially low levels, capital was destroyed, and bankruptcies, receiverships, and reorganizations were suffered by a great many of the companies engaged in industries. Notable examples of industries suffering in this way prior to the period of depression were the textile industry, both cotton and woolen, copper, coal, and lumber.

In addition to the coming to an end of the period of developing excessive capital facilities and the throwing out of employment of the men who had been engaged in their production, we also began to feel fully the effects of the technological developments which proceeded at an unprecedented rate beginning with 1914.

As I showed in a pamphlet entitled "The Way Out," which I published in 1931, the output of the average worker was increased seventy-five per cent. In other words, one man was turning out in 1925 what it had taken one and three-quarters men to turn out in 1914. An excellent example of what occurred is shown by a typical case in the experience of my own firm. In 1924 we undertook to introduce labor incentives in a large foundry employing 525 men and producing about 175 tons of castings a day. When we completed the job, we were producing the same number of castings with 375 men. Naturally, the 375 who were still employed were earning a good deal more money per individual than they were earning before, the company was securing very considerably reduced costs, and the 150 men we had let out found employment in other industries. We felt that we had done a good job for the firm who employed us and for the labor employed by that firm.

The same thing was happening in thousands of other companies throughout the country. As long as we could furnish employment to the men who were displaced in this way, everything was all right, but when we came to the end of the period of expanding capital facilities and it became no longer possible to employ these men, unemployment with the resulting lack of purchasing power began to develop.

At the same time that these two things were happening, we were faced with the loss of a large part of our foreign markets. This was brought about primarily by the fact that Argentine and Australia were able to produce wheat and beef for the world markets more cheaply than we were able to and by the fact that the manufactured products which we had formerly exported were now manufactured on machinery which we ourselves made and exported to the countries who were formerly our customers for the manufactured products. In other words, it was a splendid thing for the cotton business when China and India were buying piece goods from us. It was a splendid thing for the cotton machinery business when China and India were buying spinning frames and looms from us. However, when China and India got the spinning frames and looms set up and put their own people to work, we lost both piece goods business and the cotton machinery business. The same thing happened to a great many other commodities and in a great many other countries.

All these things seemed to have come to a head in 1929, and the result was that we were plunged from a period of prosperity into a period of depression and destruction. It seems to me, however, that certain ideas came to us during this period, which, if we had the courage to avail ourselves of them, would make it possible to work out a system which would enable us to take advantage of the era of abundance into which we have now entered.

I think the most important of these ideas is the realization that production depends on purchasing power—that it is useless to produce unless we can dispose of the products, and, if products are going to be made in quantities by mass production methods, that sufficient purchasing power has got to be put into the hands of the mass of the people to enable them to absorb these products.

I think we also have begun to realize the necessity of adjusting our productive capacity to the consumptive demands of the country. In other words, what we really need is a planned economy. This does not mean the doctrine of scarcity, which is the twist that the opponents of intelligent control try to give it, but it does mean that there is no use in producing 600,000,000 bushels of wheat when the country can only consume 500,000,000. It simply means a careful study of what productive capacities are actually necessary to take care of the purchasing power which we have created and the adjusting of our productive capacity to that purchasing power. Increase purchasing power by all means, increase consumption by all means, and as purchasing power and consumption are increased, increase our capital plant so that we at all times have a sufficient leeway to meet peak loads. But, I think we have come to see that there is no use in providing capacity for producing 20,000,000 boxes of window glass when the maximum consumption of the country is 14,000,000 boxes or capacity to produce 67,000,000 of tons of ingots of steel when the maximum use of steel is 56,000,000 tons and our average annual consumption in the eight-year boom period, ended in 1929, was only 46,000,000 tons.

Summing the thing up, a great many of us have come very definitely to the conclusion that the system of unrestricted individualism and complete freedom of competition will not work under the conditions that now exist. It seems to those of us who feel this way that, if we are going to preserve the basic principles of capitalism and private ownership of property, we have to modify our methods to conform to conditions as they actually are. There are a great many other people, of course, who do not share this belief, who believe that the best interest of the country will be served by maintaining complete freedom of individual action, complete freedom of competition, and who regard the present situation as an emergency only and are anxious to return to the old methods.

I think it is a great gain that we are now in a position to define the issue and debate the matter with some degree of intelligence. The right solution will depend upon the degree of intelligence which we are able to bring to bear on the subject and our ability to avoid passion, politics, and prejudice in the determination of our future course.

This brings us back to the statement which I made a few minutes ago to the effect that the National Industrial Recovery Act has been a disappointment to those of us who believed that it meant what it said.

We believed that the system of controlled capitalism, as I choose to call the system of controlling individuals and industry through government supervision, would be given a fair trial. The National Recovery Administration was organized, and the first codes that were approved seemed to justify this belief. Excellent control measures were embodied in the cotton textile code, in the lumber code, in the original steel code, in the glass container code, and several others, but, as time went on, it became increasingly difficult to secure adequate control provisions in our codes. Members of the legislative branch of our government raised the old cry of price-fixing and monopoly. The administrators were surrounded by various boards representing various interests and various shades of economic thought. Among the most vociferous of these boards was that representing the so-called consumer. It was inevitable that in a country operating on our political system the administrators of the Act had to give great consideration to these various points of view.

I have no doubt as to the honesty and sincerity of the men who oppose the underlying principle of the Act. We cannot expect that such a revolutionary system of industrial control as was originally contemplated by the National Industrial Recovery Act should be accepted over night by men who have been brought up to believe in unrestricted competition and by a body of voters who have been taught for years that they were exploited by business and that price-fixing and price-control mean monopoly and that monopoly means exploitation of the public.

I think the Administration also made the mistake of attempting to apply control provisions to industries which, by their very nature, do not lend themselves to national control. This mistake has been recognized and the control features of the Act have been withdrawn as they apply to the so-called service industries. The net result has been that it has been increasingly difficult to secure adequate control provisions in our codes, and the control provisions in the codes which contain adequate control provisions have been subject to constant criticism and complaint.

In this connection let us consider the so-called cost-protection clauses in the codes, which were made the subject of a recent executive order. In the early codes no objection whatever was offered to including as a code provision a stipulation that no member of the industry should sell below his own cost. These early cost-protection clauses were drawn in various ways, most of the codes providing for uniform cost accounting methods which were to be used as a basis for determining and enforcing the cost-protection clauses. Presently, these cost-protection clauses were modified to permit selling below cost to meet the competition of a competitor who was not selling below his own cost determined in accordance with the cost methods adopted by the industry. This was a fair and reasonable modification and at least established as the minimum selling price the cost of the lowest cost producer, although it does not seem a fair or reasonable provision to many of us who believe that the average industry cost should mark the minimum price level.

When we came to present the cost methods for the industries whose codes contained provisions providing for industry cost systems, we found great difficulty in securing the inclusion of items which all of us know must be included in the cost of the finished product as sold. I am not referring to interest on investment as an element of cost, for that was ruled out from the first. I recognize that interest on investment is a debatable subject, and, yet, how can industry be expected to provide capital equipment unless a fair return on the capital, which the equipment represents, is recovered in the cost?

Representatives of some of the boards in these cost discussions have gone so far as to maintain that costs should cover only material and labor and that no consideration whatever should be given to overhead. These were extreme representations and were overruled, but I only mention them to show the lengths to which certain of the advisory boards went in their efforts to nullify the effective control provisions of the Act.

Very recently our association was asked to appoint a committee to work in conjunction with the Research and Planning Division of the N. R. A. on the development of a model cost-protection clause. After a great deal of thought and consideration and some exceedingly intelligent effort on the part of Messrs. Wellington, Camman, and Howell, we produced a clause which seemed to us to cover the situation in a very thorough and adequate way. Just what consideration was given to this provision, I am at a loss to say, as no official use was ever made of it.

Later, a model cost-protection clause was prepared by the Research and Planning Division and submitted to us for comment and suggestion. The committee immediately took the matter up, proposed certain changes and amendments to the clause that had been submitted, and presented their views to the National Board, which approved the stand which the committee had taken. The suggestions and modifications were forwarded to Washington and again were ignored, for within a week the recent executive order, which practically eliminates the cost-protection clauses from future codes and indicates that an effort is to be made to renegotiate the existing codes, so that the cost-protection clauses which had been granted can be eliminated, was issued.

I bring these matters to your attention to show clearly what a desperate conflict exists in the Administration itself on the basic principle of whether industry shall be operated on a controlled or wide-open competitive basis. Notwithstanding this conflict, the fact remains that a good many codes with effective control provisions have been approved and now stand as law. I think it will be interesting, presently, to analyze these various forms of control which have been embodied in the approved codes and to gain some idea as to the effect which they are having on the various industries involved, so that we can secure a better understanding of this whole question of control and how it can be brought about.

Before doing so, however, I think there is one other underlying difficulty which the National Recovery Administration has to face, which we should make note of, and that is the difficulty of securing compliance. Most of the control provisions, which we are presently going to discuss, are at the present time theoretical, except as they are applied through voluntary action on the part of the industries involved.

There is no question in my mind but that the National Recovery Administration is anxious to secure definite and exact compliance with the provisions of the codes which have been approved. There has undoubtedly been, however, a desire to keep the matter out of the courts, in so far as that is possible, because of an underlying fear that the Act itself, either in whole or in part, would be deemed unconstitutional and that definite court decisions compelling compliance and assessing penalties against those who did not comply would be difficult to obtain. There has, of course, been no hesitation in enforcing compliance with the labor provisions of the Act, and, in the few cases where it has been necessary to take violators to court, decisions have been uniformly favorable.

There have also been certain other matters in connection with compliance taken to court, notably the allotment provisions of the lumber code, and, here again, favorable decisions have been obtained.

I think the Administration feels a good deal more confidence in its ability to secure enforcement through the courts than it did, as a result of these decisions, and that a very definite determination now exists to secure definite compliance.

One of the chief sources of dissatisfaction with the Act has been the failure on the part of the Administration to secure compliance. The honorable, fair men of an industry have lived up to the code provisions to the letter, but the minority of fifteen or twenty per cent have failed to do so, and, in failing to do so, have injured the companies which are complying.

To give the experiment which we are making a fair chance, it is absolutely necessary to bring about compliance, for it is the same fifteen or twenty per cent that have ruined industry under the voluntary control method that are now ruining it through their unwillingness to comply. Until we can establish the power of the majority to control this recalcitrant minority, and until they can be forced to live up to the rules of fair play and fair competition and control, which are embodied in the codes, we cannot determine what effect true control will have.

As I have already said, I think the Administration is fully alive to this situation and has just about completed the organization of the compliance machinery necessary to bring the matter to a head. I do not want to be understood as saying that the various administrators have been idle in the matter of securing compliance. As a matter of fact, many of them have been exceedingly helpful to the industries which they control in bringing about compliance in a friendly and persuasive way, and it is, of course, very much better to secure compliance through persuasion and logic than it is through court action, but there are some men who are impervious to either persuasion or logic, and the sooner the cases of these men are presented to the courts and we are able to definitely determine whether the codes can be enforced legally or not, the better it will be for all concerned.

Let us go back then to the various control provisions of the codes which have been approved and consider them in some detail, remembering always the basic conflict between open and controlled competition and the general public belief that price-fixing means monopoly and extortion, a thesis which I vigorously deny, as I shall presently show you.

In no code that I know of is there any provision providing for the establishment of a definite price carrying a profit, although I believe it would have been well within the intent and purpose of the Act to have permitted profit-bearing prices to have been established. Minimum prices, however, are established through the cost-protection clauses. The most effective and best administered of these cost-protection clauses is to be found in the lumber code where each sub-division is permitted and required to establish a so-called cost-protection figure, which represents the average cost in each particular sub-division over a past period. The code makes it illegal to sell below this cost-protection figure after it has been approved by the Lumber Code Authority and the Administrator.

This provision has worked out very satisfactorily for the lumber industry owing to the fact that the cost-protection figures have been reasonably set and, representing an average cost, have allowed the more efficiently operated mills to operate at a profit. Of course, the business of the entire industry has moved at these cost-protection figures, as it is impossible for any one to secure more. As long as many companies are willing to sell at these prices and as many companies were willing to sell far below these prices prior to the establishment of the code, owing to the great overcapacity of the lumber business, it is evident that there is little chance under present conditions of securing a higher price In other words, the entire industry is utterly dependent on the fairness and reasonableness with which these cost-protection prices are established. Theoretically, of course, it means that the lumber business is supposed to operate without profit, as no element representing return on investment is permitted to be included in the cost-protection figure.

As I have said, this provision has worked very satisfactorily, and, if it could be extended to other industries, would be a great help in stopping the depletion of capital. However, this provision has been subject to attack, particularly by the Darrow Committee. On just what basis the Darrow Committee thinks the lumber business should be conducted is difficult for fair-minded men to understand. I presume, however, that they feel as one of the leading representatives of the Consumers' Board expressed himself to me when I was discussing with him the necessity of allowing industry to operate at a profit. I asked him if he did not think industry should be allowed to operate at a profit and if fair prices should not include a profit factor. He said that he did not feel that any profit factor should be included under present conditions. I asked him how industry was going to live. He said that it should live on the surpluses which it had accumulated in the past. As the lumber industry and as several of our other industries have been living on their surpluses for the last three or four years, and as these surpluses are practically exhausted, I am wondering just how men who think along these lines believe industry is going to continue to exist.

Equally definite minimum prices have also been established for the oil and coal industries.

The unwillingness on the part of the Administration to grant similar provisions to other industries is based on the fact that lumber, coal, and oil are natural resource industries and are entitled to different treatment than industry in general.

The most common method of price control is the open-price plan, which has been subject to severe attack both by the Consumers' Board and the Darrow Committee. The open-price plan, as you all know, makes it necessary for every company doing business in an industry to file its prices with the Administrative Agent of the Code Authority and makes it a violation of the code to sell any of its products below the filed prices. In most of the codes a waiting period is provided between the filing and the effective date. The original theory of the waiting period was to give other companies in the industry an opportunity to know what prices were about to be made so that they could meet these prices if they chose to do so. The accusation is made, and with some degree of justice, that the waiting period has been used to bring pressure and persuasion to bear on the company who files a low price, so that they will withdraw it. There is no denying that this has happened. Whether it is desirable or undesirable depends upon whether we belong to the open or controlled competition school.

Combined with the open-price plan in many of the codes is the cost-protection clause, which theoretically at least, sets the low point below which prices cannot be filed. Whether prices in the industry come down to the low protection cost point or not depends on the conditions in the industry itself. We have found in actual practice that it is just as easy to conduct destructive competition under the open-price plan as it is without it, the only advantage being that everybody knows what everybody else is doing, if the thing is fairly and honestly carried out.

Here again, great difficulties have arisen in connection with compliance, as some companies have refused to file their prices and a good many instances have developed where sales have been made below the filed prices.

As there has been an unwillingness on the part of the Administration to allow forced inspection of the companies' books to determine whether or not they are living up to the provisions of the code, it is in many cases impossible to secure evidence necessary to bring about a conviction, although there is a moral certainty that a violation has taken place.

As the open-price plan was a legal method of conducting an industry before the adoption of the National Recovery Act, the authority to carry it out under the codes adds nothing to the right which industry previously had. The effectiveness of the codes in carrying out this method of controlling competition lies in the theoretical ability to compel every factor in the industry to file its prices and to compel all to adhere to them. In industries where good spirit has developed and a willingness to cooperate and deal fairly with each other exists, the open-price plan has undoubtedly been exceedingly helpful. Broadly speaking, however, I think the results have been disappointing because it is within the power of any one individual to bring the prices down to the low cost-protection point and because of the failure to enforce.

This method represents an attempt to fix price by indirection. It satisfies neither the proponents of the fixed reasonable price nor does it satisfy the proponents of wide-open competition. It can lead to unreasonably high prices or to unreasonably low prices. How much better it would have been had it been possible to have met the issue squarely and have given the code authority of each industry the right to fix the fair price at which the products of the industry should move from the producer to the consumer, subject to adequate check as to the reasonableness and fairness of the price. However, as I have shown, the conflict of economic and political thought is such that it has been impossible to do this; so we are forced to content ourselves with this method of dealing with the situation and to make the best use we can of it.

Even now this method of control is under attack, and whether we shall be able to retain it in our codes or not is something of a question. It seems evident that an effort is going to be made to remove the low-cost stopping point. If this is done, it will make it possible for competition in those industries where the right spirit does not exist to be even more destructive than it is today.

Another price-control feature, which has been embodied in several codes and which it is now proposed to insert in further codes and, if possible, negotiate into the old codes, is the so-called emergency provision, which provides that, where the code authority and the administrator declare that an emergency exists in the industry brought about by destructive price-cutting, the lowest reasonable cost may be determined, below which no one may sell. In my opinion, this provision has a great deal of merit, and if carried out fairly and intelligently, with reasonable determination in regard to the emergency, will go far towards supplying the gap provided by the withdrawal of the clauses prohibiting selling below individual cost. It will not, however, meet the situation adequately, because, if the provision against selling below adequate cost is withdrawn, the companies desiring to raid a special piece of large business will be able to file a price even below their cost, low enough to take it, and, after securing the business, withdraw the price and refile the higher prices which they wish to have applied to their regular run of business.

No matter from what angle we view these various attempts to secure price control, we are forced to the conclusion that they are inadequate, that they are subject to abuse, and that they are a mere side-step of the main issue of giving industry the right which it should have to control price in accordance with the views of the majority, provided no action is taken which is inimical to public interest.

Price control has been sought in other ways and is provided for in some codes through limiting the operation of productive machinery. The best example of this type of control is found in the cotton textile code, which limits the operation of productive machinery to eighty hours a week, subject to reductions or increases in the judgment of the Code Authority as approved by the Administrator. The Code Authority has recently chosen, with the approval of the Administrator, to reduce the operating hours of the industry to sixty hours per week to enable the demand to catch up to the supply.

This limitation of operating machinery has been granted to two or three other industries. It is an attempt to influence price through the creation of artificial scarcity. As long as it is impossible for the Administration to face the price issue frankly and allow industry to establish fair industry prices, it is a very helpful method of preventing destructive prices to run riot. It has proved very helpful to the cotton industry, but has, in my opinion, resulted in higher prices than are necessary or would have been established had the price issue been met frankly and openly.

The other control features which we find in various codes dealing with various trade practice and various unfair methods of competition are all highly desirable and have some effect on the price structure. Whereas, before, companies desiring to secure an advantage resorted to these unfair methods of competition, most of which are now prohibited in the codes, they are now forced to make their concessions directly through their filed prices, if they are operating under a code embodying the open-price system. This is all to the good, as it is much better to bring competition up to an open basis so that everybody knows exactly where he stands. It does not, however, cure the main evil of allowing prices to be made which do not show a fair profit margin and which increase the pressure to reduce wages and destroy capital.

In only four codes, so far as I know, has the allotment of business as a means of industry control been provided. Definite allotment is provided for in the lumber code in connection with the low-cost protection plan; definite allotment is provided for in the oil and copper codes, these three industries being natural resource industries and subject to somewhat different treatment from the general run of industry.

The allotment of production clause is embodied in the Glass Container Code without any price-control feature being added. Under this clause it is possible to protect the smaller company and to see that everybody in the industry secures an adequate share of the business.

Just why the Administration has turned its face so rigidly against clauses providing for the allotment of business is difficult for me to understand. I know of no other method by which the smaller factors in an industry can be assured of their fair share of the available demand. If any system of price control is made really effective, it usually happens that certain companies are unable to secure their adequate share of the business. It has been the failure on the part of the small companies to secure their adequate share of the business under the open-price plans, which have been more or less effective, that has led to a great deal of the dissatisfaction on the part of smaller companies with the Act and the control features thereof. Had the allotment feature been recognized and included in the codes, these smaller companies could have been assured of maintaining the same relative percentage of the volume that they had previously enjoyed.

I am not so sure, economically, that it is desirable to keep companies in operation who cannot sell their product at the prevailing industry price, but under present conditions and, politically speaking, it is certainly desirable to do so. The only means that I know of by which this can be accomplished is through the allotment principle. I shall, of course, agree that, if the allotment principle had been granted or is granted to any industry, a rigid control of price on the up-side should go along with it, because it is perfectly possible, as various administrators with whom I have discussed this question have pointed out, to use the allotment principle to extort extortionate prices if the industry is foolish enough to do so.

The more we examine the whole question of price control and business allotment, as covered by the code, the more we see that it represents a compromise between the two basic divergent points of view. Compromises are all right, and I am not criticizing the administrators of the National Recovery Act in any way for having handled the matter on a compromise basis, but, after all, there are some matters that cannot be compromised. They have got to be handled either one way or another. It seems to me that this issue of price control is one of them. It seems to me that we have got to decide whether prices should be controlled by industry, subject to adequate public check, or left uncontrolled.

It seems to me that I might, at this time, discuss with you some of the basic factors underlying the determination of price, for it is only as we thoroughly understand all of the implications of price determination that we can intelligently determine which is the right method of procedure.

As long as we operate under the capitalistic system, the question of price will remain, as it always has been, the determining factor in every economic and social question. I think we are all pretty well agreed in America that we want to maintain the capitalistic system, and, if we are going to maintain it, we must deal successfully with the question of price determination.

In my opinion, much of the difficulty that has been experienced in the last four years can be laid to the wrong way in which we have handled prices. If we had the courage to face the facts and deal with the question of fixing and maintaining prices, as they should be dealt with, then we could go very far in overcoming our present difficulties and keeping out of similar ones in the future.

The question of price embodies the whole problem of the relationship between all branches of human effort. For instance, wages are, after all, only the price that we pay for human labor. It is through prices that human selfishness and greed express themselves. I am afraid the basic philosophy of most of us is summed up in the expression "buy cheap" and "sell dear." We are all out to get just as much as we possibly can for what we have to sell and to buy just as cheaply as we possibly can what the other fellow has to sell.

This whole theory is the basis of the economic system under which this country has operated for the one hundred and fifty years of its existence. It is a system of complete freedom of the individual, of following the law of supply and demand. It is a system of unregulated and uncontrolled competition. As I have already shown, this system was largely instrumental in bringing about the crisis which occurred in 1929 by creating the excessive plant capacities and the lack of adequate purchasing power which so largely brought about the depression.

The National Industrial Recovery Act, as conceived and written, was intended to bring an end to this system of unrestricted competition and to develop, in its stead, a system of controlled competition—

in other words, of controlled price. The Act, as you know, dealt first with the price of labor—in other words, hours and wages—and set up the machinery by which at least a minimum price for labor, as expressed by the maximum hours and minimum wages of the codes, could be established. In return for the establishment of a controlled price for labor, industry was supposed to be given the right to control itself.

Now if the control of industry is to mean anything, it must mean the control of price, and, yet, what has the actual history of the N. R. A. in relation to the control provisions of the Act been so far?—a constant effort to prevent industry from setting up the effective controls which are necessary to price determination.

I do not say this in the sense of criticizing the National Recovery Administration. There are many men in the National Recovery Administration who are thoroughly conscious of the necessity of price-fixing if industry is to be operated on a controlled basis, but the term "price-fixing" has become so associated in the minds of so many people with exorbitant prices, with the building up of monopolies, and with the development of excessive profits, that the pressures exerted politically, economically, and industrially have been more than these men have been able to withstand.

I, for one, believe that the continued successful operation of this country under the capitalistic system depends on our success in operating industry on a controlled basis and definitely putting behind us the theory of unrestricted individualism and free competition. I believe that we should arrive at a clear determination of how these two methods have worked, how they will work, and make up our minds on which basis we are going to proceed.

If the advocates of unrestricted competition and complete freedom of individual effort have their way, we might as well scrap the National Industrial Recovery Act when it runs out next June, preserving, if possible, some control over the price of labor from the standpoint of social justice, reaffirm and actually enforce the anti-trust laws, and let nature takes its course. On the other hand, if we are going to adopt a system of controlled competition, let us face the facts fearlessly and openly. Controlled competition means the fixing of price.

Under the system of unrestricted competition, honestly carried out, prices are always either too high or too low. If a scarcity exists, the sellers make the prices as high as they can in an effort to extract the last possible cent of profit. If there is an oversupply, either of actual goods or of capacity for their production, prices, if left to themselves, will descend not only to the cost level of the lowest cost producer but to a still lower point, with the result that capital will be destroyed, extraordinary pressure will develop to reduce the price of labor, plants will be closed, men thrown out of employment, and the cycle will continue until the excess supplies of goods are exhausted or excess capacities have been destroyed.

As a matter of fact, we have never been able to try out the system of unrestricted competition honestly because, notwithstanding the anti-trust laws, men have been forced, through motives of self-preservation, to work together in various ways to control prices and to avoid the ultimate results of a system under which they were supposed to operate.

One of the basic reasons why we have not been able to maintain parity between the prices of agricultural and industrial products has been the inability on the part of the farmer, as the world market for his surplus diminished, to overcome the brutal working of the laws of uncontrolled competition and supply and demand through cooperative effort and organization. On the other hand, under the system of unrestricted competition, whenever men have been able, through organization or through the creation of monopolies, to secure effective control of price, they have, in their selfish greed, pushed prices up to a point which has been oppressive to the consumers of the commodities which they produced, which has failed to give labor a proper share in the products of the industry so controlled, and has built up excessive surpluses and reserves which, pressing for investment in additional productive capacities, have eventually led to destructive competition, which has destroyed the weaker factors in the industry.

Gradually these inherent defects in the system of uncontrolled competition began to be realized by the public through their representatives in our legislative bodies, and, presently, we withdrew certain industries from the field of unrestricted competition by declaring them clothed with public interest. We proceeded to set up controlled monopolies in the transportation and public utility fields.

In my opinion, all business is just as much clothed with public interest as transportation and public utilities and should be operated on a controlled monopoly basis in the same way that these industries are operated.

I think a very good field in which to study the effect of unrestricted competition, where it is carried out freely, and the public reaction to it, is in the taxicab business. When taxicabs were first introduced into American cities, there was, naturally, a limited supply, and taxicab fares were set at very much higher rates than were necessary to pay drivers adequate wages and make a reasonable return on the capital invested. Naturally, these high returns led to a rapid development of the taxicab business. In most of our cities we presently had a good many more taxicabs than we needed, with the result that rate wars were indulged in between individual drivers and companies engaged in the business, wages of drivers were driven down to practically a starvation point, and in most cities it became necessary for the public to step in and, through various taxicab ordinances, to establish a fair price at which taxicabs should operate and to establish a licensing system, which makes it necessary to secure a license before one can operate a taxicab. Even in the District of Columbia, which is operated under the direction of Congress, many of the members of which, I am informed, are bitterly opposed to any form of price-fixing, taxicab rates are definitely established by public regulation.

The public as a whole has become conscious of the abusive power which has resulted in exorbitantly high prices, whenever power to create these excessively high prices has existed. No one is less inclined than I am to minimize these abuses or to defend the men who indulge in them. On the other hand, as is always the case, it has been the instances of abuse that have been called to the public attention, and these instances of abuse have been relatively infrequent and minor in their relation to the great volume of industry.

Actually, the working of the unrestricted competitive system has produced a constant succession of failures and capital losses and has brought about destructive wage conditions in many industries, which have been exceedingly inimical to the public interest. However, through the focusing of the public attention on the abuses and through the political capital which has been made by many of our politicians in their diatribes against big business and malefactors of great wealth, the public have come to believe that any form of price-fixing is contrary to their interest and an infringement of their rights.

It is impossible to make any law or any method of procedure successful in this country unless the public as a whole is favorably inclined to it. It becomes necessary then, I think, if we are going to adopt a system of controlled competition, to educate the public so that it will understand all that the system implies and be truly favorably inclined to it.

Unfortunately, price-fixing, as most of us in industry interpret it, deals with the fixing of the minimum price only, just as we are dealing with labor prices by fixing minimum prices for labor and leaving labor free to exact as high prices as it can where it has the power to exact them. In my opinion, it is just as unsocial for a bricklayer to exact $14 a day for laying about one-third as many bricks as he can comfortably lay as it is to pay a girl working on piece-work in a garment shop at a rate which will only yield her a dollar a day for a maximum of effort.

If we are going to fix prices, and I sincerely believe that it is necessary that we should do so, it is just as necessary that we limit them on the up-side as it is that we limit them on the down-side. My own belief is that there is in all cases a certain fair price at which commodities should move between the producer and the consumer: certain fair tolls which should be exacted by those who handle these commodities on their way from the producer to the consumer.

If I were in a position to write the ticket for industry in this country, I should give each industry the right to name the prices at which its products should be sold, and I should enforce these price determinations through the due process of law. In my opinion, these prices should be based on certain factors which would insure absolute fairness and equality of treatment to capital, management, labor, and consumers—the four factors involved in every transaction. I should determine these prices on the average industry cost, using replacement costs for raw material, adequate wage rates for labor, and overheads based on a reasonable use of the facilities of the industry. I should not expect this cost to include carrying charges on idle, unused, or excessive capacity. Executive salaries should be checked and should bear a reasonable relationship to the size of the company involved.

After determining these cost factors, the selling price should include a reasonable return, let us say ten per cent, on the true capital value of the active facilities in the industry, calculated on replacement values. No return should be figured for excessive valuations or watered capital.

I admit that this would be a difficult prescription for a good many of our old-time industrialists to swallow, who believe that industry exists primarily to create private profit. On the other hand, I believe that the majority of the men controlling American industry today would accept this thesis and be willing to operate on it if it were honestly and fairly administered. I believe that we have progressed at least to the point where a good many of our industrialists recognize the fact that the primary purpose of business is social service and not the creation of private profit.

As most of you gentlemen know, I have been engaged for many years in directing the affairs of several of our large national industries through their trade associations. It has been my experience that eighty per cent, both from the point of view of numbers and capital, engaged in all of the industries with which I am familiar have a broad social view towards the industries in which they are engaged and are more interested in the welfare of their industries as a whole than they are in their own selfish profits. I do not mean that this eighty per cent are theoretical altruists. There may be a certain amount of altruism in the position which they take, but, generally speaking, their position is dictated by their intelligence and by their knowledge that their success can only come through the success of the industries of which they are a part. Being human, they would probably like to amass large profits if they felt they could do so, but they recognize the impossibility of doing so and believe that it is better to have a small, reasonably well-assured profit than it is to go through periods of excessive profit to be succeeded by periods of excessive losses.

There seems to be some inherent connection in most people's minds between price-fixing and monopoly. Just what it is, I have never been able to determine. Monopoly, as I understand it, is the exclusive enjoyment of certain rights or privileges—industrially, the exclusive control of certain products. As a matter of fact, there is nothing that tends to bring about monopoly so rapidly as unrestricted competition; there is nothing that so protects us against monopoly as price-fixing, together with a proper distribution of business among those conducting an industry. However, that brings us back to my basic contention that we must face the facts and either continue to conduct the industry of this country on the basis of unrestricted competition, which I believe will destroy either the capitalistic system or the country itself, or else move forward to the system of controlled competition, with a frank and definite recognition that controlled competition does mean price-fixing but price-fixing properly controlled and checked in the public interest.

If prices could be fixed along the lines that I have suggested, it becomes evident that several things would happen. The public would be assured of an adequate supply of commodities at a truly fair price. It is evident that if an average industry price were established, certain companies would make more than normal profit and certain companies would make less than normal profit. In a desire to make more than normal profit, constant efforts to increase the efficiency of the industry would be made. Individual initiative would be preserved, and the fair industry price would be gradually reduced so that the public would be able to buy more of the products or to secure them at a lower price.

Inefficient companies would be gradually forced out of business or compelled to modernize and to improve their own efficiency, which, in turn, would further reduce the industry price level. Earnings on securities issued against the various companies engaged in industry would be stabilized, and a sound means would be provided for investing the funds of our savings banks and insurance companies as well as building up private estates.

There is one other thing that would happen which should, I think, be recognized, and that is that given a certain fixed price in an industry at which the products of the industry would have to sell, certain companies would be unable to secure their reasonable share of the business.

There are certain factors that enter into the movement of goods between producers and consumers beyond the basic question of price. Intangible factors of personality, of quality, which cannot be determined by standards, of service, and of location, enter into the problem.

We have found that in the industries operating under codes where, under the so-called open-price provisions of the code, true uniformity of price has been brought about, as in the electrical code, certain small companies are unable to secure an adequate share of the business. The executive body of the industry should be given power to recognize these conditions and should authorize companies who cannot secure their fair share of the business at the regular industry price to sell at a sufficient differential to secure a fair share of the available volume.

Here we run into the problem of prorating of business against which so many objections have been raised, and yet it is only through the definite or tacit recognition of this principle that the position of the relatively inefficient companies, whether small or large, can be maintained. Of course, if the industry price, which represents average industry cost and fair return on industry capital, provides a return for the average efficient company, it is obvious that if these inefficient companies must be given a differential below this price, they cannot expect to make any money unless they improve their methods and bring themselves up to the position where they can sell their product at the industry price.

I recognize that the picture which I have painted is, perhaps, an idealistic one. You may say it is theoretical. I do not think that that is a just charge. I believe that before we can accomplish anything in this world we must make a plan, a blueprint—in other words, that before we can do a thing we must predetermine what it is we want to do. I think the picture which I have painted represents, frankly, the ideal condition in the industry. I am equally certain that it could be attained if the right were given to the industries who are sufficiently advanced to be willing to accept these principles to attain it. It would mean that we would have to be given control over the fifteen or twenty per cent of unsocial men who exist in each of our industries. I know of at least five large industries in this country which, if they were given the right to organize along the lines indicated above and to definitely control the fifteen or twenty per cent of unsocially-minded men in their industries, would be willing to operate their industries on this basis. It would be my idea, through N. R. A., to give these industries the opportunity of doing this.

I do not think we should make this plan immediately compulsory on all industries. On the other hand, I do believe that where seventy-five per cent of the number engaged and seventy-five per cent of the capital involved in each industry desire to operate along the control lines outlined above, they should be given the power to do so with definite control over the recalcitrant minorities. We could then watch the results secured by the industries operating along the lines outlined above. If these results proved to be what I believe they would be, we should then be able to convince the public that its true interests were best served by controlling and fixing price, and we could gradually extend the system to other industries. Until we do give the system a fair trial, our discussion of the results must necessarily be more or less theoretical.

The National Industrial Recovery Act has about a year more to run. It would be very helpful if we could actually try running four or five of our industries on the basis I have outlined so we would have their experience to guide us when we come to recast the law into permanent form.

I have gone to some detail in laying before you my ideas as to how prices should be controlled, because, important as it is to control them in the best way possible under present conditions and during the year that the National Industrial Recovery Act has to run, I am much more concerned over our future policy in regard to prices and industry control than I am with the present situation. Feeling as I do that we have entered a new era and that the methods of business and industry control which we have used in the old era are inadequate to produce the results which we all want to produce in this new era, I think you will agree with me that the most important duty for every man who is capable of thought and who is interested in the future of the country, both from his own and his children's point of view, is to give the best thought of which he is capable to a determination of our future course.

Why do I feel so imperatively the need of charting the future course of business? I feel it because in the terms "business" and "industry" we cover the whole basic problem of operating our country and of serving the material and spiritual needs of our people. It is through business and industry that our people secure the food, the clothing, the houses, the transportation, the education, the health and recreational services which are necessary to their well-being. In the era of scarcity our people were not satisfied but were willing to get along with practically the bare necessities of life, but the paradox of the thing is that in the period of scarcity people were practically assured of their ability to obtain the bare necessities of life through the enormous demand for human labor and effort in the development of our country. In our present era of plenty, demanding more than they ever demanded before, with the resources and productive plants to supply them with what they wish, they find themselves so inmeshed in the intricacies of machine production that they can no longer be sure of securing even bare sustenance except through private or public dole.

Now, gentlemen, there are certain things which the people of this country are going to have:

First—Adequate supply of the primary necessities—Food, Clothing, Shelter
Second—Adequate supply of the secondary necessities—Education, Health Service, Recreation
Third—Economic Security.

Let us examine these requirements and see if they can actually be met with the materials, plants, energy, and labor available in this country.

We hear a great deal of loose talk about being able to supply these basic requirements to everybody in the world. A very cursory analysis of the productive capacity of the world in relation to world population shows that this is an absurd fallacy. However, I do not think we are concerned at the moment with the economic problem of the whole world population. I know I am not What I am concerned about is whether we can do what we want to do with the 120,000,000 people who live in the United States of America. If we can work out a system which will produce the desired results in our own country, the rest of the world can adopt our system if it sees fit and profits by it.

What we want to determine then is whether it is possible, with what we have, to provide what we want to provide for all of our people. The best analysis of this question which I have yet seen is to be found in the third chapter of Stuart Chase's latest book, *The Economy of*

Abundance. Chase shows conclusively from facts and figures, which he has collected with painstaking care, that there is no difficulty in oversupplying food necessities and, second, that there is no difficulty in oversupplying clothing necessities.

When we come to the question of shelter, however, we find a different story. Generally speaking, the question of shelter presents a difficult problem. One does not realize how inadequately America is sheltered and what a tremendous necessity exists for the building of new and adequate houses for our people. To supply adequate shelter for the 80,000,000 people who are now living in inadequate homes would require a readjustment of our methods of financing the building of houses and apartments. This is probably the greatest problem that America has to face, and it would be several years before this housing problem could be properly met.

As a matter of fact, it is probably in the providing of adequate houses that one of the best solutions of our present difficulty lies. We have oversupplied ourselves with productive plants. Men who formerly were employed in building these plants and operating them are now out of employment. If we could put the men who are now out of employment from these sources to work building the houses which are necessary to decently house the American people, we could supply employment for every one requiring employment for several years to come.

It is difficult to understand why so much opposition exists to attacking the problem from this angle. Opposition springs from the owners of present property, the values of which would be destroyed if adequate housing were provided to replace dilapidated and unsatisfactory houses and apartments which are now housing so many of our people.

A still further difficulty is the fact that the people for whom these houses should be provided have no money with which to pay for them. The methods of financing housing are so complicated and expensive that it is impossible for them to secure the credit which should be extended to them. It should be just as easy to buy a new house as it is to buy an automobile, and, if the building of houses were properly organized, the cost of houses could be reduced in much the same way that the cost of automobiles has been reduced in the last fifteen years.

The supply of raw materials necessary to build these houses exists. The factories necessary to fabricate these raw materials exist. The labor necessary to put the materials together exists. It is merely a question of organization to meet this requirement.

Chase further shows that while education, health service, and recreation are at the present time inadequate, it is perfectly possible to create the additional teachers, the additional doctors, and the additional nurses necessary. As a matter of fact, providing of adequate educational and health service would go far towards solving the problem of employment for the more intelligent section of the unemployed. Recreation seems to be adequately provided for even at the present time. Whether it is of a desirable character and whether it is provided at a proper cost is another question.

There is no doubt, however, that the resources of the country are such as to provide all that is necessary. In other words, an analysis of our ability to provide these requirements, which the people of our country demand, shows that the ability exists.

We come next to the final requirement, which is perhaps the most important of all, namely, economic security. The gnawing fear of losing one's place in the economic structure overhangs every household in America, from the lowest to the highest. I venture the assertion that there is not one of us in this room this afternoon that has not in the back of his mind the fear of what would happen to him if he lost his job or his money, for none of us has any assurance that we could again be absorbed into the mechanism which we have created. When fear is necessary, it must be borne; when fear is unnecessary, it is intolerable. We must operate under a system which will provide an opportunity for every man who is willing and able to work to earn a generous living and to obtain his share of the natural resources and productive capacity of the country.

Now, if these are the requirements which the people of this country are going to demand, and if the resources at our disposal are sufficient to provide them, it seems to me that the important thing for us to do is to determine what system will best produce the desired results.

There seem to be two extreme points of view. On one side we have the advocates of unrestricted individualism and competition and on the other side those who advocate the socialization of industry. Under this latter heading we find Socialists and Communists of varying shades of opinion, but all are in favor of the socialization of industry, the destruction of the capitalistic system, and, to a large extent, the elimination of private ownership.

To my mind, the reactionists on the right are as great a menace to the well-being of the country as the radicals on the left. There is this to be said, however, and that is that the capitalistic system as it has so far been carried on, a system of rugged individualism and unrestricted competition, has not succeeded in producing the results which we have got to produce in this country. In my opinion, it is impossible to produce the desired results under this system. On the other hand, I am very sure that we do not want to adopt the Socialistic or Communistic systems if we can possibly avoid doing so.

There is no doubt that America is a nation of individuals. There is no doubt that we want to preserve our individualism. There is no doubt that we believe in the ownership of private property and that we want to continue the capitalistic system, the ownership of private property, and the freedom of the individual in so far as it is possible to do so and still secure our main objectives.

I believe that we can accomplish all of these results by recognition of the basic principle that the fundamental purpose of business is service and not private profit. In other words, I reiterate what I have already said, that all business is clothed with public interest and should be operated from the public interest standpoint. This does not mean the socialization of industry. On the contrary, it means continued private ownership. It does not interfere in any way with individual initiative, but it does limit the profits of industry and throws back to the people as a whole a constantly increasing share of the products of industry.

All of this depends, in my opinion, on the formulation of the right policy of price determination along the lines which I have indicated this afternoon. Gentlemen, what I have tried to present to you this afternoon is a basic formula for conducting the business of the country under what I choose to call the system of controlled capitalism. It occupies the middle ground between the extreme right and the extreme left. The course which I propose is as objectionable to the radicals on the left as it is to the reactionists on the right, but it seems to me that it must appeal to any one who believes that the well-being of the many is more important than the well-being of the few, but who believes that this should be accomplished without completely destroying the private ownership of property.

I may be wrong, but there are many indications to me that the reactionary forces are gaining ground and that a considerable part of the progress which we have made in the last two years in the direction of developing a new system may be lost. I can conceive of no greater calamity which could befall this country than for the reactionary forces to gain control again and force a return to the old methods which have brought about our present condition. If this occurs, we will create a volume of discontent and so feed the forces of radicalism that when the next breakdown occurs in the system, we shall be confronted by a revolution which may take the form of violence.

While it is true that what we have done in the last fifteen months has been revolutionary, it has been a peaceful revolution of an exceedingly mild nature. I do not see any likelihood at the moment of the radical forces on the left running away with the situation. That will only come if the reasonable revolution which we are now carrying on falters and fails and the forces on the right again impose their system on the country.

Gentlemen, what I am contending for is probably the hardest thing in the world to achieve—the middle-of-the-road course—the recognition that a change is necessary and the development of new methods in an orderly and reasonable way.

The National Industrial Recovery Act, which gives industry, theoretically at least, the right to control itself, runs out next June. As I have already stated, the way in which the Act is being carried out is a disappointment, but it is so far in advance of our old method, it holds out so much hope of enabling us to conduct experiments along the lines of true control that those of us who believe in the basic principles which underlie it must rally to its defense. Not only must we rally to its defense but we should, in my opinion, if you feel at all about the matter as I do, use all of our ability and intelligence to see that when the Act is reframed, opportunity is given to at least try out the basic principle of operating business from the standpoint of social service instead of private profit through the mechanism of the fair industry price adequately checked and controlled in the public interest.

CHAIRMAN GUNNARSON: Mr. Stevenson, the attentive interest shown by your audience is ample evidence that you have given them something to think about. I think you have stimulated their thoughts, because during your address I noticed nods of the head, both affirmatively and negatively. This would indicate that we can expect some animated discussion from the members before this convention adjourns.

Mr. Stevenson has laid a broad foundation with respect to price-fixing and selling below costs. We are to have a second paper along somewhat similar lines. It is to be presented by Mr. Howard C. Greer, one of our members from Chicago, who is in charge of Accounting for the Institute of American Meat Packers. I shall now call on Mr. Greer.

PROBLEMS IN THE APPLICATION OF CODE PROVISIONS AGAINST SELLING BELOW COST

Howard C. Greer
Director of Accounting, Institute of American Meat Packers, Chicago, Illinois

THE preceding speaker has indicated that he expects me to take issue with him on some of the points raised in his talk. Certainly I am not going to take issue with him as to the seriousness of the problem we are discussing. Certainly I am not going to question his earnest study of the problem or his intense convictions on the subject. In point of fact I feel somewhat presumptuous in expressing any views that run counter to his, when he is obviously so well informed on the subject and has given so much thought and effort to the problem.

I share strongly his view that industry must ultimately become an undertaking dedicated primarily to service rather than to profit. I share his view that the elimination of destructive price-cutting as a competitive weapon is most desirable. We differ only in our appraisal of the methods which are most likely to bring about the accomplishment of the ideals of business service and business administration which we both cherish.

Before I go on to express those ideas which I believe to be worthy of your consideration in this connection, I wish to stress the point that these remarks are of a purely personal character. They express merely my own individual views and in no way represent the opinion or sentiment of any organization or group of people with which I have any connection. I submit them not in any formal way or with any weight of authority behind them, but merely as a means of possibly stimulating your thinking and suggesting a point of view which I believe is being given too little consideration at the present time.

I take it that the premises of our discussion have been well laid in the papers given here previously today. All of us are familiar with the evolution of the plans for a self-controlled industry which were presented by the government about a year ago, and accepted hopefully, if not eagerly, by the industry and commerce of this country. It was said freely that the government would now abolish the unrestricted action of economic forces and would substitute regulations and compulsion based on the joint opinion of business men and representatives of government. We were to substitute for business as it was, business as it ought to be.

The primary objective of the government was to get more men back to work. In exchange for its cooperation in the matter of re-employment, higher wages, etc., industry was promised, or led to expect, that it would be given permission to control trade practices and possibly prices, through a set of rules, and that it would be freed from the danger of prosecution under the anti-trust laws for such activities.

The portion of this program on which most business men seized with the greatest enthusiasm was that which seemed to authorize the fixing of prices. Most of the codes which have been adopted—particularly the earlier ones—contain provisions for the fixing of prices in the industry, whether directly by agreement or indirectly by the application of some formula. These formulas sometimes represented purely arbitrary methods of arriving at selling prices, but most frequently took the form of prohibitions against the making of sales "below cost."

We are all aware that the N. R. A., under one influence or another, has steadily retreated from the position which business men understood that it was taking at the outset in the matter of price-fixing. It has been announced recently that outright price-fixing arrangements will not be permitted in future codes, and that any provisions which seem to afford what the business man calls "cost protection," must be modified so as to eliminate any possibility of monopolistic practices in the setting of prices. Many people, however,—both those in the National Recovery Administration itself and those in business—feel that minimum price-fixing arrangements of some kind are indispensable to the operation of the whole N. R. A. program. It seems to me worth while to examine this view, not so much from the standpoint of the N. R. A. program, but from the more general standpoint of the future welfare of industry.

It is easy to see a great many dangers and difficulties in outright price-fixing by agreement. Representatives of the consumers interests were quick to attack such provisions in codes, and they have been generally credited with the responsibility for abandonment of the policy permitting such agreements. Now, while I do not propose to give consideration in this talk to the consumers aspect of the problem, I believe it is worth suggesting in passing that the possible exploitation of the consumer through price-fixing is considerably overestimated. The consumer, after all, has only a certain amount of money to spend, and that amount is not increased by price-fixing activities on the part of the people who supply his wants. He may be made to suffer through a reduction in the total output of goods, which is almost certain to accompany the fixing of unreasonable high prices, but he cannot be forced to pay higher prices and still consume the same quantity of all the various goods he is buying. The consumer's reaction to fixed prices is likely to be much more serious to the producer than to the consumer himself.

This brings us to a consideration of the problem from the standpoint of industry—that is, whether price-fixing of any kind is beneficial to industry and should be adopted and encouraged if proper legal sanction can be obtained. This is a complicated question, and one to which a simple yes or no answer is not possible. We can only consider the various elements in the situation and try to weigh their relative importance in determining sound business policy in this field.

As I have listened to discussions on this subject and have reviewed the literature dealing with it, I have been impressed with the apparent conflicts of judgment which are not really conflicts but rather differences in the point of view from which the judgment has been formulated We may attempt to determine, for example, what is a satisfactory policy for meeting an emergency, trying an experiment, or setting up a short-range program. This involves a somewhat opportunistic attitude, a resort to expedients, the adoption of whatever promises prompt assistance in a desperate situation. We may, on the other hand, attempt to discover what will be of the greatest lasting benefit, what is suitable for a long-time program, what is basically sound. We then attempt to develop fundamental principles, which may sometimes have to be abandoned temporarily, but which should be a means of guidance whenever we are attempting to build a plan that will be serviceable over long periods of time under what may be considered normal conditions. With these two points of view, it is usually easy to criticize one program in terms of the other; hence the apparent differences of opinion between those who are fundamentally in agreement.

For example, I believe it can safely be said that as a long-run proposition the prices of products and commodities generally cannot be fixed arbitrarily by anyone. As a short-run proposition prices can be fixed arbitrarily, and certainly are in many instances. Perhaps we should consider what will happen in the long run if we proceed with a given short-run policy. It is even possible to argue that the ultimate collapse of a short-run program does not necessarily represent a failure to attain its objectives.

In this discussion of price regulation through code provisions against selling below cost we encounter another conflict of opinion which is in reality a difference in point of view. We speak of these activities as though they have in all instances identical objectives. As a matter of fact the definition of selling below cost adopted by some industries is so entirely different from that adopted by other industries that neither the objectives nor the arguments in defence of them are anywhere near the same. Due to the confusion of our thinking on this subject, accountants may find their assent to one set of principles so twisted that it represents an endorsement of something quite different, both in character and in effect.

Almost everyone is convinced that there are sound objectives to what we loosely call destructive price-cutting or cutthroat competition. What we mean by these terms is the deliberate acceptance of business by some enterprises at unprofitable prices, prices below their costs, for the purpose of injuring a supposedly weaker competitor who cannot afford to sustain the losses incident to doing business at such prices. Even the representatives of consumers usually offer no objection to the thesis that this is a bad practice and ought to be stopped if possible.

Let us note, however, where this argument is made to lead. Selling below cost is a vicious and destructive practice. But what constitutes cost? The manufacturer answers, "Cost is the total cost of producing and selling the article in question." This position is supported promptly and vigorously by the cost accountant. He has argued for years that selling prices should reflect all costs, including production, distribution, administrative and financial charges. His formula will be an all-inclusive one. When the cost accountant gets through with his computation of total cost, the manufacturer will add what he calls a "reasonable profit." It is a vicious practice, he will say, to sell at anything other than cost plus a reasonable profit.

Unfortunately we are now quite a distance off base. Rigid application of this theory would mean that no product could ever be sold at a price *which would not be profitable if all sales were made on the same basis.* This is something quite different from providing against willful price-cutting to injure a competitor.

As accountants you gentlemen all know that in most industries some goods must always be sold, and all goods must sometimes be sold, at prices lower than those which will be arrived at by such a formula. When any single sale is under consideration, the question to be answered by a business unit is not whether the price will cover every element of cost plus a profit, but whether the company will be better off as a result of making the sale at whatever price can be obtained than it will be if it does not make the sale at all.

Many products will not carry all the overhead which would be assigned to them under a rigid cost-apportionment system. On many occasions a factory is glad to get business which will cover out-of-pocket costs and contribute something toward general overhead. The arbitrary prohibition against entering into any business transactions on such a price basis is probably impossible, certainly impractical.

If we set out to prove that a given price policy is deliberately destructive, we must probably be prepared to prove that the seller is not recovering even his direct out-of-pocket costs for labor, materials, etc. If he is getting anything over and above such costs, the business may be profitable to him, in the sense that he will be better off for handling it. My conviction is that we might possibly be able to enforce rules against selling below cost if we confine them to sales below out-of-pocket cost. This, however, is a long way from what manufacturers want, and the rule would actually cover such a relatively small proportion of the cases which industry is seeking to eliminate, that most business men probably feel that it would hardly be worth while to make the effort.

Let us consider, then, the type of selling-below-cost provision which is far more common, and which many of us have been called on during the past year to develop for industries with which we have some contact. Under these code provisions the usual type of cost formula provides for inclusion of all direct expenses, all factory overhead, the expense of storing, handling, delivering, and selling, and an allowance for administrative expenses. Some of the formulas eliminate one or more of these items, and some include still additional items, such as advertising, experimental and development expense, interest on investment, etc. Is it sound and practical to impose such a code provision on an industry and will it work out to the advantage of the industry?

The objections of such a policy are of three kinds. Two have been discussed at such length that I shall merely mention them here without attempting to develop the arguments pro and con.

One objection is that under the best of formulas, costs are difficult to define and determine precisely, completely, comparably, and equitably. The difficulties are impressive but, in my opinion, not insurmountable. I have sufficient confidence in the ability and ingenuity of American cost accountants to believe that in the long run this phase of the problem can be met, and that industries can determine and agree on cost methods and cost figures which shall be satisfactory for the purposes mentioned.

The second objection to the policy is that enforcement of such code provisions are impossible because of the vast number of transactions involved, the delay attendant on finding and proving violations, and the great difficulty of exacting penalties and correcting injustices. This problem seems to me much more serious, and I agree fully with the writer for the Brookings Institution, who in his booklet *Price Control*

Provisions in N. R. A. Codes, observes that enforcement probably will be possible only in those industries where there is a nearly unanimous *voluntary* adherence to the code provisions.

The third objection, and the one to which I want to ask your particular attention, is that such provisions, even if honestly and effectively enforced, may not be in the interests of the industries which seek to benefit by them. I shall try to point out what seemed to me the compelling reasons for considering such undertakings as representing at best a temporary expedient, designed to meet an emergency, and not as a part of fundamental business philosophy and practice.

Most business men want permission to fix prices by agreement. There are many who question the soundness and effectiveness of such a policy, but numerically the great majority in many if not most industries would welcome with the greatest enthusiasm an unrestricted opportunity to meet with competitors and agree on the price to be charged for their products.

It is no secret, of course, that this sort of thing has been done in many lines of business, regularly or irregularly, for many generations. There are probably no exceptions to the rule that such agreements have been made only to be broken or abandoned, and that no schedule of fixed prices has ever stayed put over any long period of time. With all this experience behind them, many business men still seem not to realize that large-scale, long-time price-fixing has never worked and never will work. They cannot understand why anything that functions so well for a short time will not continue to function well indefinitely.

The error in their point of view is based, I believe, on a fundamental misconception of the nature and function of price in our business economy—an error to which, I regret to say, cost accountants have contributed as grievously as any other group of people.

Prices are *measures* of the *relative value* of various commodities *in exchange* for one another. Since they are merely measures, and measures of relationships at that, the fixing of all prices is inherently impossible in the very nature of the case.

So long as prices represent values, they must depend on the things which give rise to value. You can not create value by fiat. Value depends on the desirability of the product, its usefulness, the extent to which it is wanted by prospective purchasers. All values are necessarily relative to one another, and these relationships are inherent.

When a price is "fixed" in terms of the ideas of those who have goods to sell, it ceases to become a measure of the value of those goods and becomes an arbitrary rule governing exchanges of products between individuals. The effect of adopting and enforcing such rules is not to change values, but merely to force people to transact exchanges according to arbitrary terms. The inevitable effect of such regulation is that much potential business will not be transacted at all. If the price of an article is too high, people will do without it, or shift to some alternative product.

It makes no particular difference whether the arbitrary price set is based on "costs," or taken out of thin air. The mere fact that an article costs a certain amount does not make it worth that much. Business men are obsessed with the idea that they create values by incurring costs—which is good cost accounting but rotten economics. Business men are forever saying that they are "entitled" to the recovery of their costs plus a profit, that any additional costs will result in increasing the price of the product, that prices must reflect costs, etc. With this sort of background of thinking it is natural that they lean toward the idea of prices fixed by agreement on the basis of costs.

Now actually prices are not controlled by costs, either as to individual products and businesses, or as to commodities and industries as a whole. If anyone seriously thinks they are, he has only to consider the multitude of examples to the contrary which are obvious on every hand. If values depend on costs, why did practically all business concerns in the United States sell the major portion of their goods at a loss in 1932? What accounts for the fact that in every year there are large numbers of individual companies, and many whole industries, which fail to recover their costs in their selling prices? Why did a great majority of all the interurban railroads in the United States become unable to sell their services for more than cost in the decade following 1920? And, on the other hand, why has it been possible for the manufacturers of many specialty items to sell their products at prices representing from ten to a hundred times the cost of production.

The answer is simple; prices are controlled by values, not by costs. Rather than say that costs control prices it would be more nearly accurate to say that prices control costs. What a manufacturer can afford to pay for the labor and materials which go into his product is determined by what purchasers are willing to pay for the product.

That, however, is still an incomplete statement of the case. Actually there are three elements in the equation—selling price, costs, and volume of business. These elements are inevitably interrelated. Changes in one element are accompanied by changes in the other two. Often it is impossible to say which change is a cause and which is an effect, just as it may be impossible to say whether a property is valuable because it yields a high return or whether the return is high because the property is valuable.

The meat packing business, with which I have been connected for a number of years, offers a striking example of the operation of these three factors in determining the course of business. I believe the factors are equally important in practically all lines of business, but they happen to be particularly obvious in a business such as ours.

In certain seasons of the year the supplies of live stock ready for marketing are greater than at other seasons. It is the policy of the meat packing companies to buy such excess supplies as and when offered, to process them into meat products, and to store any excess products until some time when the live stock supplies are lighter and there is a better opportunity to move the products into consumption. Thus we ordinarily expect to see our stocks of pork products increase each month from November or December to April or May, and then to decrease during the balance of the year.

The accumulation and distribution of these stocks of products is controlled through the medium of price. We can always sell more meat by lowering prices; we can always raise prices if we are willing to sell less. If we think our stocks are accumulating too rapidly in the fall and winter, or are not moving out fast enough in the late spring and summer, we adjust our prices to whatever extent is necessary. Conversely, if we feel that our supplies are too moderate and that smaller live stock runs may be anticipated, we stiffen up our prices and hold our products off the market.

What the product originally cost scarcely influences our selling price at all. Rather, the selling prices which we can obtain, or hope to obtain in the future, influence the cost which we are willing to incur in acquiring our raw materials. Prices of hogs and cattle rise and fall with the present and prospective prices of pork and beef. Our volume of sales rises and falls as we deliberately adjust it, through the medium of price, to the available supplies of live stock and to the present and prospective stocks of product.

I do not mean to imply that there is any concerted action along these lines by meat packing companies. Each company follows its own policy, and oftentimes the policies of various companies will differ radically, depending on their view of the present and probable future market situation. The aggregate of all of the individual policies, however, provides the effect I have just discussed in adjusting selling prices, costs, and volume.

Now, of course, our industry is different from others in some respects. We do not control our supply of raw materials, but handle all that is offered by live stock producers. Even industries which do control their raw materials and supplies, however, are subject to the same laws of price, cost, and volume. You may be able to choose whether you will have volume or price, but there are few cases in which you can have them both without limit.

You may think these are theoretical considerations. Let me assure you that they are exceedingly practical considerations in the meat packing industry. But if they seem theoretical, let us turn to the necessary practical effects of a price-fixing policy in an industry of some other type.

The preceding speaker, and many other speakers and writers of note, believe that there is some "fair" price for every product, which can be determined (by formula or otherwise), and that when this fair price has been discovered, all we need is a rule prohibiting people from buying or selling goods at any other price. I find myself completely baffled at the problem of setting fair prices for all commodities or even any one commodity. What possible measure of the fairness of price can there be, other than what people are willing to pay? The Interstate Commerce Commission and the numerous public utility commissions have been struggling for years with this problem as it relates to a few commodities and services which are furnished practically on a monopoly basis, but few people feel that they have arrived at any very acceptable solutions.

Setting a fair price involves an evaluation of the services of labor, the proper returns to capital, etc. It also involves an assumption that the industry is reasonably efficient, not overbuilt or overpromoted, that its products are useful and desirable in proportion to their costs, and many others things. I know of no criterion which can be applied to measure the fairness of a price when such factors are taken into consideration.

But let us suppose for the sake of argument that by some magical means we have developed a fair price—high enough to satisfy every producer and justifiable on the basis of some cost formula as to the goods in question. What will be the effect if we prescribe that all goods shall be sold at not less than that price?

First, as to the industry as a whole. It is almost inevitable that the price will bring about some restriction of the volume which might otherwise be attained. Expansion of volume will be curbed. This may easily be at the expense of potential profits. We all know the history of the enormous earnings of the automobile industry, which was led for years by a manufacturer whose cardinal principle of operation was to cut his prices below his costs and trust to obtaining sufficient additional volume to achieve lower costs and a restored margin of profit. One of the speakers on this morning's program emphasized the tremendous development of business in his line, due to a willingness to accept lower prices for the sake of greater volume. It is questionable whether most industries can afford to close the door permanently to such expansion and profits by some rigid price-fixing formula.

If the price fixed is as high as most manufacturers will want it, there is an almost inevitable encouragement to the use of substitute products. Almost every item has some substitute which will come into general favor as soon as undue price disparity appears. Does an industry want to build up its competitor industries through such methods?

A further misfortune is likely to befall an industry through reduction of the pressure for efficiency, of the demand for improvements in products and methods. Business enterprises quickly become soft and flabby if they are protected by a wall of artificial prices. High cost operators no longer find it necessary to cut expenses, and soon the entire industry is attacked by the pressure of competition from competing products.

Second, as to the relations between units in the industry. If the aggregate volume of business to be done by the industry is restricted in some artificial way, it is clear that it must be done either through some apportionment of the available volume between the operating units in the industry, or through the establishment of some system of price differentials which will automatically distribute the volume in a satisfactory way. Not everyone can sell his entire output at an identical price; some products and some services are more in demand than others. Some way must be found of directing the demand into the channels which the industry wishes it to follow.

If it is decided to apportion the volume between companies in some arbitrary way, the industry is faced with the necessity of determining what constitutes a fair share for each unit. This involves each unit in efforts to secure the favor of the code authority in the furtherance of its individual interests. It takes the development of the business out of the realm of economics and puts it into the realm of politics. Even if it can be done to the satisfaction of the participants, the tendency seems to me unwholesome.

If instead of alloting the business on some arbitrary basis, the various units are permitted to establish price differentials (presumably in line with the relative desirability of their products) the problem of "fair share" does not altogether disappear. It is further complicated by the fact that consumer preferences are not static, so that a given set of differentials which are satisfactory at one time may be wholly unsatisfactory at another.

With apportioned volume and a prohibition against sales below cost the opportunity for new units to enter a field is greatly limited, if not removed altogether. In some industries there is no way for a new industry to obtain a quota; under the code provisions, if enforced, the business would remain forevermore in the hands of those now engaged in it. What sort of a situation would this create for the rising generation of business men, if all industries were so restricted that no new operator could enter any of them?

Third, as to the effect on individual companies. It is clear that freedom of initiative in matters of developing markets and merchandising products would be largely destroyed. The ordinary weapons of competition would be removed. It is easy to see how a restriction of this kind might well be fatal to many business units even though they had the greatly desired benefit of so-called price protection. They would have to forego business which might increase their profits and which might be satisfactory to their customers. They might have to discontinue some lines of product and some channels of distribution, even though satisfactory to them and to those with whom they deal. They might even be forced out of business if the advantages of selling a low-cost, low-priced product were taken away from them. There is no advantage in a high price at which no goods are sold.

But, finally, and most important of all—does anyone suppose that a popular government would permanently permit business to fix its own prices on such a basis as to guarantee the recovery of costs and the earnings of what business men would consider a reasonable profit? This seems to me inconceivable. I see no escape from the conclusion that if such a system of cost-calculating and price-fixing were to be set up in all industries, it would merely constitute the machinery which would then be taken over and used by the government to regulate profits down to whatever minimum (or negative) amount the exigencies of a political situation might require. Has business reached the point where it wishes to sign away the opportunity for its individual component parts to do a bigger and better and more profitable business at some more fortunate future time?

You have heard many people say that individualism in business has failed, that the system of free competition must be abandoned if capitalism is to be saved. For my part I can say that if a reasonably free competition in business activity must be abandoned, then capitalism might just as well be abandoned along with it In fact it is hard to understand how one can be preserved without the other. Competition is inherent in the nature of capitalism, as we understand and practice it.

As a matter of fact, there is no proof that free competition had anything important to do with our lamented business collapse. It can be argued with equal force that restrictions on free competition and the obstacles to normal trade relations, created by political and other artificial barriers, were the things responsible for the state of disorder into which we have fallen. All of us agree, doubtless, that we should curb the type of piracy, faking, and under-handed double-dealing which have characterized some business activity. Fundamentally, however, we should probably do well to devote more attention to obtaining adequate distribution for such benefits as flow from a normal functioning of business enterprises, than in trying to fix and control the amount of benefits themselves. We must have something to divide before we can do a very satisfactory job of dividing it.

It seems to me, therefore, that we cannot regard price-fixing among competitors, on the basis of cost formulas or otherwise, as offering anything like salvation to hard-pressed business enterprises. For industries or for individual concerns it seems to me to offer more of danger and difficulty than of protection and help. If it can be justified at all it must be as an expedient to meet an emergency situation. If we let the principle of competition disappear we are likely to find that the structure of capitalism has disappeared along with it.

I am saying this to you gentlemen, as cost accountants, particularly because I believe that those in our profession can play a most important part in building up sound business policies, by making clear to business men the underlying cost implications in some of the proposals which are so popular at the present time. I am anxious to see accountants measure up to their opportunities and responsibilities in this connection.

I am also anxious that we shall not permit ourselves a false conception on the importance of some of these current discussions, and lose sight of the essential functions which cost accounting performs. In this connection I can do no better than to quote from a recent talk by Professor Herbert Taggart, himself a representative of the N. R. A., in which he made the following observations:

> The primary justification for cost accounting has always been and must continue to be that it is an essential tool of management. Cost accountants can make a good case for themselves, in the long run, only in this

> field. Cost accounting is not primarily a price-making device. The present emphasis on this function is not healthy. Cost systems set up and installed with an eye single to price-making are bound to lose caste when the emergency is over and the emphasis on prices as a basis of fair competition is past.
>
> Cost accountants must continue, as in the past, to prove their worth to management on the ground that they furnish facts for the guidance of internal policies. They furnish data on what to produce and how to produce it, on who is efficient and who is not, and why; on wastes and losses and how to correct them; on savings and the rewards therefor; on what departments, branches, lines, and products are making money, and what are not. If cost accounting cannot be sold for these purposes, it cannot permanently be sold at all.

In all of which I most heartily concur.

CHAIRMAN GUNNARSON: Thank you, Mr. Greer, for focusing our attention on some fundamental problems. There can be no question now that our discussion sessions will bring forth many points of view regarding the problems presented.

As Mr. Greer was speaking, I recalled an incident that occurred at one time in an army camp. It is related that a Major of infantry was being transferred to a new post. In accordance with regulations a Sergeant of the Quarter-Master Corps was detailed to take an inventory of the Major's household effects as they were being packed for shipment to his new post.

The Sergeant proceeded to take inventory. In the living room, he made entries on the inventory sheet: "1 divan," "1 upholstered chair," and so on. He came to the dining room and entered on his sheet: "1 dining room table," "6 dining room chairs," "1 buffet," "glasses," "dishes" and all the other items found. Finally toward the end of the sheet there was this entry: "6 pints whiskey." Evidently this man was not an accountant, because he had crossed off the "6" and made the entry read: "5 pints whiskey." Not only that, but he had crossed off the "5" and entered: "4 pints whiskey." Finally, in writing which was barely legible, he had: "3 pints whiskey." On the bottom of the sheet in letters of uncertain form and size was this final entry: "1 revolving carpet."

I hope that the presentations made by our speakers today have not left you in that frame of mind.

Lack of time precludes our consideration of the questions discussed this afternoon. I want to remind you, however, that on Thursday we have set aside all of our sessions for an open forum, at which time any questions that have been raised may be discussed fully.

Having completed my function as Chairman of today's sessions, I want to take this opportunity of extending to you my deep appreciation for your attentativeness. I also want to thank Mr. Stevenson and Mr. Greer for their thoughtful and stimulating addresses this afternoon. Thank you, gentlemen.

. . . The meeting adjourned at five o'clock. . . .

SESSION III

PROBLEMS IN THE APPLICATION OF UNIFORM COST ACCOUNTING METHODS

WEDNESDAY MORNING, JUNE 27, 1934

C. Howard Knapp, Vice President and Controller,
Waitt and Bond, Inc , Newark, New Jersey
Chairman

VERL L. ELLIOTT was born in Edna, Kansas. He graduated from the Commercial Course of Labette County, Kansas, High School. While in the Ordnance Department of the Army, he worked on several of the larger cost-plus Government war contracts in the vicinity of Wilmington, Delaware; Philadelphia, Pa.; and New York City. After the war, he graduated from the Wharton School of Accounts and Finance of the University of Pennsylvania. He joined the National Association of Cost Accountants in 1921, and served for two years as director of the Philadelphia Chapter. He is also a member of the National Office Management Association, and the Controllers' Institute of America. He has taken an active part in the work of the Uniform Accounting Committee of the American Petroleum Institute, and has been chairman of the Committee for the past three years. He is a member of the Accounting Committee of the Oil Code Authority (Planning and Coordination Committee). Since 1921, he has been with The Atlantic Refining Company, Philadelphia, of which company he is Controller and General Office Manager.

MARTIN A. MOORE was educated at Seton Hall Preparatory School, Newark Institute of Arts and Sciences and New York University, where he was awarded the degree of Bachelor of Commercial Science in 1926. He also attended the Graduate School of Business Administration at New York University and has successfully passed the New York State Certified Public Accountants' examination. Aside from spending two years in public accounting work, his remaining experience has been with the Hyatt Roller Bearing Company, where he has functioned as Controller for the past six years He has addressed the Newark, Reading and New Haven chapters and at the present time is Vice President of the Newark Chapter.

DOMER E. DEWEY was graduated from the Wharton School of Accounts and Finance of the University of Pennsylvania, in 1924, and was then employed by the Syracuse Cabinet Company in the capacity of cost accountant, which position he held for a period of two years. In 1926 he became associated with the Laundryowners' National Association of the United States and Canada, and was transferred to an affiliated organization, the American Institute Laundry, as Plant Manager, which position he held until 1927 He was then appointed Assistant Secretary-Treasurer of the American Institute of Laundering, Incorporated, the parent company. He held this position until 1930, when he returned to the Laundryowners' National Association, and at the present time is Director of that association's Department of Accounting.

PROBLEMS IN THE APPLICATION OF UNIFORM COST ACCOUNTING METHODS

CHAIRMAN MARSH: Having learned yesterday what the National Industrial Recovery Act was all about, and having discussed a great many of the price-control features and allotment features, we now come this morning to the problems in the application of uniform cost accounting methods.

This afternoon we shall discuss the standard costs in the codes and problems of statistical reports under the codes.

The Chairman for today's session is Mr. Howard Knapp. Mr. Knapp is Vice President and Controller for Waitt & Bond, Inc., Congress Cigar Company, and Porto Rican American Tobacco Company of Newark. Mr. Knapp was formerly President of the Newark Chapter and is now one of the National Directors of our Association.

It gives me great pleasure to introduce to you Mr. Howard Knapp, the Chairman for today.

CHAIRMAN KNAPP: We certainly have been fortunate this year in getting off to one of the finest starts that we ever have had at any convention. Monday, as most of you know, the day was perfect and we had a marvelous golf outing. Several of the caddies told me it was one of the greatest treats they ever had in all their lives. They had caddied for open tournaments and that sort of thing, but never in the experience of many had they seen as many unusual shots as they witnessed that day.

I learned of one of these most unusual shots in the locker room. The reason I think there might be some truth to this one is because I heard it in the locker room before the usual locker room festivities started. It was the case of Charlie Reitell, whom almost all of you know. It was the first time he had ever played golf, and I think that Hagen or Dutra or any of the other professionals never came into the locker room with more enthusiasm over their game than Charlie had for his. At the very top of his lungs he shouted for all those within hearing, "I just had 141, and I never even saw the course before!" In addition to that, he almost made a hole in one that he related with great glee. It was only afterwards that I learned the full details. He smacked a ball from the seventeenth tee that wound up within a foot of the cup, but I afterward learned that the cup was the cup on the sixteenth green.

As Mr. Marsh has told you, our technical session started yesterday with a wonderful degree of enthusiasm. I do not believe that at any of the conventions we have ever had or any organization ever had, was there as fine a series of papers and talks given as yesterday. I am sure that today you are going to be equally pleased.

As you know, yesterday the National Recovery Act was discussed by those whose experiences have been such that they were well qualified to talk to you. A spade was called a spade, although some of the time maybe some of the other speakers thought the speaker's spade was really a club or something like that. At any rate, we had a great day.

Yesterday the talks were of a more general nature. We heard about the National Recovery Act from the standpoint of the Administration itself, from the standpoint of trade associations, and from the standpoint of industry. Today we are going to listen to more definite problems with respect to specific industries.

The subject of the morning has to do with problems in the application of uniform cost accounting, and we are going to listen to this subject from three separate angles: first, from the standpoint of a representative company working in natural resources; second, from the standpoint of a manufacturing unit; and third and last, from the standpoint of trade and distribution.

The first speaker is Mr. Verl L. Elliott. Mr. Elliott is going to speak from the standpoint of natural resources. Mr. Elliott was educated in the schools of his home state, Kansas. He was with the Ordnance Department during the War and worked on a number of large war-time, cost-plus contracts. After the War, he went to the University of Pennsylvania, and was graduated from Wharton School of Commerce. He has had a great deal of experience with codes, being a member of the Accounting Committee of the Oil Code Authority, in addition to which he is Chairman of the Accounting Practice Committee of the American Petroleum Institute. He has been a member of the Philadelphia Chapter for ten or eleven years, serving as a director for several terms.

It was my pleasure, about a month ago, to attend a convention at which Mr. Elliott was present. Although not listed among the speakers, his knowledge of the oil industry was such that the presiding officer asked him to make a few remarks from the floor. Mr. Elliott responded in such a splendid way, both from the standpoint of the interesting things he had to say and from the standpoint of the humor of his remarks, that he practically stole the show.

In connection with the humor of his remarks, I do not know whether I should have said to him what I did this morning, but there was something about his style that reminded me of Will Rogers, and I told him so. He replied that he was born only five or six miles from Will's birthplace, so I think that may account for the similarity. Just in order to make it a little more complete, I inquired whether he had his gum with him or not. Believe it or not, he pulled out three packages of gum from his coat pocket!

Members and guests, it gives me great pleasure at this time to introduce to you Mr. Verl Elliott, Controller of The Atlantic Refining Company of Philadelphia, who will speak to you on the subject already mentioned. I am sure you are going to enjoy it very much.

PROBLEMS IN THE APPLICATION OF UNIFORM COST ACCOUNTING METHODS FOR NATURAL RESOURCE INDUSTRIES

VERL L. ELLIOTT

Controller, The Atlantic Refining Company, Philadelphia, Pennsylvania

ALTHOUGH I was born rather close to the birthplace of Will Rogers, I want it understood that I was born a good many years after Will Rogers was. The only difference between Will Rogers and the rest of the Oklahomans is that Will can act natural on the stage and the rest of us can not. If we could, we could all make $5,000 to $7,500 a night on the radio the same as he does.

As the Chairman has mentioned, it is my privilege to be a member of the Accounting Committee for the Oil Code Authority, known as the Planning and Coordination Committee. Accordingly, I was in Washington several weeks last fall, and from time to time since then. Some of you were in Washington also in connection with the various codes, and know of the confusion that existed. It was terrible. Five or six men would be located in a small office with one desk and a chair. They were supposed to turn out an important piece of work in a few hours that would ordinarily require weeks of consideration. Consequently, many grave errors were made. Frequently, no columnar paper (so necessary to accountants) could be purchased in either Washington or Baltimore. No rooms were available in Washington hotels, notwithstanding most of them were in the hands of a receiver.

Large companies were fighting the small companies in the same industry as to how the representation should be apportioned on the code authority. Manufacturers and sales distributors had different ideas as to how the code should read. Competitive industries were trying to gain vantage points with each other. Competition between various industries is a development of the last ten or fifteen years, and is not diminishing under the New Deal. The coal industry claims the price of fuel oil is too low and is putting thousands of miners out of jobs. The railroads claim the trucking industry has unjustly taken part of their business.

Probably a few years from now we will look back upon the first year of the New Deal and think of it much as we do of the Constitutional Convention, or maybe more properly as the Articles of Confederation which preceded the Constitution. As the Articles of Confederation were a forerunner of the Constitution, so the National Industrial Recovery Act may prove to be the predecessor of a more permanent form of self-government for business under the New Deal. When arguments waxed too warm in the Constitutional Convention in Philadelphia, a recess of a day or two was declared, thus permitting the delegates to cool off. General Johnson did not work just that way, but he did call in all the critics of the National Recovery Administration, and gave them a chance to blow off steam. Simultaneously, he took up the available space in the newspapers and overshadowed the critics, who were poorly organized.

One of the good things that has come about under the New Deal is that various industries are starting to think and plan from a national viewpoint for the first time, at least in times of peace. With few exceptions, the various trade associations within an industry covered only certain sections, such as New England, Atlantic Coast, Pacific Coast, or the Southern States. Even now, no one railroad under the same management runs from the Atlantic Coast to the Pacific Coast.

The oil industry is one of the few industries that had a trade association with several thousand members from all parts of the United States, which was truly representative of the various phases of the business. The American Petroleum Institute, with a membership of approximately 3,000, holds two meetings per year, at which various committees make reports on standardization and uniform work carried on for the benefit of the entire industry. This includes such committees as Crude Oil Production, Petroleum Refining, Marketing, Fundamental Research, Uniform Accounting, Engineering, Accident Prevention, and Public Relations.

Probably much of the delay in code making was due to most industries not being nationally organized.

In the oil industry, where there has been a large national trade organization for some 15 years, only the surface has been scratched, toward bringing about uniformity. When an attempt was made to bring about uniform classification of various jobs, it was found that in one part of the country oil companies paid machinists more wages than boilermakers, whereas a few hundred miles away boilermakers received more than machinists. There seemed to be no reason except that it was "an old Spanish custom."

There has been much confusion as to what code or how many codes a company must comply with. An integrated oil company may make (1) their own tin cans, (2) wooden or steel barrels, (3) boxes, (4) candles, (5) paint, (6) sell petroleum coke, (7) do their own construction work, (8) operate hundreds of trucks, and (9) conduct an open-air parking space in connection with some of their service stations. Of course, they would belong to the oil code, but each of the above nine items is covered by codes other than the oil code, with different maximum hours per week and minimum wages. A crew of men may be transferred back and forth from cleaning a still to manufacturing cans or doing construction work. Which code should apply under such circumstances?

In many cases, each code authority claimed jurisdiction. Many cases of this kind are still unsettled. It is not unusual for a company to get notice that it has violated provisions of a code which it has never seen or did not know existed.

It is now a settled point that uniform cost accounting cannot be forced on an industry. Model cost-finding and accounting systems may be recommended in codes, but may not be made obligatory. Code authorities may not suggest inclusion of uniform additions, percentages, or differentials designed to bring about arbitrary uniformity of costs or prices.

Bringing about uniform cost accounting by the process of recommendation for most industries will be a very, very slow process. Each company thinks its system is the best and should become the uniform system. How much progress would be made if the general manager of a concern could only "recommend" that the employes follow a particular plan of operation? If every one responded well to "recommendations," the tax collector would only need to pass the hat, instead of resorting to foreclosures.

Doubtless, the greatest handicap in establishing uniform cost accounting in any industry, and particularly in the natural resource industries, is the human element. Honest differences of opinion exist in great numbers, and it requires much time and patience to reconcile them.

The three largest natural resource industries are coal, lumber, and oil. Most of the codes of the natural resource industries have the cost-protection or cost-recovery principle in them. In other words, goods should not be sold below cost. No one seems to know what cost is meant for this purpose—whether it means a company's own individual cost, or a fair and reasonable cost for the industry. Indications are that this theory is rapidly becoming obsolete.

What is cost anyway? Shortly after the various codes commenced to emit from Washington, I was much shocked—shocked to realize that no industry seemed to know what cost was. I well knew that the oil industry did not know its cost for the various products, but I had long supposed that most other industries did. Then I was completely flabbergasted to realize that even the National Association of Cost Accountants did not know what cost was, or at least the N.R.A. would not accept their definition. For more than a decade, I have been coming to these annual N. A. C. A. conventions, spending our company's good money, and still no one seems to know what cost is.

I am one of those accountants who used to think that one of the uses of cost was to establish price. But I am pretty well on the fence now. If I hear one or two more talks like Mr. Greer's yesterday morning, I am reasonably sure I am going to be on the side that believes the principal use of cost accounting has to do with management in reducing costs rather than having anything to do with setting prices, because I have now been in business a couple of decades and never yet have I seen a very long period of time when costs have had much to do with the prices. The prices were either way below cost or way above costs.

In any industry we will find that some companies are more efficient than others. This is an obstacle in adopting cost accounting, for many executives do not want their stockholders to be able to make a direct comparison of their results with other companies in the same line of business, and in the same general location. So long as there is no uniform method of calculating profits, it is very simple to explain that the results are not comparable due to difference in accounting methods.

Then there is a different idea as to what constitutes a fair rate of return on the invested capital. In these days lots of people would be very happy if they could get a six per cent return on their invested capital. Only three or four years ago people talked about ten or twelve per cent return on their invested capital, in the natural resource industries, due to the hazards of the industries.

Another obstacle has to do with those companies which started in business in 1870 and 1880 and 1900 and bought all their natural resource reserves at a very, very low price. There are other companies who started in business in 1914 and a lot of them built their plants in 1917, 1918 and 1920. It is not an uncommon thing in the oil business for a refinery which has been built we will say from 1917 to 1920 to cost two or three times as much for the same capacity as a refinery which was built prior to 1914.

There are different methods of charging off the depreciation, obsolescence, amortization, and other capital recovery items. We are all aware that perhaps some of the companies have charged off too much depreciation and depletion over the last fifteen or twenty years. If so, they may have some trouble ahead with the recent Treasury Decision 4422, which came out a month or two ago. When we were in Washington last fall, one of the questions asked was whether these companies which had over-depreciated and over-depleted should recapitalize and charge the same value out over again in the uniform cost system in the oil industry, if, as, and when one should ever be adopted.

In recent years, there has been a great deal of revaluation of assets, particularly in the natural resource industries. One of the oil companies wrote $25,000,000 worth of oil lands and leaseholds down to $1, notwithstanding the fact that those leaseholds have thousands of oil wells on them that are pumping today. It is estimated that this company has favored its profit and loss statement by about $5,000,000 a year, on account of the lesser charge for depreciation and depletion as compared with what it would have been if they had not revalued the assets.

If the day should come about in the next few years that we would go through some period of inflation, either mild or otherwise, we will probably experience a complete reversal of this writing down of assets and concerns will be writing them up again just like some companies did in 1918 and 1919, and like companies did in Belgium and France and the other countries which went through the period of inflation.

I sometimes wonder whether we will not have to have a national revaluation day in this country for all business. I hope it is effective January 1st, if it ever does come. But values are so absurd in many industries for companies in the same line of business, that until something is done to correct the comparison of these values we can never hope to have comparable profit and loss statements and cost accounting.

The company I am with started in 1870. We have one of the largest refineries in the United States, covering 650 acres of land, in the City of Philadelphia. Most of the buildings were built years ago, when a brick mason received $1.25 a day. I do not know what the bricks sold for, but the brick buildings are still in use and I think they will be in use long after I am dead and gone. We have built other refineries. One was constructed about 1918, when bricklayers got $12 or $15 a day, and probably laid fewer cubic feet of wall per day than did the men in 1870, who worked for $1.25.

If a company has three or four plants and all of them are shut down but one, and that one plant is operating at practically full capacity, should they use idle expense of the closed plants in ascertaining their cost? Another company may have one plant which has the same capacity as all three or four of these other plants I just talked about, and it may be running at only one-third or one-fourth of capacity. Should that company use its idle plant expense, which is not nearly so easily ascertained as in the case of a company which has separate and distinct plants? We were faced with that question in the oil industry when we were talking about uniform accounting some months ago.

I wonder if anyone knows what such a thing as normal output consists of any more? We used to talk about the previous year and the previous two or three years, but it is doubtful if even the previous five years gives an acceptable figure to use for normal output any more.

Of course, there is always the question as to whether or not interest on invested capital should be considered as an element of cost. There is no doubt but that interest on invested capital should be considered for certain purposes, such as comparing the cost of buying a machine which is more or less automatic with another process of making goods which is largely hand labor. All of the proposed cost formulas of the oil industry have had interest on invested capital very deeply imbedded in them and I believe that if a uniform cost accounting formula is ever adopted for the oil industry it will include interest on the invested capital at six per cent. The reason for that is the Tariff Commission made an exhaustive study of the oil industry some three or four years ago, and the Tariff Commission in all its work uses a six per cent interest on invested capital to build up the American costs of goods as compared with what the foreign costs will or should be. They use the six per cent interest on the invested capital in ascertaining the cost of American goods to see how high the tariff should be on the foreign goods.

There have been a number of formulas drawn up for uniform cost accounting in the oil industry. They have been sent to me at Philadelphia, or sometimes individuals call up on the telephone and want to read them over the telephone and want to know if I have any suggestions for changes. This six per cent interest clause is always included. Whenever I see that clause, I cannot help thinking of the story about the man who wanted to buy a sawmill.

A backwoodsman from some state wrote in to a company and said that he wanted to buy a sawmill and asked for a catalog and best prices. The company wrote back, "We manufacture sawmills from $250 to $50,000. Kindly let us know what kind of sawmill you want." The backwoodsman replied, "Who in the h— would want a sawmill if he had $50,000?"

So that is about the way we feel in the oil industry. If we could include six per cent on our invested capital as cost, we would be perfectly willing to recover only cost, at least at the present time.

There is the old question of whether or not depreciation should be taken on the original cost or the replacement cost. The predominating method for ascertaining costs in the natural resource industries, whether it is coal, lumber, or oil, is the sales value method. You are familiar with what that is. You merely take all costs and add them together and ascertain the total income by various lines of products, and prorate the costs to each particular product, considering the yield of that product and the price for which it is sold.

Several of these cost formulas for the oil industry which have been formulated by the Code Committee at Washington (usually written by lawyers), have simply had a provision that costs will be ascertained in accordance with the formula used by the Tariff Commission in their Report No. 30, which they compiled two or three years ago. They used the sales value method, but they did not figure the costs until some two or three years after the close of the period.

If it is necessary to figure costs instantaneously on a sales value method, one must know what yields and prices are anticipated. It is simple enough to look backward and use the sales value method, but when you are trying to obtain an instantaneous cost or make a future cost calculation, it is an entirely different matter.

The trouble with the sales value method of costs is that as long as there is any profit in the industry as a whole, all of the individual products will also show a profit. Therefore, that method of figuring costs will be of little use to any code authority which is trying to prosecute a company for selling one particular product below cost.

A good many industries, other than the natural resources, are fortunate in that they can get more or less accurate costs of direct labor and direct material. Their difference consists mostly in distributing overhead, but in the natural resource industries there is no way of getting the direct labor or the direct material cost. In the oil industry, we will put so many barrels of crude oil through a still and the same fuel and the same labor that produces gasoline also yields fuel oil, lubricating oil, wax, asphalt, and all the rest of the products. It must be purely an arbitrary matter as to how these costs are divided between products.

Coal Industry

I corresponded with the code authority for the coal industry and for the lumber industry. The Coal Industry Code Authority told me that they had done nothing, so far as the code was concerned, about uniform costs, but they did have a uniform accounting committee which compiled a report in May, 1919, fifteen years ago, and it remains unchanged as yet. It certainly must be a good report to remain unchanged since 1919, and it must also be a good report, too, because they had not the advantage of belonging to this Association. As I recall it, this Association was started in 1919.

They sent me a copy of the report, which I read with much interest. I find that almost the entire report deals with the 1917 and 1918 income tax law. Then at the end they have a summary which lays a good deal of stress on these three points: (1) the necessity for a detailed analysis of accounts; (2) the distinction between capital and operating expenditures; (3) and the adoption of a voucher system.

Of course, we have to remember that this report was written fifteen years ago, but as we know uniform accounting today, there is scarcely a word about it in the report. Doubtless, someone reading fifteen years from now what we are saying today will have just as much amusement as we get out of reading this report. Nothing is said about standard costs or budgets or predetermined costs.

Then to climax the situation, the very last page of the report (having wandered from the green, succulent fields of income tax and voucher systems) has a paragraph called "Suggestions as to Price Making." Evidently sales engineers and sales analysts were not doing their stuff in those days as much as they are now, or certainly an accounting committee would have been content to leave that subject alone. The first paragraph of this section says, "The demand for fuel fluctuates with industrial activity and seasonal temperatures. Such demand, whether large or small, is at all times imperative. Demand for coal is not decreased by high prices, nor increased by low prices" You see that is what one gets for going down in writing I am sure Mr. Greer and some of the other economists would not altogether agree with the theory that the prices have nothing whatever to do with demand, and vice versa.

There is another part of this report that appears somewhat amusing now. It reads: "Indemnity for a killed or injured workman is an inevitable item of cost, and provision for this must not be overlooked either by those who carry insurance and pay a premium or those who meet those costs out of a fund set up for that purpose. Society has always borne the burden indirectly and inadequately, but statutes passed by the state and federal governments providing for workmen's compensation are evidence that public policy now sanctions the assumption of this indemnity in a business-like and adequate manner."

It might be of interest to some of you to know there are four states today that do not have workmen's compensation laws. Those states are Arkansas, Florida, Mississippi, and South Carolina. A company had the misfortune, two or three years ago, to be building a warehouse right on the line between Georgia and Florida. Georgia has a compensation law. There was a colored man on top of this house when they were putting the roof on, who rolled off. He rolled off on the Florida side and was killed. It cost the company much more than if he had fallen on the Georgia side.

There is another interesting paragraph in this coal report, about "the salvation of capital" It reads, "The many whose accounting methods leave much to be desired will derive the most benefit from adopting a proper accounting system. They will know better how they stand, what they must have to cover their requirements, and proper accounting will help them to exercise tenacity and perseverance requisite for the salvation of their capital and to win a proper return thereon." They say furthermore, "The Operator who conducts his selling campaign without due regard to the requirements of the industry as a whole as reflected in the cost of doing business is an unfair competitor."

There is the nucleus of the New Deal or the N. R. A. in that report. That was in 1919, when most of the companies were earning probably twenty to twenty-five per cent on their invested capital, and a good many were paying the eighty per cent excess profits tax, so we see the New Deal idea has been flirting around with us for a long period of time.

Lumber Industry

The lumber industry probably has a more complete code in many respects than almost any other industry I do not pretend to have looked over all codes, but I have had contact with the lumber industry, because it was so closely related to the oil industry.

As someone intimated yesterday, the lumber code is very complete. They have a Department of Costs and Prices. They are working on the cost-recovery principle, that is, prices should not be below cost. They have a schedule of forty minimum prices. They have an allotment of production to each of the mills. Last fall someone told me there were some mills that could make three 1 x 10 planks, 12 feet long, per month. That was their allotment that particular month.

I have not talked to the lumber people since the new policy of the N. R. A. came out, about uniform cost accounting. Their cost accounting feature, as I understood it, was compulsory before these new policies were announced.

They employ a firm of accountants—Seidman and Seidman—who are specialists in the lumber industry. Reports are gathered together by various sections of the country, from which the average costs are compiled and from which the minimum prices are established. As interpreted by Mr. John McClure, who is Chief of the Department of Cost and Prices of the Lumber Code Authority, Article IX of the code provides:

> Whenever and so long as the Authority determines that it will contribute towards accomplishment of the declared purpose of the code, and whenever it is satisfied that it is able to determine cost of production as defined in this section (a), the Authority is authorized to establish and from time to time revise minimum prices f o b. mill, to protect the cost of production of items and classifications of lumber and timber products The responsibility is also placed upon the authority to maintain free competitive conditions and to secure equal application of the provisions of this Article, to prevent monopolies or monopolistic practices This is a big order. The complexities of the timber products industries present many difficulties, but the job had to be done if the industry was to survive.

Mr. McClure continues:

> The Authority undertook the task with earnestness and determination. Cost data was obtained from all those known to have costs available. A firm was engaged to assist in the compilation of cost records. Weighted average costs are arrived at in accordance with the formula provided in the code. Total costs are ascertained from all available sources. The items produced are listed and the cost is distributed over these items on the basis of their relative market value over a representative period.

This is the sales value method again.

Oil Industry

I have tried to cover in a brief way the coal industry and the lumber industry, and I am now going to say something about the oil industry. It has about $11,000,000,000 invested capital. It is said to be the second largest industry in the United States. It is probably one of the most self-contained industries. The average integrated oil company buys or leases land. They drill their own wells, pump the oil above ground if it does not flow, lay their own pipe lines (crude oil lines), and if the oil needs to come by water they have their own ocean-going vessels. They own their refineries. They make boxes, tin cans and barrels. Now, several of the companies have their own gasoline lines from the refinery to the tanks throughout the United States, from which they take this gasoline in new bulk haulers or the small trucks and convey it to their own service stations and sell to the ultimate consumer, who is the automobile owner.

That is why there is a certain amount of mild competition existing between the oil industry and a great many other industries. They handle their own production, transportation, manufacturing and distribution.

It was a great surprise to most of us in the oil business when the gasoline consumption volume held up as well as it did all through this depression. There was more gasoline consumed in 1933 than there was in 1929, notwithstanding the fact that there were about ten per cent less automobiles in the United States. You know the reason as well as I do. All the unemployed that could possibly do so held on to a five- or ten-year-old car.

One night I went to see a friend who had been unfortunate in this depression. I do not think he had an income of more than seven or eight dollars a week for the last two or three years. He has two children in high school. He had an old Dodge car. The upholstery was worn out. Some sofa pillows were on top of the springs on the seat. He had an inner tube out, and was patching it when I drove up. I do not believe there was an area of six inches square on that inner tube that did not have a patch. Yet, he was still running his automobile and bought gasoline, one or two gallons at a time.

I asked him why he had kept the automobile during the depression. He said, "Well, I absolutely have to have that in order to get any place." What little work he did pick up around here and there he had to use his car. He had to go two or three miles to and from work, and he lives in the country, not close to a street-car line. He had been posting bills for one of the theaters in a suburban town, and they gave him $2.50 a week for driving the automobile 20 miles. It was a piece-work operation. It was just that sort of thing that kept up the gasoline consumption during the depression.

The American Petroleum Institute has had a Uniform Accounting Committee in the oil industry since 1923. It was due to the income tax laws that this division commenced. We have had about two meetings a year since then, and we now have a uniform Balance Sheet and Income Statement that has been recommended by the Directors of the American Petroleum Institute. It is quite universally used in the industry, with minor changes.

We have been working with Mr. Hoxsey, of the New York Stock Exchange, and now have a seventeen-point program under way with the Exchange. The Exchange wants these seventeen points made uniform, at least by all the companies which are listed on the New York Stock Exchange.

One of the subjects we have about finished: that has to do with valuing the inventory. We have been working not only with the Stock Exchange, but also with a sub-committee of the American Institute of Accountants, in an effort to devise a uniform system of inventory valuation. Last month at Pittsburgh, the uniform system was approved by the oil industry's Accounting Committee. It has not yet been approved by the American Institute of Accountants.

I am going to take just a minute to give you the three highlights of that inventory system, because it is the result of three years of hard work in making recommendations. For some inexplicable reason, it went through the Committee unanimously, notwithstanding the fact we had much opposition for the past two or three years.

This inventory system is called the "Last In, First Out" system. As long as the inventory quantities are the same, it provides for charging current costs against current sales. This is a theory of costing that has received much more consideration since the N. R. A. than previously. Most operating executives in the basic industries are very insistent that current costs be charged against current sales, to obtain the correct profit.

We are not contemplating reducing our inventories to the lower of cost or market, so far as profit and loss are concerned. We intend to show in parenthesis or as a footnote the difference between the market value and book value. The products and the grades of crude oil will be grouped, until only a few grades of oil are carried separately on inventory. Those are the three basic principles of this inventory system which stand a fair chance of becoming uniform throughout the oil industry.

A little over a year ago, East Texas crude oil, which is a predominant grade, was selling at ten cents a barrel. Today that oil is selling at one dollar a barrel, and it has been one dollar a barrel since last October. In other words, there has been an increase of 900 per cent in the price of this crude oil at the well.

The oil industry began in Cleveland, as most of you know. Mr. Rockefeller started his business there. When I first entered the oil business, I commenced to think I had made a terrible mistake by not being an engineer or a chemist. It seemed to me they were getting all the breaks. Then, a few years ago, I read a book by John Winkler, called *John D., A Portrait in Oils*. On one page in that book I came across this paragraph. This is Mr. Rockefeller talking to Mr. Winkler:

> "I knew where I stood at the close of every business day," says John D. proudly. "I charted my course by figures, nothing but figures. I never felt the need of scientific knowledge, have never felt it. A young man who wants to succeed in business does not require chemistry or physics. He can always hire scientists No, he should study figures, figures, figures and apply them to his business. What does he intend to sell or manufacture and how many will buy his product? Let him first take paper and pencil and study his market and its possibilities Figures come first, always."

I felt maybe this quotation might be a consolation to some of you bookkeepers who think you ought to be engineers.

One of the unique things about the oil industry is that the State of Texas produces about forty per cent of all the oil in the United States, which incidentally is about twenty-five per cent of all the oil produced in the world. The big bone of contention in the Oil Code has to do with state rights. Texas is a very peculiar state in many respects. They claim to have certain state rights that no other state in the United States has. It is based upon their Treaty of Annexation to the United States, which, if I recall my history correctly, was signed about 1845. They did not come in under the original Constitution. They have several paragraphs about reserving the right of natural resources and lands for the state's own use, and there are millions and millions of acres of land in the State of Texas that are owned by the state school system. Texas reserves a right to regulate her own oil industry and so far the Oil Code has been unable to do very much within the State of Texas.

The oil industry is unique in another respect, inasmuch as gasoline is taxed 120 per cent of the wholesale value of the commodity. Last year there was about $1,000,000,000 worth of gasoline and motor oil taxes collected, about nine per cent on the invested capital. The peculiar part of it is that until recently nearly all of this sum has been spent on roads, which in turn helped the automobile and the oil industry. I have been unable to think of any other industry that has been taxed heavily and yet the taxes went right back into something which in turn helped that particular industry.

Now about the Oil Code itself. It does not come under the N. R. A. Of course, it does come under the National Industrial Recovery Act. We have a separate Administrator, Honorable Harold L. Ickes, who is Secretary of the Interior.

It has many, many sub-committees. The main sub-committees are on Production, Refining, Marketing, Transportation, Accounting, Labor, Legal, Finance.

Last Friday, when I was in Washington, I went over to see the Secretary of the Oil Code Authority and asked him how many people were on these sub-committees. The last count I had was 2,000, which was last fall. He told me he did not know exactly. They had a large file with thousands of cards in it, but he believed it was between 2,500 and 3,000.

We discovered, in sending out questionnaires to the oil industry, that there was a great lack of uniform terminology. Gross production, net production, royalty interest, company interest, and working interest do not have the same meaning to all the oil companies.

The oil industry is working on the theory of a quota in interstate commerce. Judge Beatty, the Chairman of the Oil Code Authority, has a theory that while they cannot control the production of oil within a particular state, particularly in view of the stand taken by the State of Texas, they can control all the oil in interstate commerce. He has written a book on the subject and cites Supreme Court decisions. He has such a big following among the legal fraternity that it will be substantiated by the courts. That was the heart of the oil bill which was not passed at the last session of Congress. Texas and Oklahoma could produce all the oil they wanted to, but they could not ship a drop of it out of their states unless it was approved by the Oil Administrator. As you know, that bill did not go through for various political reasons. At the present time, they are trying to change the Oil Code, to put the quotas-in-commerce theory in one of the sections of the Oil Code.

Of course, the Oil Code is no stronger than the National Industrial Recovery Act. The Oil Administrator tried to get a special bill through Congress which would divorce the Oil Code from the N. I. R. A., but was not successful. Instead, we are supposed to get a thorough investigation by Congress, of both the oil industry and the Oil Code Administration.

Doubtless, all these N. I. R. A. codes will tend to bring about a standard quality of product

A suggestion was made in Washington a few months ago that the principal commodities be classified in the A, B, C, and D grades, with a definite specification set up for gasoline and various kinds of cloth, boots, and shoes, and everything else. Naturally, the advertising agencies, the radio people, the newspapers, and all other periodicals jumped all over that idea because it will very materially affect their business. I do not know what it would do to a magazine if you took all the advertising of products out of the periodical, but it does seem that idea is strong enough that it may not be permanently submerged.

The Oil Code contains the following provision pertaining to selling below cost:

> Refiners, distributors, jobbers, wholesalers, retailers and others engaged in the sale of petroleum shall not sell any such refined petroleum products below cost of manufacturing or importation into the state where offered for sale, plus reasonable expenses in the cost of marketing as observed under prudent management, fixed taxes and inspection fees by the Federal or State government or any political subdivision thereof, provided, however, that any person is permitted to meet competition in violation of this rule concerning which he has made complaint to the Planning and Coordination Committee, or any authorized agency thereof, but only pending action thereon.
>
> An authority, committee or commission delegated by the National Recovery Administration for such purposes shall receive complaints of violation of this rule and make such investigations and/or hold such hearings as it deems necessary to determine whether the prices complained of are in violation of this rule.

In effect, this probably means the cost-recovery principle, although no one seems to know just what is intended, and no serious effort has been made to enforce it. Although many changes of this provision have been considered, none have yet been adopted.

Accordingly, little or nothing has been done toward uniform cost accounting in the oil industry. This is largely due to the difficulty of ascertaining cost of various products when produced from one raw material, i. e., crude oil. Fuel oil competes directly with other forms of fuel such as coal, gas and electricity, which may have a bearing also. The majority of the companies in the oil industry use the sales value method for purposes requiring a cost, such as valuing product inventory. A few companies use the by-product method, and some use the average cost method.

I believe that we are going to have some kind of uniform accounting in this country, whether it is under the old deal or the New Deal. It is so fundamentally sound and there is going to be a need for it in the future such as we have never felt in the past. There are a few industries that have a most complete uniform accounting system. One is the Typothetae of America, with headquarters in Washington, which, as you know, is the printing industry, but we all know uniform cost accounting has not saved the printing industry. There are few industries which have had more trouble in the depression than the printing industry, but I do not think that can be based on the fact that they have a good uniform accounting system. It is probably due to inventions, gang printing, and too much competition.

So I am willing to go on record as a prediction that sometime in the future we will have uniform accounting of one kind or another.

CHAIRMAN KNAPP: We will now proceed with the second paper of this morning's session. Our speaker on this occasion is Mr. Martin A. Moore Mr. Moore was graduated from New York University in 1926 and also attended the Graduate School of Business Administration of the same University. He has had several years of public accounting experience and has successfully passed the certified public accountants' examination in the State of New York.

For the last six years he has been Controller of the Hyatt Roller Bearing Company of Harrison, New Jersey, which most of you know is a subsidiary of the General Motors Corporation.

Mr. Moore has previously addressed several of our chapters and has always been very well received. He is at the present time Vice President-Elect of our Newark Chapter, and as a member of that Chapter, it gives me a great deal of pride to introduce to you Mr. Martin Moore, who will speak upon this same subject from the standpoint of manufacturing.

PROBLEMS IN THE APPLICATION OF UNIFORM COST ACCOUNTING METHODS IN MANUFACTURING INDUSTRIES

MARTIN A. MOORE

Controller, Hyatt Roller Bearing Company, Harrison, New Jersey

IN THESE days of so much loose talk of economic revolution, with new measures succeeding each other with machine-gun rapidity —measures to some degree, at least, new and strange—it is not easy to keep a proper balance of thought and action. We can readily accept the fact that misconceptions of purpose will arise, policies will be misunderstood, and general confusion of intent exist. I feel that, to some degree at least, such misconception, misunderstanding and confusion exist on the subject of uniform accounting. To many, particularly the uninitiated, uniform accounting means merely one thing—price-fixing. To another group it means the effort of large units to force all competition to subscribe to an accounting pattern that will result in virtual monopoly. To a far greater number it means an effort on the part of government to force all business into the constricting vise of government control. The fact that the vast majority of codes contain "fair practice price provisions" gives weight, they claim, to their idea of government compulsion.

These ideas are unfortunate, especially the prevailing emphasis on the note of compulsion. The present interest in the subject of uniform accounting is founded on something more substantial. It is a vital part of a business philosophy that has been evolving for many years, the significance of which is more forcibly driven home by the efforts of N. R. A. It is a philosophy built around a clear-cut recognition of the interests of all who are affected by the workings of industry—a clear-cut recognition of industry's social responsibilities. Uniform accounting is a part of a philosophy which places emphasis where it properly belongs, on the industry, rather than on an individual unit in an industry. Instead of springing from the idea of compulsion, the great interest in the subject at this time seems to me to be clear evidence of "Industry Coming of Age."

It has been the favorite indoor sport of the past year for every man and his brother to point out the reasons for the world-economic debacle and the remedies for curing all the ills that beset us. We are not presumptuous enough to engage in this sport. We do feel, however, that a lack of a scientific approach to the solution of industrial problems, a lack of vital statistics pertaining to an industry and the inability of all units of an industry to establish sound economic policies based on fundamental accounting facts, contributed in no small measure to the intensity of the depression from which we are slowly emerging.

The past five years have brought home most forcibly the fact that there is no social or economic justification for the existence of any unit in any industry that is incapable of producing something at a price to permit the greatest number to improve their standard of living and at the same time reward equitably all those responsible for the production of the article—i.e., labor, capital, management. We have learned all too well the interdependence of all units in an industry. We recognize that the health of an industry is contingent upon the well-being of the members that comprise it and, further than this, the economic health of an industry depends upon all the members of an industry "talking the same language and playing the game by the same rules." This to me is "Industry Coming of Age"—it is the essence of business democracy and of business regulating itself. Likewise it is the heart of the movement for uniform accounting—an effort to have industry "talk the same language and play the game by the same rules."

What Uniform Accounting Covers

When we speak of uniform accounting we mean, of course, uniformity in all accounting, for we clearly recognize that the full benefits of accurate cost-keeping are lost unless there is a complete tie-up between cost and general accounts. Our discussion, of course, is confined to uniform cost accounting methods.

The fundamental concept of uniform accounting is uniformity of approach in accounting principles, and methods if possible. It covers the formulation of rules and procedures which enable any unit in an industry to ascertain its products costs according to well-defined accounting principles.

Now, what are some of the specific advantages that an industry may obtain from a uniform accounting plan? Here are a few:

1. Those members of the industry who have no cost plan, or whose cost plan may be weak, will get the benefit of the sound cost accounting principles embodied in a uniform accounting plan. To that extent their policies will be predicated on accounting facts.

2. It should promote better business methods and develop better business executives through a more general knowledge of the cost of doing business.

3. It should eliminate to a great extent the uneconomic "no profit" sales which contributed so greatly to the cutthroat competition of the "New Era."

4. It should provide for better stabilization of business and for a fuller appreciation of industry's social responsibilities through the possible development of comprehensive statistics on costs, wage rates, production, plant facilities, etc. It should furnish those individuals who have to a great degree a common problem a basis of facts from which to develop sound policies of "economic morality."

5. It can provide bases of comparison as an aid to improving the effectiveness of individual units.

Proper Viewpoint and Approach to Problem Is Necessary

In handling a subject of this nature, it is very easy to wander "all over the lot." In order to keep our thinking straight—in order not to wander too far afield—we will consider that we are members of the cost committee of a manufacturing industry assembled for the purpose of analyzing the problems facing us in installing a uniform accounting plan for our industry.

First of all we must clearly recognize the complexity of the problem. It is not easy. We must recognize the need of many months of patient, painstaking effort. For we must remember that within the industry there are many diverse units. There are the so-called large companies and also the very small ones. There are companies with well established cost plans and those with practically no cost system whatsoever. There are those units with capable accountants like yourselves and those in which the accountant does everything from running the elevator to carrying the boss' brief case.

Our problems may range from a simple definition of cost and an explanation of the various elements in each cost group to the very elaborate uniform accounting plans such as those of the National Machine Tool Builders' Association or the National Electrical Manufacturers' Association. On account of particular conditions in the industry it may be necessary, as is the case in the Canvas Goods Industry, to design the cost plan in two stages, one for the so-called smaller company and one for the larger company. Then again, our studies may result in finding conditions similar to those evidenced in a recent quotation by the Assistant to the President of the Cotton Textile Institute:

> It is well to remember that in spite of a quite prevalent and quite understandable public tendency to believe that economic business procedures are matters which can be reduced to rigid rules and standard formulae, experience nevertheless convinces us that no absolute uniformity of cost procedure can be practically feasible or economically sound for even a single specified variety of cotton mills, much less for the cotton manufacturing industry as a whole. Broad general principles may well be established and universally observed. But even in a group of mills as homogeneous in character as that producing carded yarns the variety of situations and circumstances is so great that no one specific approach to cost finding can be applied indiscriminately to all such mills, nor perhaps to any large percentage of the group.

These are the broad general problems that must be viewed in our approach to uniformity in cost methods.

Having hurdled this major problem of the scope of our work, we are prepared to tackle the problems involved in the treatment of principles and methods necessary to a correct application of a uniform accounting plan to our industry. In this connection, before we come down to the particular problems in our own industry, we shall probably want to acquaint ourselves with the work that has already been done in this field by other industries. In other words, we shall follow that good old American custom of taking the best of what has been done before and improving on it for our own use.

This means, for example, a review of all the literature prepared on this subject by the Department of Manufacture of the Chamber of Commerce of the United States. We are fortunate in this respect in having as one of our National Directors, Mr. A. B. Gunnarson, Manager of this Department. The material supplied by Mr. Gunnarson has been of inestimable value in the preparation of this paper. Then there are the various uniform cost accounting plans which are in effect today, many of which have seen the light of day under N. R. A. auspices. These range from the simple mimeographed definition of cost to the very elaborate uniform accounting manuals—most of which are on file at N. A. C. A. headquarters in New York. In addition to this, we would probably review the very excellent treatments of this subject that have been appearing in the various business periodicals throughout the country.

With this background then we are able to establish the goal for the cost committee's efforts and to set up the guide posts to mark off the route to that goal.

The Uniform Cost Manual

Let us assume, for purposes of illustration only, that our industry is of such a nature that it is possible to develop a thorough uniform accounting manual outlining clear-cut accounting principles and methods. This, then, is the goal of the cost committee.

The accounting manual should show the minimum requirements for a good accounting system and clearly define accounting terms in order that all companies may include the same elements in the various stages of cost. The circumstances in the industry dictate the extent to which the plan is developed. The manual may cover the subjects indicated in Figure I.

Naturally we cannot cover all of the problems that will be met in the development of our uniform accounting manual. We can, however, focus our attention on a number of difficulties that must be solved before uniformity can be achieved. To help us in our thinking, we can

SUGGESTED INDEX OF COST ACCOUNTING MANUAL FOR UNIFORM ACCOUNTING PLAN FOR MANUFACTURING INDUSTRIES

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   - A. Assets
   - B. Liabilities
   - C. Profit and Loss Accounts
2. Definitions of Controlling Accounts
3. Fixed Assets
   - A. Classification of Fixed Assets
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     1. Condensed Accounts
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6. General Cost System
   - A General Departmentalization
   - B. Suggested Types of Cost System
   - C. Definitions of Cost Elements
     1. Manufacturing Costs
     2. Commercial or Distribution Costs
   - D. Basis for Allocation of Cost to Product
     1. Material
     2. Labor
     3. Manufacturing Expense
     4. Commercial or Distribution Expense
   - E. Use of Normal or Average Rate of Expense in Costs
   - F. Methods of Estimating Costs
   - G. Means of Developing Profit by Lines
   - H. Bookkeeping and Other Records to Aid in Compilation of Accurate Costs

Figure I

divide our discussion into these two sections: (1) Problems in the classification of costs to proper cost groups; (2) Allocating costs to product.

I. Problems in Classification

It is essential in the first place to have a good definition of cost. The various interpretations of the term in code discussions emphasize the importance of this point. It may be, as one uniform accounting plan indicates:

> Cost is the net outlay for material, labor and expense in connection with the procuring, processing, marketing and distribution of products, plus all other expenses incidental and necessary to the conduct of the business.

Classification of Costs to Main Cost Groups

Then there must be a general agreement and clear-cut explanations of the main cost groups. This is essential if industry is to include similar cost elements in the various stages of cost. In this connection total cost is sometimes divided into the two broad classes: manufacturing cost and commercial expense. In the former group we include direct labor, direct material and factory burden; in the latter, selling expense, administrative expense and advertising expense.

Typical definitions of manufacturing cost and commercial expense found in uniform accounting plans are as follows:

> Manufacturing Cost of Product shall consist of the amount of direct or productive labor and the net cost of direct or raw material (including inbound transportation) consumed directly in the fabrication of product, plus an amount for manufacturing expense or burden, calculated in a scientific but practical manner and in accordance with the degree with which such product has utilized the plant and equipment and indirect organization in its fabrication.
>
> Commercial Expense—all expenses incurred in the marketing of the product and administering the affairs of the business. This group includes (a) Administrative Expense, (b) Selling Expense, (c) Advertising Expense.

When we have arrived at a common understanding of the classification of main cost groups, we can then discuss the classification problems of specific elements in each group.

Direct Labor

While it is correct to say that as long as each cost group is handled on the same basis by all members of the industry, no cost distortions will exist, nevertheless it seems to me that the elements of cost in each group must be treated uniformly if we are to get the full benefits of a uniform accounting plan.

It is surprising to note within the same industry the various treatments of this fundamental cost element in manufacturing cost, direct labor. If our industry is to "talk the same language," let us get off to the right start by getting a general agreement on this term. In some instances we find direct labor represents only that labor which is expended directly on the product. In others we find that in addition to the classification just mentioned, there is included a certain percentage of set-up men, process inspectors, skilled helpers. Then again, the labor in such departments as heat treating, annealing, plating, etc., while fundamentally productive operations, is treated as manufacturing expense or factory burden cost. This is for accounting expediency only as it is often impractical to attempt to identify such labor, although productive, with the product handled. Very often the type of wage payment plan in effect influences the classification of the direct labor element. Final inspection costs also prove a bone of contention. In some cases this item is treated as direct productive labor, in others it is considered as burden cost.

Then too, there should be general agreement on the question of whether or not direct labor shall include any costs of spoiled work. It must be recognized that in some cases it is necessary for extra quantities to be fabricated in order to produce the required schedule. The nature of a particular operation or particular product may dictate that certain percentages of labor expended on this spoiled work must be included in direct labor costs.

These are a few of the problems involved in the proper classification of direct or productive labor costs in a manufacturing industry. Elementary problems? Yes—but fundamental to a proper approach to uniformity.

Direct or Productive Material

The cost committee must develop a complete, all-inclusive definition of direct or productive material. In some manufacturing industries this problem is easily solved. In others, however, in addition to that material which is an integral part of the finished product, it may be necessary to include as direct material such materials as acids, oils, and paints, which are directly contributory to the conversion and fabrication of materials although they may not be apparent in the finished product.

Shall we include in direct material handling, storing, and transportation charges? This is the policy in some instances, in others transportation charges only are included in the direct material costs. In some cases transportation charges are carried in an inbound transportation inventory account. A relationship between the valuation of direct material inventory and inbound transportation inventory is maintained; the inbound transportation applicable to direct material consumed in fabrication of products sold being charged directly to cost of sales.

It is also necessary to establish a definite policy as to whether or not the material cost in spoiled work shall be included in direct material cost. Ordinarily items of this nature find their way into the factory burden accounts. An exception to this rule is found in those cases where an unusual quantity in number or value of spoiled work may be caused by the nature of a particular operation or particular product, rather than ordinary manufacturing delinquency.

It is necessary, likewise, for the cost committee to decide proper bases for inventory evaluation of direct materials, also for evaluating direct material in cost estimates that are utilized in establishing selling prices.

In the uniform cost plan of the Rubber Manufacturers' Association the following method is prescribed:

> Material Cost shall be predetermined utilizing *the replacement value* of major raw materials Such replacement prices shall represent the average future market price for each major raw material as quoted for delivery during the ensuing three months as supplied on the first day of each month by Rubber Manufacturers' Association
>
> The replacement market price of raw materials shall be used without exception, even though such materials be procured from subsidiaries or affiliated companies.

Factory Burden

We come now to the third element in the manufacturing cost group, i.e., factory burden. It is in this element that we meet our biggest problems in classification in our uniform accounting plan. The fundamental problem is to arrive at a good "industry" definition of factory burden and then rigidly adhere to that definition.

One uniform accounting plan defines factory burden as "all those expenses made in connection with and incidental to manufacturing operations over and above the prime cost" (prime cost being interpreted to mean direct labor and direct material). These items include:

Supervision of factory operations and departments incidental thereto

Non-productive labor

Tools

Materials and supplies necessary to the manufacturing operations, but which do not appear in tangible form in the finished product

Maintenance—Upkeep and rearrangement of all buildings, machinery and equipment used in the manufacturing operations

Depreciation, rent, insurance, taxes on all manufacturing facilities.

It may be of some interest to see the manner in which this important cost element is defined in some of the other uniform cost accounting plans that are being used today. In the outline of cost accounting principles for the Washing and Ironing Machine Manufacturing Industry, factory burden is classified:

> All expense incidental to purchasing, receiving, movement and transfer of material parts and product, their processing through to the Shipping Department and their planning and scheduling, routing, costing, timekeeping and recording in the processes of production. It will include a portion of administrative salaries and expense that can be fairly allocated to the cost of production and the cost of replacement parts furnished customers.

It is interesting to note that in the definition given above, a portion of administrative costs is allocated to factory burden and is, therefore, a part of the manufacturing cost group.

The definition of cost prepared under Article 8 in the Code of Fair Competition for the Hosiery Industry classifies factory burden as:

> All expenditures for Labor, Service and Supplies that are necessary in connection with the operation and maintenance of the mill, but which are not directly applied or do not physically become a part of the product. It also includes taxes, insurance and depreciation on all fixed assets which are used and are necessary to the manufacture of hosiery.

So much for the problems facing us in arriving at a good definition of factory burden. The next difficulty is to be certain that our detail account classification of factory burden items will adequately cover all the needs of the industry. This, of course, applies to all account classifications. It is mentioned at this point because it is in the classification of factory burden accounts that the problem is especially important. Remember, we have to look out for the interests of the small as well as the large companies.

Factory Burden Account Classification

It is usual in this connection to classify the factory burden into major groups and then by means of condensed accounts—sub-accounts and further subdivisions, if necessary—provide for the needs of all members, regardless of the detail they may require.

The main groupings in factory burden may be as follows:

Indirect Labor	Maintenance
Factory Supplies	Losses, Errors, Defects
Tools	Fixed Charges
Heat, Light, Water, Power	Miscellaneous

An example of numbering to supply sufficient detail for the larger companies and yet permit the smaller companies, through use of the condensed accounts, to get the benefit of uniformity in classification of factory burden is shown in Figure II.

EXAMPLE OF ACCOUNT NUMBERING TO SERVE NEEDS OF LARGE AND SMALL UNITS IN A MANUFACTURING INDUSTRY

Condensed Accounts	Sub-Accounts	Further Subdivisions
500—Indirect Labor	510—Supervision	511—Supervision
		512—Foremen and Assistants
		513—Inspectors
	520—Clerical	
	530—Service	531—Elevator and Crane Operators
		532—Stockkeepers and Helpers
		533—Tool Crib Attendants

Figure II

Depreciation Classification and Policies Stumbling Block to Uniformity

Next we come to the problems involved in obtaining uniformity in the nature of the items to be included in each of our uniform factory burden classifications. What shall be included? What shall be excluded? What accounting policies shall govern the treatment of the various accounts in the factory burden group? We could perhaps spend the remaining sessions on this phase of the discussion, but I think that by selecting a few of these problems we can indicate the nature of the difficulties that block the path to uniform treatment in manufacturing industries.

Improper handling of depreciation costs and uneconomic pricing programs predicated on faulty depreciation policies have played havoc with many industries. The great disparity in costs of products common to an industry in many cases can be traced to this source. It is obvious, therefore, that a proper handling of depreciation costs is essential to uniform accounting for manufacturing costs.

The cost committee must first of all establish clearly what depreciation includes Then there must be a clear-cut classification of so-called fixed or plant assets. This is vital if proper depreciation is to be applied to each particular class of plant items.

Then, of course, comes the problem of deciding upon the proper rates of depreciation and the method to be used in applying these rates, i.e., straight line, annuity method, production basis, reducing plan, or sinking fund. In many uniform accounting plans the depreciation rates recommended by the income tax division of the Treasury Department are utilized. An example of Plant Account Classification and Schedule of Depreciation Rates is shown in Figure III. This is the January, 1934 classification of plant assets outlined in the Standard Accounting and Cost System for the Electrical Manufacturing Industry.

There must be a correct understanding as to whether or not depreciation rates shall be adjusted for subnormal or abnormal production, also whether depreciation will be based upon cost or replacement values. These latter subjects create as many debates among accountants as the old stand-by, interest on investment. It is sufficient to state that in some uniform accounting plans or cost formulas, for example that of the Rubber Manufacturers' Association, recognition is given to the great disparity in cost values of capital assets, and depreciation rates are applied to not less than a fair replacement value. The pros and cons on this subject are very ably set forth in the December 15, 1933 Bulletin of the N. A C. A. on the subject of "Essential Elements of Cost for Uniform Accounting Under N. R. A." Those members of the cost accountants' "brain trust" who were responsible for this pamphlet made a worth while contribution to the ever-growing literature on this subject.

Another problem that presents itself in the establishment of uniform policies in plant asset accounting is the treatment of depreciation on fixed assets purchased "second-hand." The past four years have witnessed quite an increase in this type of plant acquisition and unless there is a common policy adopted for handling depreciation costs on this used equipment, cost distortions will result.

In a definition of cost for the Hosiery Industry we find:

> The basis for depreciation shall be original cost, including freight and inspection, except that in the case of plant and equipment recently acquired at an abnormally low price, the basis shall be fair replacement value new of such assets.

These same provisions appear in the Cost Accounting System of the Malleable Iron Industry.

CLASSIFICATION OF PLANT ASSETS AND DEPRECIATION RATES RECOMMENDED IN THE STANDARD ACCOUNTING AND COST SYSTEM FOR THE ELECTRICAL MANUFACTURING INDUSTRY

Classification	*Per Cent*
LAND	0
GRADING AND ASSESSMENTS	10
BUILDING AND STRUCTURES	
1131 Buildings, Wood, Sheet Iron and Stucco	10
Buildings, Brick and Wood	4
Buildings, Steel and Concrete	2½
1132 Structures	8⅓
1134 General Service Piping and Wiring	6¼
MACHINERY AND TOOLS	
1141 Machinery	8⅓
1142 Electrical Apparatus	8⅓
1143 Ovens and Furnaces	10
1144 Conveyor Equipment	16⅔
1145 Small Tools	20
1146 Electrical Accessories	16⅔
1147 Molds, Jigs, Dies and Special Tools	(a)
1148 Metal Flasks:	
Cast Iron and Steel	12½
Channel and Rolled Steel	20
Aluminum	10
FOUNDATIONS AND INSTALLATION	
1151 Foundations—Machinery and Electrical Apparatus	16⅔
1152 Installations—Machinery and Electrical Apparatus	16⅔
FURNITURE AND FIXTURES	
1161 Factory Fixtures and Equipment	20
1162 Furniture and Appliances in Factory Offices	10
TRANSPORTATION SYSTEM	
1171 Roads and Sidewalks	12½
1172 Railway Tracks and Overhead Equipment	6¼
1173 Rolling Stock	6¼
1174 Automobiles and Trucks (Gas)	25
1175 Electrical Vehicles and Trailers	16⅔
1176 Other Conveyances	25
PATTERNS AND DRAWINGS	
1181 Patterns	(a)
1182 Drawings	(a)
UNFINISHED PLANT	0

(a) It is contemplated that the cost of molds, jigs, punches, dies and special tools and cost of patterns and drawings will be charged to 172—Unliquidated Development and Complaints and liquidated by charges to the cost of production to which they apply. At the option of the company these expenditures may be entered direct against indirect manufacturing expense under the proper headings.

What shall industry's policy be with regard to fully depreciated assets? On this point the cost accounting system of the Malleable Iron Industry indicates the policy that is followed in a number of uniform accounting plans:

> Where assets of the Industry have been fully depreciated an allowance for depreciation based on the fair replacement value of the property shall be added.

A question may be raised too as to the propriety of this and other parts of the depreciation procedure from the standpoint of the income tax laws. Many of the uniform accounting plans clearly recognize the necessity of deviating to some extent from practices designed primarily to comply with the income tax law provisions. The uniform accounting manual usually provides for the reconciliation of the industry's uniform practice and income tax law requirements.

It is perhaps needless to indicate that the uniform accounting plan must provide for proper segregation of excess plant costs. These are usually considered as profit and loss charges and not as a part of the manufacturing cost.

These are some of the problems that present themselves in our attempt to establish a uniform method of handling depreciation classifications and policies in our manufacturing cost segregation. The nature of this discussion is typical of the approach that must be taken in establishing a uniform classification of all of the other factory burden costs.

Research and Development

Within the ranks of one industry we will find some units spending considerable sums for development and research, while others merely "follow the leader." So, too, there appear to be some differences of opinion on the proper accounting treatment of research and development costs. In some instances these items are considered as the normal expenses required to perpetuate the business existence and, therefore, (regardless of amount) are included in the factory burden element of manufacturing costs. In other instances these costs find their way into factory burden via deferred expenses. Then again, these charges are prorated over selling costs and factory burden. They are sometimes looked on as profit and loss charges. Naturally if industry is to "talk the same language," there must be a uniform method established for handling these costs.

In a number of cost formulas developed under the fair practice provisions of codes the problem of research and development costs is given considerable attention. For example, in the cost principles for the Washing and Ironing Machine Manufacturing Industry:

> All direct costs of developing and obtaining new products or improving present products will not be included in calculations of model costs and should be eliminated from other classifications of expense Such costs are not common to all manufacturers and their inclusion as overhead would penalize the progressive manufacturer.

In the standard cost formula adopted by the Luggage and Fancy Leather Goods Industry there is a statement:

> Overhead shall not include development work or other items not properly allowable to the operations of the year in question.

And in the definition of cost for the Hosiery Industry, in the items to be excluded from cost they list research and development.

And so we must "take our pick." The conditions in each industry must decide whether or not research and development costs shall be classified as factory burden costs.

Welfare Costs

A somewhat similar problem prevails within an industry in the handling of welfare costs. Some units maintain well-equipped plant restaurants and hospitals, various types of employes' welfare organizations, and group insurance plans. Other units in the same industry have practically no costs of this nature. Ordinarily we should expect the cost of such welfare and personnel work—at least that part of the cost which is applicable to factory operations—to be classified in the factory burden section of manufacturing cost. Nevertheless, here again we find that in a number of uniform cost formulas that have been developed under the N. R. A. codes these welfare costs are eliminated from product cost, as that term is to be understood by the industry. Such a provision appears in the Definition of Cost for the Hosiery Industry.

Of course, we must understand that some of the interpretations that have been placed on the classification of such items as welfare costs, research and development costs, etc., are in many cases influenced to a great degree by the selling-below-cost provisions of N. R. A. codes. Despite the fact that some units in an industry may sustain such costs and others do not, it is perfectly obvious that where they are sustained they are a part of product costs. They are, too, more generally treated as part of the manufacturing cost group, at least that portion of the cost which applies logically to factory operations.

Packing and Shipping Costs

Another problem presented to the cost committee under the general subject of factory burden classification is the uniform treatment of packing and shipping costs. The particular conditions in the industry, especially the nature of the product, will decide the manner in which these costs will be classified. In some instances manufacturing costs end with the delivery of the finished product to finished stores or warehouses. In these cases packing and shipping expenses are classified as commercial or distribution expense, usually in the selling expense group. Some industries have a separate classification, "loading and shipping expense" in the commercial expense section. In other cases the packing and shipping costs are tied in directly to processing operations and considered as part of the factory burden costs.

Expense Common to Cost Groups

We will find that there are many cost items that must be prorated between the different cost groups, i e., between manufacturing and selling expense. The uniform accounting manual must make clear the industry's policy in this regard. Such items as taxes, depreciation and insurance, are as chargeable to factory burden as to selling and administrative expense. An illustration of one of these cost elements—insurance—will show what is meant. In the Outline of Cost Accounting Principles for the Washing and Ironing Machine Manufacturing Industry a uniform plan for classifying insurance costs to the proper cost center or cost group is shown. (See Figure IV.) Unless there is a uniform policy within the industry in this regard, distortions in cost as reflected in the various cost stages are inevitable.

I realize that this discussion just about scratches the surface of the problems that must be met and solved in the establishment of uniform classification of costs for the factory burden section of the manufacturing cost group. It gives us, however, a general idea of the nature of kinks that must be straightened out before uniformity in accounting treatment becomes a reality.

Commercial Expense—Selling, Administrative, Advertising

For ease in discussion, we indicated two major divisions of product cost, manufacturing cost and commercial expense. We said this latter group covered selling expense, administrative expense and advertising expense. In this section of the paper we are still concerned with problems of classification to proper cost groups.

RECOMMENDED DISTRIBUTION OF INSURANCE COSTS—WASHING AND IRONING MACHINE INDUSTRY

1. Fire Insurance	
A Building and Building Equipment	Building Department
B. Inventory	General Factory
C. Plant Machinery and Equipment	Production and Service Depts.
D. Office Furniture and Fixtures	General and Administrative
2. Compensation Insurance	All Depts. based on Payroll
3. Boiler Insurance	Steam Plant
4 Employes' Fidelity Bonds	General and Administrative
5. Use and Occupancy Insurance	General and Administrative
6 Automobile Insurance (All Types)	Garage Expense
7. Public Liability Insurance	General Factory
8. Life Insurance	Other Deductions from Income
9 Windstorm, Hail, Tornado (and Others of this Type) Insurance	General Factory

Figure IV

In manufacturing industries, particularly those fabricating a highly technical product, the question of proper classification of sales engineering costs presents some difficulties. In many instances these so-called sales engineers not only work on the development of new products and improvement in present product, but they are also utilized in the work of preparing engineering designs for the application of the present product: in other words, a considerable part of their time is spent on direct sales activity. It is quite easy, of course, for any particular unit to make the distribution of these costs between selling expense and factory burden (development and research), but unless there is a uniformity of classification within the industry, the units in the industry are not "talking the same language."

It is perhaps needless to state that the selling expense group must contain provision for all charges properly allocatable to selling activity. These will include rent (in lieu of depreciation), taxes, insurance, supplies, telephone, telegraph, etc.

Administrative Expense

We indicated previously in this paper that in a number of industries the so-called administrative expense is prorated over the factory burden and selling expense on the principle that the two functions of business are making and selling a product, and all costs therefore fall into these two groups. By far the greater number of manufacturing industries very definitely classify the items that fall into administrative expense and consider this item as a separate section of the commercial expense group.

As mentioned earlier in this discussion the Uniform Cost Plan for the Washing and Ironing Machine Manufacturing Industry provides for a proration of administrative costs to manufacturing costs.

Here again I would refer you to the N. A. C. A. brain trust "slants" on this problem as given in the December 15, 1933, Bulletin of the Association on the subject of "Essential Elements of Cost for Uniform Accounting Under the N. R. A."

Some General Problems of Classification

We have covered some of the problems involved in the uniform classification of costs to proper cost groups. Before we go into the problems involved in the distribution or allocation of costs to products, it would perhaps be advisable to point out one or two of what we might term, for want of a better title, general problems of classification for a manufacturing industry.

First of all in this group we list the "old chestnut"—interest on investment. All that I am going to say on this subject is that the members of the cost committee of the industry must make up their minds as to whether or not interest on investment is to be considered as an element of cost. In a manufacturing industry where raw materials must be stored for a considerable period of time, this may be an important cost element. There may be other instances when this course may seem warranted. On page 34, Section XV, of the Manual of Cost Procedures recommended by the National Machine Tool Builders' Association we find:

> Good business practice contemplates Selling Prices that will cover the cost of material, labor and burden, plus an investment income and real profit from operations. In order that the variations in the investments in the different productive centers may earn their share of this investment income, operations through which the product flows must bear their proportionate share of the interest on investment used in the operation.

This principle was accepted by the Association when it adopted the Scovell-Wellington Cost Report in 1921. Page 3 of this report reads as follows:

> After a thorough consideration of the matter, the Executive Committee has decided unanimously to recommend to the industry that interest on investment be included in calculating the cost of manufacture This account is maintained to measure this element of cost.

Another example of a "stray" that must be settled by the cost committee in the interests of uniform classification is the proper account distribution of borings, turnings, scrap, etc. Shall these be handled as reductions of direct material cost or as other income? In many cases, due to the difficulty in definitely allocating these credits to the proper direct material classification, they are handled as other income.

Perhaps we can see, from the discussion thus far on problems in the classification to proper cost groups, the reason I emphasized in the beginning of this paper for the need of patient, painstaking, compromising effort.

We turn now to the second main group of problems which must be met in the application of uniform cost accounting to manufacturing industries—problems involved in allocating costs to product.

II. Allocating Costs to Product

We are all practical enough to realize that even though there is uniformity in the classification of costs to cost groups by all members of an industry, unless there is an accurate, equitable, uniform distribution of all costs to product, unless common bases are used by all members of the industry, all the refinement that is registered in the uniform classification to cost groups is practically useless. The prime purpose of the uniform cost plan is to enable all members of the industry to know the true cost of manufacturing, selling and distributing the product. This of necessity implies a correct allocation of these costs to all products manufactured.

Basic Problems in Allocating Costs to Product

It appears to me that in arriving at a uniform method of allocating all costs to the products of an industry, these problems are paramount:

1. Correct allocation of manufacturing costs to product. This in turn involves:
    - (a) General uniformity in departmentalization
    - (b) Redistribution of expense of so-called non-productive, service or general factory departments to productive centers to arrive at proper factory burden rate
    - (c) Base to be utilized in allocating factory burden to product

2. Bases for allocation of commercial expense (selling, administration and advertising) to product
3. Normal volume.

Departmentalization

The December 15, 1933, Bulletin of the N. A. C. A. showed a typical set-up of plant departmentalization for a manufacturing industry. Segregations were made between the productive burden centers and the so-called non-productive, service, and miscellaneous departments.

The cost committee must agree upon a departmentalization set-up that substantially represents the best "industry" opinion on this subject. In some cases, as was indicated in our discussion on the problems involved in the uniform classification for direct labor costs, a department which is fundamentally a productive center may, for accounting expediency only, be classified as non-productive and the costs treated as factory burden. As was mentioned previously, this sometimes applies to heat treating, annealing, and plating departments. This is done because it is sometimes impracticable to identify the labor of such departments (while productive) with the product handled.

Distribution of Non-Productive Departments to Productive Centers

After the general departmentalization has been agreed upon, the next problem to be faced is the establishment of a uniform method for distributing the expense of the non-productive departments to the productive centers. By way of illustration only, I am showing in Figure V the basis of distribution suggested in the uniform accounting plan for the steel and iron foundries industry.

When a uniform basis for the redistribution of the expense of the non-productive, service and general factory departments has been agreed upon, a basis is established for the development of productive department burden rates. The next step is the adoption of a uniform base for utilizing these rates in the development of product manufacturing costs.

Application of Burden Costs to Product

We are all familiar with the various bases that are used in applying factory burden cost to product. These are labor dollars, labor hours, and machine hours, or perhaps—as is suggested in the accounting plan of the National Battery Manufacturers' Association—a unit of production, all sizes being reduced to an equivalent. It is needless to empha-

BASIS OF DISTRIBUTION OF EXPENSE OF SERVICE AND NON-PRODUCTIVE DEPARTMENTS TO PRODUCTIVE CENTERS—RECOMMENDED BY STEEL AND ALLOY FOUNDRIES INDUSTRY

DISTRIBUTION OF NON-PRODUCTIVE BURDEN

Power Plant—on K.W.H basis—multiplying normal load of each motor by operating hours in each department.

Heating Department—separate and distributed on basis of cubical contents of each department.

Building Expense—on floor space basis

Drayage and Trucking—distributed to departments served on a basis of truck hours.

Works Management, General Superintendence, Product Planning and Time Study, Payroll, Cost, Employment and Welfare, Safety and Dispensary—direct expense plus share of Heating and Building Expense distributed on basis of payroll hours.

Laboratory to Productive, Auxiliary Departments and Selling Expense—on basis of services rendered—laboratory hours.

Purchasing Department to Productive and Expense Material Stores—on basis of stores issued each month.

Receiving and Stores Departments—on basis of materials consumed.

General Engineering to Departments and Selling Expense—on basis of services rendered.

Maintenance Departments—on basis of repair labor hours in each department.

Inspection Department to Production Departments—on basis of loss on defectives.

Waste Disposal Department—on basis of tons of waste removed from each department.

FIGURE V

size that there must be uniformity in the base used for applying factory burden to product or cost distortions will result.

Commercial Expense

The problems involved in securing a uniform treatment in allocating the so-called distribution expense to product would consume considerable more time than we have at our disposal. We are apparently just beginning to realize the importance of a proper allocation to product of this vital cost element. The very essence of the industry's plan to arrive at true costs implies an attempt to allocate selling, administrative and advertising costs to product in as scientific a manner as possible. This may mean recommendations and procedures for analyzing these costs to product types, territory, etc., in order to avoid the uneconomic averaging that has been so prevalent to date. In analyzing many of the uniform plans that are in effect at the present time, you are impressed with the manner in which this vital issue is dodged.

I am sure, however, that the increased interest in the uniform accounting movement, and the knowledge that its success depends to a great degree upon industry's uniform treatment of the so-called distribution expense in arriving at product cost, will add great momentum to the move of securing the same refinement in the allocation of distribution costs as is evident in the treatment of manufacturing costs. I also feel quite sure that the speaker who is to follow me will have something important to tell us of the problems that face us in the allocation of distribution costs to product. The same basic problems which he will discuss apply to manufacturing industries.

Normal Volume

I have purposely omitted thus far in our discussion of the problems involved in the allocation of costs to product what is perhaps the most important problem facing us in the application of uniform accounting to manufacturing industries. We need not be told that the allocation of factory burden and commercial expense—selling, administration and advertising—is made on the basis of normal volume activity.

This leads us to the crux of the uniform cost plan. What is normal volume for an industry to be? Right here we have perhaps the most difficult problem facing manufacturing industries endeavoring to establish a uniform cost accounting plan. What is normal volume to be? Shall it be on the basis of the individual plant's or the industry's "capacity to make"? Or the individual plant's or industry's "capacity to make and sell"? Shall we use current and succeeding years' outlook—a five-year experience, a combination of, say, three years' past experience and two years' forecast? Shall it be established on the basis of each department's capacity without regard to the interrelationship between departments? In other words, shall we give consideration to "bottle-neck" departments?

We know that the rate of plant operation is affected by general business conditions, seasonal fluctuation in sales likely within years of large volume, the industry's policy with respect to the seasonal accumulation of finished units or their components, the necessity and importance of maintaining excess plant capacity for emergency use, and many other factors. In addition, normal volume may be affected by changes in equipment affording lower costs, lower sales prices and, therefore, greater potential normal market. Rapid changes in manufacturing facilities, changes in design, and obsolescence all add to the difficulties. So, too, the introduction of new products increases the "headache" of establishing the volume to be used in allocating factory burden and commercial expense costs to the product.

The cost committee for a manufacturing industry has a real opportunity for sound thinking on this important subject, for it is obvious that grave economic consequences can follow as a result of pricing policies predicated on incorrect volume estimates.

It would appear to be a sound policy, in the first place, in establishing normal volume, to keep before us the economic situation of the industry rather than any abnormal situation pertaining to a particular unit in the industry. Also, where a manufacturing plant manufactures more than one product, complete information on the normal volume of each product manufactured is necessary, otherwise cost inequalities develop.

In the N. A. C. A. Bulletin of December 15, 1933, it is stated: "consideration must be given to conditions in industry over a period of years sufficient to establish a normal *for general acceptance* and this must be modified by whatever action may be taken under codes to limit or control production."

I feel that we can afford to take the time to look at the treatment given this subject in some of the uniform accounting plans that are being used at present. One treatment of normal volume is given on pages 4, 5 and 6 of the Definition of Cost under Article VIII of the Code of Fair Competition for the Electrical Manufacturing Industry:

> Normal volume may be computed most appropriately in relation to the capacity of the equipment available for production in the plant, that is, the installed equipment after making allowances for excess facilities as defined below. Normal volume is not dependent entirely on the equipment available for production. At the same time, in reality, the sales department in selling the company's product is engaged in selling the use of the company's facilities.
>
> All computations of normal volume are predicated on the operation of the plant on a single-shift basis, that is, on the number of hours per week (or per month or year) worked by the employees (unless, for example, the normal or established practice in a particular branch of the industry is to operate the plant on other than a single-shift basis).
>
> A plant has a theoretical capacity, that is, a capacity to produce at the full speed of all of its equipment and without interruption from any cause. It is impossible, of course, to operate a plant at such a rate and reduction must be made for those factors that result in a rate of production at less

than theoretical capacity This reduction must include allowance for the stoppage of the machine for normal causes such as renewing the supply of material, removing the finished product, adjusting the machine, etc Allowance also must be made for the fact that the machine will be operated by an average operator who cannot be expected to secure the maximum production.

Other allowances must be made such as no operators or material available for machines, machines stopped for repairs or because of no power or steam, and machines stopped because of delays incident to production of imperfect goods. In other words, theoretical capacity should be reduced to the extent necessary to take into account all causes of idleness except a shortage of orders.

The amount of reduction from theoretical capacity to normal capacity as here used, varies, of course, from plant to plant but it is usually found that the amount of allowance is 15 to 20 per cent and maybe more.

The next question for consideration is as to whether there is need for further reduction due to the inability to secure orders throughout a period of years, sometimes called the business cycle, to keep the plant operating at normal capacity. In attacking this problem, attention should first be given to the possibility that there may be excess facilities in the plant . . .

Sharp distinction should be drawn between excess facilities and idle facilities. Idle facilities are those which for greater or less lengths of time are out of operation but are retained in their normal positions in the event production requirements make it necessary again to use them.

The overhead expenses incident to excess facilities should not be charged to the cost of products. The expenses of idle facilities, however, should be charged to the cost of products through inclusion in normal overhead expenses for, although not in use, they are held available for use.

Where a plant has been carefully engineered for the production of a line of goods not subject to wide variations in demand, it will be equitable to determine normal volume on the basis of the output of equipment at normal capacity Where, however, the demand for the product is subject to fluctuations different from or greater than the fluctuations of general business, and where it has not been feasible to keep the equipment of the plant in close balance with production requirements (even though there be no excess facilities or after making allowance for such excess facilities) further allowances should be made due to the fact that the equipment will not be operated over a period of years at the capacity of which it is capable.

The need for this allowance is particularly evident at the present time. The great disarrangement of production requirements as the result of the depression due not alone to lack of orders but also to changes in the kind and styles of products demanded by purchasers means that many plants will not be able to operate at normal capacity as defined above during the next few years. Allowance should be made, therefore, for this condition.

In the cost accounting principles for the Washing and Ironing Machine Manufacturing Industry we find:

> In establishing the basis of normal productive capacity the ratio of the average annual sales volume in units (using a five year period) of the Industry will be determined in relation to the maximum production volume in units possible if the available facilities for manufacture in the Industry were operated for a fifty-week period at a 40-hour week This ratio or percentage of average volume to maximum volume will be applied in each of the Companies to their maximum volume expressed in Direct Labor Dollars (Productive Labor × Average Current Wage Rate) in order to arrive at the Normal Productive Labor to use as the basis in determining the ratio of budgeted Fixed Factory Burden

In the definition of cost for the Hosiery Industry the normal volume is indicated as follows:

> (1) From the fifty-two, eighty-hour weeks of the year, or other provision for the operation of productive machines as may be provided by amendment to the Code, deduct legal holidays and the time allowed for taking inventory in order to determine the maximum possible time that the knitting departments would be devoted to production, and express the result in terms of total productive hours
>
> (2) Compute total maximum production that the knitting departments are capable of accomplishing in the total productive hours, and consider this the maximum capacity of the mill.
>
> (3) Normal capacity will be stated as 75% of maximum capacity. The deduction of 25% is to provide for loss of time due to break-down, pattern changes, making samples, seasonal fluctuations and other causes. In any case where a mill's total production has exceeded 75% of the maximum capacity for the previous fiscal year, the actual percentage of maximum capacity so attained may be used in place of the 75% otherwise specified.

In the cost accounting system for the Malleable Iron Industry approved April 25, 1934, there appears the following on page 6:

> (1) In order to determine the amount of Fixed Plant Charges and Administrative and Selling Expense to be distributed, the following procedure shall be used:
>
> "Normal Operations" of the individual producer for any semi-annual accounting period shall be determined by taking not more than sixty-five (65) per cent of the best six (6) consecutive months' production of such individual producer ("practical capacity") since Jan. 1, 1924, and for any quarterly accounting period, one-half of such amount.
>
> Determine the precentages which production of the individual producer for the last preceding semi-annual or quarterly accounting period is of normal operations for the same length of time. Distribute this percentage of total Fixed Plant Charges for the same accounting period, adjusted to a basis of normal operations as follows (when not severally departmentalized): 10% on the basis of pounds of metal poured (melting department expense), 40% on the basis of molding direct labor, 10% on the basis of coremaking direct labor, 10% on the basis of the combined

> grinding and finishing direct labor, and 30% on the basis of the weight of good finished casting produced, all for the same semi-annual or quarterly accounting period to determine the amount per ton or percentage, as the case may be, to be added to the respective departmental indirect costs.
>
> Determine the percentage which production of the individual producer for the last preceding semi-annual or quarterly accounting period is of normal operations for the same length of time and distribute this percentage of the total Administrative and Selling Expense for the same accounting period, adjusted to the basis of normal operations, on the basis of manufacturing cost for the same semi-annual or quarterly accounting period.

And finally, we note in the Rubber Manufacturing Industry:

> Each year the Accounting Department of the Rubber Manufacturers' Association shall establish the average annual volume of sales during the preceding five or seven years, for each Division or Sub-Division of the Industry as each Division may determine. They shall establish also each year the current potential productive capacity per hour for each Division using the same basis of measurement. The average annual volume of sales divided by the potential productive capacity per hour will indicate the number of hours that the division must operate per year to supply the annual demand for its products averaged over a cycle of five or seven years. The Rubber Manufacturers' Association will report this number of hours to each member of the Division as the standard for the ensuing year.

No Royal Road to Uniform Accounting

I feel that from our discussion we recognize the general problems facing those industries that would adopt uniform accounting methods. I know that we appreciate the importance of a proper viewpoint, a proper approach to the solution of these problems. I think from the illustrations that have been given we can discern the problems involved in the classification of costs to proper cost groups, uniformity in the classification of cost elements of each cost group, and the allocation of costs to product.

All these and other problems have been recognized by the considerable number of manufacturing industries that have already adopted a uniform accounting plan. It matters not whether the plan merely covered fundamental definitions of cost or whether it was an elaborate accounting manual. Make no mistake about it—a real start has been made. Mr. Gunnarson, Manager of the Department of Manufacture of the Chamber of Commerce of the United States indicates that about 150 industries have made some progress in the field of uniform cost accounting. These industries include: Malleable Iron, Electrical Manufacturers', Machine Tool, Fishing Tackle, Luggage and Leather

Goods, Washing and Ironing Machine Manufacturing, and Hosiery—to indicate the variety of interests covered. In reporting on one accounting plan we find that "as a result of the promotion of cost accounting it is estimated that 60% of the members in the industry are reasonably informed on costs of various products manufactured. In 1925 not more than 25% of this industry had adequate cost methods."

I do not mean, of course, that the plans in effect are being strictly adhered to. Nor do I mean to infer that in the industries mentioned above "their troubles are over." In most cases, only a start has been made. In many instances they have not even gone beyond the definition stage, but I repeat a start has been made and that is the important thing.

There is no royal road to uniform cost accounting. Patient, painstaking efforts are required. There must be a "will to uniformity" and, very important, too, a good "follow through." If there is a whole-hearted, open-minded, compromising attitude, if the viewpoint of the industry's interest rather than that of the individual unit prevails, if decisions are made on the basis of the well-being of the majority rather than of a few units, then success will follow the effort.

We must not fall into the accounting pitfall of "whole hog or none" in attempting to work out all the fine details before making a start. This often prevents a start being made and there is nothing gained by anticipating difficulties that will never occur. Where only principles can be adopted, let us be practical and adopt them; where principles and methods can be used, let us use them.

Shift in Accounting Emphasis

Accountants are facing new opportunities in the widespread interest in the uniform accounting movement. Just as the shift in emphasis in industry is from the individual unit to industry itself, so, too, the shift in accounting emphasis is from the viewpoint of the individual company to the industry in general. This means sharp readjustments in the outlook of the individual who must help in applying the new business philosophy. It means a much broader perspective and viewpoint—it means the narrow provincialism that has dominated much of our accounting thinking must be a thing of the past.

In the long run it is the accountant who must solve the greatest problem in the application of uniform accounting to manufacturing industries. It is the accountant who must show industry the benefits of the uniform accounting plan—the benefits of "talking the same language and playing the game by the same rules." It is the accountant who by his education, training and experience must be able to show industry that in a uniform accounting plan we have a symbol of "Industry Coming of Age," by means of which the strange, dark fetishes of an old order can be dissipated in the bright glow of enlightened self-interest.

CHAIRMAN KNAPP: I am sure you were all very much interested in what Mr. Moore had to say to you. He has prepared a very excellent and interesting paper on this subject, and I want most heartily to recommend that one of the first things you do when you get your Year Book is to turn to Mr. Moore's paper, which will be there in its entirety. I am very sure I can recommend it as something worth while.

We have as our third speaker on this morning's program, a man who is to talk with us on the same subject from the viewpoint of trade and distribution. Mr. Domer E. Dewey, the next speaker, is a member of our Chicago Chapter. He is a graduate of the Wharton School of Commerce of the University of Pennsylvania. Since 1926 he has been associated with the Laundryowners National Association of the United States and Canada and some of their subsidiary companies. At the present time he is their Director in Charge of the Department of Accounting. He has given an intensive study to the various accounting problems that have developed in that industry, and I am sure will present to you something that will be very much worth while.

THE N. R. A. AND UNIFORM ACCOUNTING FOR THE LAUNDRY INDUSTRY

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BEFORE discussing the uniform accounting system which has been developed for the laundry industry, I would like to give you a picture of the size of the laundry industry and the trade association which represents it. I believe that this is necessary in order that you may be better able to follow the various steps in the development of our Uniform Accounting System.

The 1931 Census of Commercial Power Laundries shows that there were 6,400 laundries, employing 217,138 people (exclusive of office employes and executives) and doing an annual volume of business of $465,969,305.

The Census figures for the year 1933 are not yet available, and of course, will show a decrease when compared with those for 1931. The laundry industry, according to latest available data, ranks eighth in number of employes and thirtieth in sales volume, when compared with other industries. These figures should impress you with the fact that the laundry industry is an important one.

Unlike many trade associations which either came into existence as a result of the N. R. A. or were materially strengthened by it, the Laundryowners National Association of the United States and Canada, which I will hereafter refer to as the L. N. A., will be celebrating its fifty-first anniversary at its annual convention in Cincinnati this fall. It has 2,700 laundryowner members representing forty-two per cent of all laundries and approximately seventy-five per cent of total laundry volume. The remaining twenty-five per cent of the laundry volume is done by small units which are not members and are the type of plants which are not interested in association activities. It has in addition 300 associate members, companies whose products or services are sold within the laundry industry.

The membership roster of the L. N. A. includes members located in Canada, Alaska, Republic of Panama, Cuba, India, New Zealand, Philippine Islands, South Africa, Australia, Belgium, Bermuda, Denmark, England, Holland, Sweden, Switzerland and Japan.

One of the most important functions of the L. N. A. is to serve as a clearing house for laundry information. This is accumulated and dispensed by the various Service Departments, of which there are five, each supervised by a departmental director. These departments are as follows:

1. Department of Research and Textiles
2. Department of Engineering
3. Department of Sales Promotion
4. Department of Publicity
5. Department of Accounting

The L. N. A. also owns and controls the American Institute of Laundering, Inc., which has an investment in buildings and equipment of three-quarters of a million dollars. The American Institute of Laundering operates a commercial laundry unit, which is a practical proving and improving laboratory for the laundry industry. It also conducts a vocational training school for future laundry executives.

Five two-month courses are taught each year in this school, consisting of Power Plant Engineering, Laundry Production, Textiles and Washroom Practice, Accounting and Office Administration, and Sales, Service and Advertising. Each course is taught by the various departmental directors and their associates, thus assuring the students in each course thorough laundry instruction by teachers who have a practical knowledge of the subjects being taught. A separate student training laundry and special laboratories are part of the facilities of the school.

The idea of a uniform system of accounting for the laundry industry was conceived long before the N. R. A. made it advisable that all members of an industry adopt a uniform method of ascertaining and recording their costs.

Twenty years ago Mr. W. E. Fitch, then General Manager of the L. N. A., with the approval of the Board of Directors, retained a firm of public accountants to do the initial work incident to the preparation of an expense chart which was to serve as the basis for a uniform accounting system for the laundry industry. This chart of expenses was prepared and submitted to the delegates present at the annual convention in Niagara Falls in 1914. The unanimous approval of delegates was obtained.

The firm of public accountants which designed the original expense classification was appointed as installing agent and this arrangement was continued for a few years, when it was decided that it was to the advantage of the L. N. A. to employ its own accountants for installation work. This decision resulted in the creation of the Accounting Department, which was the first L. N. A. Service Department to be established.

The difficulties in promoting uniform accounting within the laundry industry were numerous. Laundryowners were not accustomed to recording the pertinent facts pertaining to their business. Many did not employ full-time bookkeepers, and some attempted to keep a few records during their spare time, with little knowledge of bookkeeping principles. It was very difficult to sell laundryowners on the idea that the additional expense resulting from the employment of a bookkeeper and the use of specially prepared accounting forms, would pay large dividends. Some laundryowners could not be interested in keeping their costs on a comparable basis, because they were suspicious of those with whom it would be to their advantage to compare costs. These were some of the problems which were encountered many years ago. They were partially solved by persistent educational efforts on the part of the L. N. A., and by the example of those laundryowners who were accounting-minded and who had profited from the use of our accounting system. Uniform accounting was stressed in all L. N. A. and trade publications, at all state and local meetings, and at the annual conventions. The compilation and publication of average cost figures created more interest in uniform accounting than any other one factor.

The original uniform accounting system was called a "Uniform Cost Accounting System" for the reason that it provided for the recording of the various expenses or costs of the average laundry on a uniform basis. It was not a cost system in the same sense as we cost accountants think of a cost system, for the reason that it did not provide for the costs of the various services. It did, however, give the laundryowner more usable information concerning his various expenses or costs than had been available at any time in the past.

Several revisions were made in the system between the time of its inception in 1914 and the year 1933, each revision resulting in some improvement. Approximately 1,000 systems were in use at the time that the N. R. A. came into existence.

A further revision of the system was being contemplated prior to the passage of the N. I. R. A. The passage of this act provided the opportune time to make this revision.

During the time from 1914 to 1933 there were several public accounting firms which had been specializing in laundry accounting, and which had developed systems of their own somewhat comparable to the L. N. A. system. These systems were in general use in the territories served by these accountants. The L. N. A. realized that, in addition to its own system, the systems of these accounting firms had sufficient merit to warrant serious consideration in the interest of uniformity. Accordingly, representatives from these accounting firms were invited to cooperate with the L. N. A. in its most recent revision. This cooperation was secured and appreciated. These accounting firms have agreed to adopt our revised expense classification, and to convert their present clients to it. As a result, more laundries have been added to those already using our expense classification.

The following is the Operating Expense Account Classification which we recommend be adopted by all laundries. This operating expense account classification is the foundation upon which our uniform system of accounting is built. It consists of what we term the eight major divisions of laundry operating expense, which are:

1. Productive Labor Costs
2. Productive Supply Costs
3. Power Plant Costs
4. Building Overhead Costs
5. Laundry Machinery Overhead Costs
6. Indirect Overhead Costs
7. Collection, Delivery and Sales Promotion Costs
8. Office and Administrative Costs

We recommend that the smaller laundries maintain only eight operating expense accounts (Simplified Expense Account Classification), one account to correspond with each major expense division, as indicated by (S) on the following chart, and that the average laundry maintain what we term the Basic Expense Account Classification, which is the Simplified Classification broken down into detail accounts as indicated by (B) on the following chart.

You will note that the decimal system of account numbering is used, providing for a further breakdown of Basic Expense Accounts if this is desired. Our system is flexible to the extent that it can be used by all laundries irrespective of size. It is available to non-members, as well as members, at the extremely low price of $32.50, which includes approximately one year's supply of forms, three Stanite binders and a Manual of Instruction.

L. N. A. Operating Expense Account Classification

(S) indicates Accounts in Simplified Classification
(B) indicates Accounts in Basic Classification.

(S) 1. Productive Labor Costs
- (B) 1.1—Productive Labor (Laundering)
- (B) 1.2—Productive Labor (Dry Cleaning)
- (B) 1 3—Outside Work

(S) 2. Productive Supply Costs
- (B) 2 2—Nets and Marking
- (B) 2 3—Washroom Supplies
- (B) 2.4—Water and Softener Supplies
- (B) 2.5—Ironing and Finishing Supplies
- (B) 2 6—Packaging Supplies
- (B) 2.7—Dry Cleaning Supplies

(S) Power Plant Costs
- (B) 3 1—Power Plant Wages
- (B) 3.2—Fuel
- (B) 3.3—Repairs and Maintenance
- (B) 3 4—Depreciation (Equipment)
- (B) 3 5—Insurance (Other than Property)
- (B) 3.6—Purchased Power and Light

(S) 4. Building Overhead Costs
- (B) 4 2—Rent of Laundry Building
- (B) 4.3—Repairs and Maintenance
- (B) 4.4—Depreciation
- (B) 4 5—Insurance
- (B) 4 6—Taxes

(S) 5. LAUNDRY MACHINERY OVERHEAD COSTS
- (B) 5.3—Repairs and Maintenance
- (B) 5.4—Depreciation
- (B) 5.5—Insurance
- (B) 5.6—Taxes

(S) 6. INDIRECT OVERHEAD COSTS
- (B) 6.1—Indirect Labor
- (B) 6.2—Superintendence (Plant)
- (B) 6.3—Supplies and Expense
- (B) 6.5—Compensation and other Insurance

(S) 7. COLLECTION, DELIVERY AND SALES PROMOTION COSTS
- (B) 7.1—Routemen's Wages and Commissions
- (B) 7.2—Route Supervision
- (B) 7.3—Delivery Equipment Operating Expense
- (B) 7.4—Depreciation (Equipment)
- (B) 7.5—Liability and Other Insurance
- (B) 7.6—Agency, Branch and Call Office Expense
- (B) 7.7—Advertising and Publicity
- (B) 7.8—Sales Promotion Salaries and Expense
- (B) 7.9—Claim Adjustments

(S) 8. OFFICE AND ADMINISTRATIVE COSTS
- (B) 8 1—Office Salaries
- (B) 8 2—Stationery, Printing and Postage
- (B) 8.3—Other Office Expense
- (B) 8.4—Depreciation (Office Equipment)
- (B) 8.5—Executive Salaries
- (B) 8.6—Employe Free Work
- (B) 8.7—Bad Debts
- (B) 8.8—Dues and Subscriptions
- (B) 8 9—Other Administrative Expenses

The passage of the N. I. R. A. led us to believe that all members of the laundry industry would be required to record their costs on a uniform basis and that costs of the individual services would be necessary for the purpose of establishing selling prices. Fortunately, we had a uniform system of accounting already developed and in use, which would enable many laundryowners to meet those requirements of N. R. A. pertaining to uniform accounting. Our system was also available to non-member laundries.

Due to material reduction in the personnel of the Accounting Department during the previous three years, and anticipating a widespread demand for the installation of our system, we appointed reputable public accounting firms with offices in approximately sixty different cities throughout the United States and Canada to act as our accounting representatives for installation and cost work. These accounting firms are associate members of our Association and pay dues in accordance with its by-laws. The L. N. A. receives no revenue from work done by its authorized accountants. The only income received from authorized accountants is in the form of associate membership dues, which are nominal. We thus prepared to enable laundryowners to meet that part of the N. I. R. A. which pertained to uniform accounting.

You will have observed, no doubt, that I have not referred to uniform cost accounting for the laundry industry, except to mention that our original accounting system was called a uniform cost accounting system, when, in fact, it was only a general accounting system adapted to the needs of the laundry industry. Our revised system is called a Uniform System of Accounting for the Laundry Industry, and has nothing to do with costs of the individual services except that it forms the basis for the determination of such costs.

Since it has not been an easy task to convince laundryowners that it was to their advantage that they keep adequate general accounting records and since the office personnel of the average laundry is neither adequate nor qualified to maintain a permanent cost accounting system, we have not recommended that such a system be installed. In the past we have recommended to those laundryowners who desired to know the costs of their individual services, that they employ our cost accountants or other cost accountants familiar with the laundry industry and our cost procedure to conduct test cost surveys in their plants. Very few laundries are maintaining cost accounting systems at the present time.

The final code for the laundry industry, as approved by the President, did not make it necessary that costs of laundry services be determined for the purpose of establishing selling prices. The price-fixing provision was a part of it until assent to the code was withdrawn by the code authority. The following is quoted from the code: "To require that all individual and group cost data, as may be necessary under this Code, be ascertained, and costs allocated to the various laundry services and articles in a manner approved by the Code Authority." This provision of the laundry code meant that in those instances where it might have been necessary to determine the costs of the various laundry services, that the L. N. A. method of cost finding was to be followed. I will now give you a brief outline of the procedure which we follow in determining laundry costs by services.

Laundry cost accounting procedure is rather unique in that it is concerned neither with the manufacture of a product, nor with the conversion of a natural resource. It is concerned with the re-conditioning of fabrics over which it has no control as to quality, size or style.

Since every week is a complete sales and production cycle in the laundry industry, a cost survey can cover one or two weeks' production, or more, depending upon the wishes of the laundryowner whose plant is to be costed. It is always desirable, of course, to avoid weeks in which there are holidays or other conditions present which tend to affect normal production.

After a study of the flow of work and conditions peculiar to the plant to be costed has been made, it is necessary to provide for the recording of sales data according to services; production data consisting of number of pieces and pounds laundered according to the various service classifications; power plant data, consisting of fuel consumed, boiler horse power produced, electricity generated, etc.; also miscellaneous data, such as inventory of supplies on floor at beginning and end of cost period, and instruction of employes in use of time cards, on which they are to record time spent on the various operations according to classes of service; and other details.

An Operating Statement for the period to be costed, which follows the form of the Operating Expense Account Classification previously described, is the basis for distribution of labor, supply and laundering overhead costs to the various production departments or centers and then to the various services and their sub-classifications. The production departments common to the majority of laundries are as follows:

1. Identification
2. Washing and Extracting
3. Wet Assembling and Dispatching
4. Starching
5. Drying
6. General Machine Ironing
7. General Hand Ironing
8. Collar Starching, Ironing and Finishing
9. Shirt Ironing and Finishing
10. Handkerchief Ironing
11. Flatwork Ironing
12. Curtain Finishing
13. Blanket Finishing
14. Mending
15. Assorting and Wrapping

The Operating Statement cannot, of course, be completed until the end of the period being costed, as many of the expense items to appear thereon are taken from the records for the cost period. Actual cost figures are used wherever possible, such as payroll, supplies and other items which can be directly applied to the period. Certain overhead items, etc., are averaged over a reasonable period of time and then proportionately applied to the period of the survey.

I will not attempt to give you a description of the various steps which are followed, and the schedules which are used to distribute the costs shown on the Operating Statement for the cost period, to the various production departments and from these departments to the various services. I do believe, however, that you will be interested in learning of the methods which we use to distribute the various costs. I believe that these methods are consistent with recognized principles of cost accounting.

Productive labor costs are distributed direct to the various departments and from departments, direct to services Proration of productive labor cost is made to sub-classifications of services on pound or piece percentage basis, whichever is most logical.

Productive supply costs are distributed direct to departments and from departments direct to services and sub-classifications, where possible; otherwise on a pound percentage basis.

Power plant costs are converted into cost per boiler horsepower and kilowatt hour and distributed to departments, according to boiler horsepower and kilowatt consumption of each department. Departmental power costs are distributed to services and sub-classifications according to the percentage which the departmental productive labor for each service is of the total departmental productive labor.

Building overhead costs are distributed to the various departments on a percentage of floor space basis and to services and sub-classifications on a departmental productive labor percentage basis.

Laundry machinery overhead costs are distributed to the various departments on an equipment valuation basis and from departments to services and sub-classifications on the same basis as power and building overhead costs.

Indirect overhead costs are distributed to the various departments by several different methods. Indirect labor is distributed on a floor space basis; superintendence, direct when possible, otherwise on a total productive labor basis; and supplies and expense, and compensation insurance on a total productive labor basis. Departmental indirect overhead costs are distributed to services and sub-classifications on a departmental productive labor basis.

Collection, delivery and sales promotion costs are distributed direct to services by several methods. Routemen's wages and commissions are distributed to the various services on a sales percentage basis. All other costs are distributed on a bundle percentage basis. Distribution to service sub-classifications are made on a pound percentage basis.

Office and administrative costs are distributed direct to services and sub-classification on a total productive labor basis. The theory underlying this method of distribution is that these costs are governed in a large measure by the size of the business and that size is reflected with reasonable accuracy by productive labor payroll, each service receiving benefits of these general costs more or less in relation to the amount of labor employed.

It will have been noted, no doubt, that productive labor payroll has been used as the basis for distribution of several major expenses. This is done for the reason that productive labor is the most important expense item in laundering and has been found to be a practical basis for distribution of many laundering costs.

I have told you something about the laundry industry, our trade association, our uniform system of accounting and our cost accounting procedure. It has been suggested that I discuss some of the problems which N. R. A. has brought or could bring to the uniform system of accounting in use by our members.

Problems Under the N. R. A.

Fortunately, our major accounting problems have not resulted, nor do we believe they will result, from the N. R. A. As previously mentioned, we had a uniform system of accounting long before the government started to work the letters of the alphabet overtime. We had a uniform system of accounting in use and ready in case the N. R. A. made uniform accounting compulsory within our industry. No accounting problems have yet accrued to us, because of the N. R. A. Our problem has been largely that of educating members of our industry to realize that the voluntary adoption of our system would prove to be the most profitable investment ever made by them.

We would have a problem to solve as a result of N. R. A. if it had made, or were to make it necessary that all laundries know their individual service costs for the purpose of establishing selling prices under a code. It would then be necessary to quickly develop a simple method of cost procedure which could be followed by the accounting personnel of all laundries, and have cost accountants familiar with laundry cost procedure available for any special cost work which might result due to N. R. A. and a laundry code.

Cost procedure which might be considered as being simple by cost accountants would be too involved for the majority of laundry bookkeepers, or other office employes who might be asked to ascertain individual plant costs, and, as a result, it is doubtful whether the service costs as obtained would reflect actual cost conditions. Simple cost accounting procedure or systems cannot be developed quickly, and incorrect costs are of no value.

We have already partially solved the problem of having qualified cost accountants available for special cost work through the appointment of public accountants to represent us in accounting matters. The services of these accountants are available for installation and cost work. It is our plan to have those of our authorized accountants who are not experienced in laundry cost work assist some other authorized accountant who has had this experience, in conducting one or more cost surveys. This plan, which would be somewhat comparable to a chain letter proposition, would result in all authorized accountants receiving instruction in our cost procedure methods in the shortest possible time.

Another problem which would have to be solved, if the N. R. A. were to make it necessary that costs of services be determined for purposes of establishing selling prices, would be that pertaining to distribution of overhead to the various services. This problem is already existing in other industries as pertaining to their products, and either has been discussed or will be discussed in some of the sessions. The consensus of opinion of accountants associated with the laundry industry is that overhead on idle and unused equipment and floor space should not be charged to the services, but should be eliminated before making the overhead charge. The problem of proper distribution of overhead to present-day volume must be solved, irrespective of future N. R. A. developments.

Selling prices in the laundry industry have always been established by two types of competition, that of trade competitors and home managers, who will either do their own laundering, or have it done in their homes if laundry prices are considered too high. The N. R. A. may permit laundries to fix their selling prices, but it is the home manager who will decide how long they will remain fixed. Laundering is a service which can be done by the home manager if the prices charged by commercial laundries are more than she can afford to pay. Laundry prices will, therefore, continue to be fixed by trade and home competition. Costs by services need not be known by classes of service for the purpose of establishing the price which the home manager can and will pay.

It is well known that the purpose of N. R. A. and the codes of fair competition was to increase wages, reduce number of hours worked by employes, thus increasing purchasing power, and to regulate competition within the various industries so that they would be enabled to meet the wage and hour provisions. The act specifically excluded the regulation of domestic and manual labor. This meant that washwomen and maids in the home, who are most important laundry competition factors, could not be regulated as to hours and wages. The situation of the laundry industry was unique in that while it was subject to the minimum wage and maximum hour provisions, its most important competition could not be regulated. This condition did not exist in any other industry. The fundamental purpose of the act was to regulate all competition and place it on the same basis. The act failed in its application to the laundry industry because of reasons stated.

In the future the L. N. A. will stress, more than ever, the necessity for uniform accounting in the laundry industry. Further reductions in cost must be made in laundering operations, and these can be accomplished by maintaining our revised system of accounting and making practical use of the information which it provides. We will make further revisions in our cost procedure methods and will have the facilities to enable laundryowners to ascertain their service costs.

CHAIRMAN KNAPP: I want to reiterate, in connection with the open forum tomorrow, that on account of the scarcity of time all discussion will be postponed in connection with these morning papers until that time. You will note that it states in the second sentence on this questionnaire: "All questions and points submitted will be discussed as far as possible, preference being given to accounting problems arising under the codes." That was the subject of this morning's session.

I think it would be a splendid idea if, in writing your question on this blank, you also make reference to Mr. Elliott's talk, Mr. Moore's talk, or Mr. Dewey's talk, as the case might be, and we shall see if we can arrange with Dr. Reitell to have those questions all come up together, so there will be a sort of contact between this morning's session and the questions that will come up at a certain time in the forum tomorrow.

I am sure you have enjoyed the morning session, and am equally sure you will enjoy the afternoon session. The time is late and group luncheons begin quite soon. In order that there may be no delay in starting the afternoon session and in order that we may be able to get into the meeting all that it is possible to pack into it, let us all try to be here promptly at two o'clock this afternoon.

Until that time, the session is adjourned.

. . The meeting recessed at twelve-fifteen o'clock. . . .

SESSION IV

STANDARD COSTS AND STATISTICS UNDER THE CODES

WEDNESDAY AFTERNOON, JUNE 27, 1934

C. HOWARD KNAPP, *Chairman*

ERIC A CAMMAN was born in Cincinnati, Ohio, received his high school training at Curtis High School, Staten Island, and his higher education from Columbia University night sessions His broad practical experience was obtained in contact with the following positions which he has held Secretary-Treasurer of the Lehigh Coke Company; private secretary to Edward Dean Adams, banker; junior partner of G. Charter Harrison & Company, cost installation man with Scovell, Wellington & Company; Assistant Controller and later Assistant Treasurer of J. H. Williams & Company; in charge of Systems Department and later Partner, Peat, Marwick, Mitchell and Company.

Mr. Camman was a charter member of the National Association of Cost Accountants and has served the Association in many capacities for a number of years. In 1927–28 he was President of the New York Chapter. Elected to the National Board in 1930, he served as Director in Charge of Research for the years 1930–1931 and 1931–1932, and as Director in Charge of Chapters for 1932–1933 and 1933–1934. During the past year he has served as Vice President, and has been nominated for the Presidency for the coming year.

In addition to his affiliation with our Association, Mr. Camman is a member of the American Institute of Accountants, the New York Society of Certified Public Accountants, and the Society of Certified Public Accountants of the State of New Jersey. He is the author of several articles on cost accounting subjects and of *Basic Standard Costs* published by the American Institute Publishing Company in 1932.

DR. ALBERT J. HETTINGER received his A B. degree from Stanford University in 1916, his M.A. degree from the same University in 1917, and his Ph.D degree from Harvard University in 1920 Following graduate work at Stanford he became affiliated with the U. S. Railroad Administration, serving as Statistician in the Operating Statistics Section during 1918–19, and acquiring the title of Statistician to Financial Assistant of Director General in the latter year. Upon the completion of his work for the Ph.D degree, Dr. Hettinger became Consulting Statistician for the Federal Reserve Bank of Boston, while continuing to teach in the Graduate School of Business Administration at Harvard. During 1920–21 he served as Instructor in Transportation, in 1921–22 as Instructor in Business Statistics, and from 1922 to 1926 as Assistant Professor in Business Statistics. He then became head of the Department of Statistics which position he held until 1932, when he became President of the Investment Research Corporation Trustees, Investment Company of America of Detroit. During the past year he has been employed as Economist with the Research and Planning Division of the National Recovery Administration.

STANDARD COSTS AND STATISTICS UNDER THE CODES

CHAIRMAN KNAPP: It certainly is fine to start our afternoon session with such a splendid attendance. I know we have something very much worth while in store for you.

You all know Eric Camman You have heard him before. I had the pleasure of having luncheon with Dr. Hettinger, and I can assure you we have two very fine speakers for this afternoon.

There are perhaps two reasons for attending these conventions. One covers the very excellent technical sessions we have, and another is the splendid social good times that we enjoy. A third reason, and a very much worth while feature of every convention, is the ability to visit the exhibits out there where you will find on display some of the very latest labor-saving devices.

I think probably it is an endorsement to the fine technical sessions we have been having and the wonderfully good times as well, that people have not been as interested as they should have been in the marvelous exhibits out there. I am sure that particularly those of you whose companies are paying your expenses here will have companies who will be cheated somewhat if you do not take advantage of this occasion to go out and look at the latest labor-saving devices.

I am very sorry that I can not tell stories the way some people can. I wish I knew one as good as Mr. Gunnarson's "revolving rug" story of yesterday. The only thing I can think of that is at all pertinent to this meeting and my being here is the fact that I am conscious of a certain inability to use the correct word in order to properly express myself.

In recognition of that failing on my part, I was very much interested in hearing a story the other day that most of you may have heard, about a man who was exceedingly famous for always being able to say the correct word to express the meaning he had in mind. Unfortunately, however, for this fellow, he was discovered one time by his wife in the act of embracing his very beautiful French parlor maid.

The wife, coming in, said, "Why, John! I am surprised!"

He could not resist the temptation to speak correctly or to correct those who were not speaking correctly. So he said, "Pardon me, darling, but I am the one who is surprised. You are astonished."

That is quite similar to a companion story that has to do with Dr. Johnson, the famous English language purist. He was not only famous for his purity of English language, but was perhaps a little infamous for some of his personal habits.

At a dinner party that was being held one evening, a lady, upon finding out that she was to sit next to Dr Johnson, went to her host and said, "Will you please change my seating? I find I am sitting next to Dr. Johnson. I do not want to sit there because he smells."

Dr. Johnson happened to overhear the remark, and he could not resist the temptation to correct the lady. So he said, "Pardon me, Madam You are the one who smells. I stink."

I hope that my remarks will not be so ungrammatical or my words so ill-chosen that in any way you will be reminded of Dr. Johnson's remark about himself.

It is quite evident, in connection with the bulletin that was published today, that the first speaker on our afternoon program needs no introduction. I know that is the usual way to start an introduction of some one quite famous, but if you will notice the bulletin of this morning, it says almost nothing about Eric Camman.

I do have some information here that you may not know, and I am sure you will be interested in it.

Mr. Camman was born at Cincinnati, Ohio, received his high school training in Staten Island and his higher education at Columbia. He has had a broad, practical experience, as you know, both with industrial companies and in public practice. At the present time he is a partner of Peat, Marwick, Mitchell and Company.

Mr. Camman's history with our Association has been remarkable. He was a charter member of the Association at the time it was formed; in 1927 and 1928 was President of the New York Chapter; in 1930 and 1932 he was Director in charge of Research; and from 1932 to 1934 Director in charge of Chapters. This last year he was Vice President, and I think there is a chance of his being made President at the meeting this week because he is the only nominee. That is not the only reason, however, why he will be elected.

In addition to his affiliation with our Association, he has spoken, at some time or another at almost all of the chapters. He is also a member of the American Institute of Accountants, the New York Society of Certified Public Accountants, and the Society of Certified Public Accountants of the State of New Jersey.

He has, as you know, written a number of articles on cost accounting subjects and is the author of *Basic Standard Costs,* recently published by the American Institute Publishing Company.

Mr. Camman is probably our most versatile member. I do not need to comment at all upon his ability in his profession, because you all know that. His golf game is of such a character that it is unusual. You will notice that, too, by looking at the list of prize winners at Monday's tournament Those of his friends who are fortunate enough, or unfortunate enough—I do not know just which it is—to be with him more or less have always wondered at his powers of endurance I can assure you, however, that it will not be necessary for any of you in this audience to have powers of endurance to listen to him this afternoon.

Mr Camman will speak to you on "The Use of Standard Costs Under the Codes."

THE USE OF STANDARD COSTS UNDER THE CODES

Eric A. Camman
Partner, Peat, Marwick, Mitchell and Company, New York, New York

IT SEEMS to me that in the wording of the subject "The Use of Standard Costs Under the Codes" there is an implication that is very similar to the broader implication present nowadays since the recovery measures have been passed, that under the New Deal all things must be different, and that old principles must pass into the discard.

I seem to sense at times a belief that even human nature must change since we have the National Industrial Recovery Act and the codes. But we are now about at the stage, I think, where we are beginning to realize that possibly human nature will not change so quickly. Nor can our problems be solved solely by means of codes.

However, I should like to make this observation, in speaking of this title "The Use of Standard Costs Under the Codes." In my opinion, there is no change whatever in the status. There is just as much use now as ever before. There is no change that I can see in the benefits to be obtained by using standard costs.

There is a good deal of confusion at present, which I attribute to the introduction of cost-protection clauses in the codes. Many of us are now in the position of wondering what costs are and how we may have to change all our previous conceptions of cost accounting, largely through the conflicting and disturbing wording that we have found in selling-below-cost clauses. While the definitions of costs in codes are not very numerous, those we have seen range all the way from prime costs, on the one hand, to complete costs, including the cost of selling and distribution into the hands of the consumer, on the other. In between, we have some very interesting and at times diverting definitions of what costs are, including some which seem to limit the salary of the chief executive to $10,000 a year, and which eliminate sales commissions and other items we have usually regarded as costs.

I think we are approaching a clarification, however, of this confusion. The selling-below-cost principle, the principle of cost-protection, is gradually simmering down to one of establishing a floor below which selling prices shall not be cut, that floor being at the lower range of costs in industry, although this reference to cost-protection floor, I am sorry to say, has been omitted from the recent price policy published by the Administration.

With respect to standard costs, however, I might say that there is one new development under the codes. This applies in any case in which a standard cost system is in operation and costs come into question. It might be necessary for you to establish procedure, if you do not already have it, for bringing into account cost variations. In other words, if a question of the actual cost of a particular product or line of products arises, a standard cost may not be acceptable as the representative cost, particularly if the price levels have moved away from the point at which they stood when the standard costs were established. That, as far as I can see, is the only new point to be considered.

However, there may now be greater opportunities for usefulness than there have been before in the use of standard costs on a group scale, on an industry scale. I believe that the Recovery Act will stimulate cost accounting development as much as the Internal Revenue Act stimulated the keeping of general accounts. As you all know, when the Internal Revenue Act was passed it made it obligatory for every concern to keep a set of books. I have heard it said that some concerns today even keep two sets of books.

The great advantage in the use of standard costs, which I should like to take the time to bring out this afternoon, is not the one of cost calculation; in my opinion, it is the one of planning for better management. Professor Greer, yesterday afternoon, brought out most clearly, I thought, one very important concept which I hope you will all take with you from our meeting this year, and that is this: that prices are symptoms, that they are the measures of values and not something that can be arbitrarily determined.

He said, as you will remember, that prices, costs and volume were inseparable and inevitably interlocked. In making that statement, he gave me an excellent theme, because it was my plan this afternoon to illustrate by some concrete examples just this interlocking between these three factors and to show how by means of standard costs you may compute what may be the result of any assumed combination of them. This use of standard costs is just as applicable today under the New Deal as it was formerly, perhaps more so.

At this point my speech is at an end, and we can now begin to make some calculations which will bring out how standard costs can be used as machinery for reaching decisions quickly these fast-moving days. You will find that two sheets of paper have been placed at each chair Let us insert figures in the tables on these sheets as we go along.

You will observe at the head of Sheet 1 of these two sheets, a very simple budget intended to cover a line of products, setting down sales, cost and margin:

TABLE I

Basic Budget for a Line of Products

(1) Sales	$80,000	(4)	100%
(2) Cost	56,000	(5)	70
(3) Margin	$24,000	(6)	30%

I call the $24,000 margin because it is not profit. We are leaving out of consideration selling and distribution costs in this calculation. You will see that the standard ratio between cost and sales is 70.

Now let us assume that since this basic budget was established conditions have changed. We find that volume has gone up 10 per cent, price has dropped 10 per cent, and cost has gone up 8 per cent. We wish to know quickly what the effect of these changes will be upon the margin we expect to make. If you will take your pencils and insert in Table II the following characters, we will make this calculation.

Before going ahead with the calculations, I want to say that as a matter of convenience I intend to round out all figures. The results we get will be close enough for our present purpose of illustration. By carrying out the percentages to decimal numbers you will find that precise results are obtained.

Turning again to Table II, in the first space of line 11 put in 110; the volume is up 10 per cent. In the second space put 90; the price is down 10 per cent. We now multiply the volume level by the price level, 110 $\times$ 90 is 99; put that in the space to the right. In other words, we will realize 99 from sales.

Costs are up 8 per cent; so on line 12 put in 108 in the first space. In the second space put 110; the volume is up 10 per cent. In the third space insert 70; you will remember in the basic budget costs have a weight of 70 only. $108 \times 110 \times 70$ is 83 in round figures; put that in the space at the right:

TABLE II

(7) Volume . . .	up 10%	(11)	Sales 110×90	=99
(8) Price . . .	down 10%	(12)	Cost $108 \times 110 \times 70$	=83
(9) Cost	up 8%	(13)		16
(10) Margin	?	(14)	$12,800	

We now have as the factors in our calculation, sales of 99, costs of 83. Subtract line 12 from line 11 and put the answer 16 on line 13. We find we will have 16 per cent left for margin. This percentage applied to our basic budget of sales gives us $12,800 as the margin we will realize under these assumed conditions. Insert that on line 14.

You can make this calculation more quickly than I can tell it to you. The answer then is, that under this changed combination of price, costs and volume, margin will be reduced approximately one-half.

Let us take a different set of circumstances. The sales manager says, "I know we have not touched the potential market for this product; we can sell at least 25 per cent more." The controller tells us costs are up 10 per cent. The sales manager asks: "If I sell 25 per cent more and costs stay up 10 per cent, at what price must I sell to make a margin of $20,000?"

There is the question. With volume up 25 per cent and costs up 10 per cent, how much must the price be for the goods to realize $20,000 margin?

We are now dealing with Table III. Our calculation, in this instance, is first to find out how much we need to cover costs. On line 19 we will start to make the calculation. We have assumed that volume is up 25 per cent, therefore insert 125 in the first space. Costs are up 10 per cent. Put in 110 in the second space. Costs, however, have a weight of only 70. Put that figure in the third space. $125 \times 110 \times 70$ is 96; insert 96 in the space to the right. It is what we need to cover costs.

Having ascertained how much we need to cover costs we must next add how much we need to cover margin. We wish to make $20,000. As $20,000 represents 25 per cent on our basic budget of sales, we must realize not only the 96 to cover costs but 25 in addition. Insert 25 on line 20. We need then the sum of the two (lines 19 and 20), which you can insert on line 21. The sum is 121, i e., 96 plus 25. That represents the level of sales which we must realize to make this margin.

It is axiomatic that the level of sales is always the product of volume and price. You found that in the first calculation volume 110 × price 90 gave us 99 as the level of sales, so in this case the 121 has in it both volume and price. If we wish to find either, knowing one, we can do so by division. We know in this case that the volume is 125 so if you will put that down on line 21 as being divided into 121, and put the answer, 97, on line 22, you will have found the price level at which we must sell these products in order to realize this margin.

TABLE III

(15) Volume	up 25%	(19) Costs 125×110×70	=96
(16) Cost	up 10%	(20)	25
(17) Margin	$20,000	(21)	125)121
(18) Price	?	(22)	97
(23) Sales	$96,800		
(24) Cost	77,000		
(25) Margin	$19,800		

Just in order to prove or make clear the calculation, I have provided some lines at the left below to insert the dollar figures.

Under this assumption, sales, on line 23, will amount to $96,800,—in other words, the budget sales $80,000 × 121. Costs, on line 24, will amount to $77,000, that is to say the budget cost of $56,000 × volume level 125 × cost level 110. Margin, on line 25, will be the difference between the two, $19,800. We find we will realize a margin of approximately $20,000 under these circumstances.

At this point you may be inquiring: what is the purpose of all these calculations? Here is an example: we are trying to decide upon a policy, a policy as to price, a policy as to line. In Table IV let us make a series of quick calculations:

TABLE IV

(26) Price Level	90	(29) Sales	99
(27) Volume Level	110	(30) Cost	81
(28) Cost Level	105	(31) Margin	18
(32) Price Level	95	(35) Sales	95
(33) Volume Level	100	(36) Cost	74
(34) Cost Level	105	(37) Margin	21
(38) Price Level	95	(41) Sales	95
(39) Volume Level	100	(42) Cost	70
(40) Cost Level	100	(43) Margin	25
(44) Price Level	90	(47) Sales	117
(45) Volume Level	130	(48) Cost	82
(46) Cost Level	90	(49) Margin	35

Let us in the first case assume that the price level, line 26, is down 10 points to 90, the volume level, line 27, is up 10 points to 110 and the cost level, line 28, is up 5 points to 105. Under these conditions, sales will be 99, that is to say 110 $\times$ 90. Put 99 in on line 29. Costs will be 81, namely 105 $\times$ 110 $\times$ 70. Insert 81 on line 30. Sales at 99 and costs at 81 leaves 18 for margin, which we enter on line 31. Under this particular set of circumstances, we will make 18 per cent margin, or $14,400.

Let us take another case, to see what we can do if we can stiffen this price a little bit. Assume that we can stiffen it 5 points. Insert 95 on line 32. Let us say that in doing that we must sacrifice some volume, and we only realize 100 for volume, line 33. Costs, we find, remain at 105, line 34.

Under these circumstances, what happens? Sales will be 95. Fill that in on line 35. Costs will be 74. That is 100 $\times$ 105 $\times$ 70. It is actually 73½, but I rounded it up to 74. The margin will be 21. Put 74 on line 36 and 21 on line 37.

Clearly this policy is more profitable than the preceding one. If we can stiffen the price by selling a little bit less and maintaining costs at the present level, we will make more money.

Let us proceed a little further. Let us assume that the price can be stiffened only to 95; that it is the maximum we can hope to accomplish when we are up against competitive conditions.

What else can we do to improve our profits? The volume is set at 100. We now have two of the factors. Insert 95 on line 38, and 100 on line 39.

The only other alternative we have to get margin is to reduce costs. Let us assume we can reduce costs. Insert 100 on line 40. Under this policy what will happen? Sales will be 95, line 41. Costs will be 70, line 42, leaving 25 for margin, line 43.

Obviously this policy is a still better one. If we sacrifice a little volume, stiffen the price a little and turn our attention to the costs, our margin will be still greater.

Now just one more example of this kind. Let us say that we can get an increased volume by lowering our selling price and by improving our product and at the same time we are able to substantially reduce costs. Let us assume that we can reduce costs to the level of 90. Insert that on line 46. Assume that we can do this and turn out a better product. We decide to reduce the price to 90. Insert that on line 44. Through the combination of improved quality and reduced price we expect our volume will increase to 130, line 45.

What will be the result? Our sales, line 47, will become 117. That is 90 × 130. Our costs will be 82, which is 90 × 130 × 70. Insert 82 on line 48. And our margin, lo and behold, is 35. Put that on line 49.

This relationship is typified by the automobile industry. In other words, by reducing prices, by reducing costs, and obtaining thereby an increase in volume, the margin is substantially greater than before.

As I believe I remarked before, in connection with these calculations, at this time you may be asking: what good are all these calculations—they will not solve our problems? It is not my contention that with machinery of this kind you will have no further problems; it is merely that this means of calculation will help.

Let us take a totally different set of circumstances and a different question. The sales manager says, "Well, our price is down 10 per cent and our costs are up 5 per cent. How much must I sell to make $24,000 margin?"

Please turn to sheet 2. On line 54 insert the price level, which is 90. Out of price we must first cover costs before we can find what is left for margin. Costs in this combination are up 5 per cent, therefore they stand at 73½. That is 105 × 70. These figures go on line 55. This leaves 16½ points for margin. Put that on line 56. However, in order to make $24,000 margin we need 30 points. If you will put 30 next to the right of 16½ on line 56 and divide, we find that in order to make $24,000 we have to increase the volume substantially. 16½ divided into 30 is 182, line 57. In other words, with costs up 5 per cent and price down 10, we must almost double the volume if we are to obtain the desired margin, a condition that usually cannot be realized.

TABLE V

(50)	Price.	down 10%	(54)	90
(51)	Cost.	up 5%	(55)	105×70 = 73½
(52)	Margin.	$ 24,000	(56)	16½)30
(53)	Volume.	?	(57)	182
(58)	Sales	$131,000		
(59)	Cost	107,000		
(60)	Margin.	$ 24,000		

In the first five minutes you can demonstrate that any hope to get the margin by grasping for volume is out of consideration. Too frequently that is not clear in deliberations of this kind. Very often, as you know, there is just a blind grasping.

If you want to insert the figures proving these calculations, I will be glad to give them to you.

Sales under this combination would be $131,000, line 58. That is to say 182 × 90 × $80,000 Costs would be $107,000, line 59. That is, 182 × 105 × $56,000. And the margin would be $24,000, line 60.

You will notice that we have not yet taken into account the gain that will accrue through an overabsorption of fixed costs. It is a burden-carrying gain which is the real object in striving for volume. The more we sell, the more fixed costs we will absorb.

In order to make that calculation, you will have to follow a separate reasoning. I think essentially so, because if it is not done in that way the results will be a confused understanding of what will happen.

Let us assume that for the particular line of products represented by the basic budget, taxes, depreciation, insurance, etc., representing fixed costs, amount to $6,800 or $68 per point. Put that on line 61 of Table VI. Under the present assumed set of conditions, namely, price at 90 and costs at 105, with volume at par, we make 16½ per cent margin, which amounts to $13,200, or $132 per point. Insert that on line 62. We get $13,200 thus: 90 — 73.5 = 16.5 × $80,000.

We have now separated the margin-making increment from the fixed cost earning increment, if I may put it that way, in these operations. In total, we will make $200 per point of volume, namely $68 fixed cost and $132 margin. Insert $200 on line 63.

We find that the percentage which the margin element bears to the total is 66. That is $132 divided by $200. Therefore, we need to do only 66 per cent of the additional 82 points of volume that we previously thought we needed to have, in order to make the $24,000 we want to make. On line 65 in the first space put 66 and in the second space 82. 66 × 82 = 54; put that in the space to the right on line 65. Thus, instead of having to sell at a volume level of 182 we need only sell 154. The necessary volume is 154. Insert that on line 66.

TABLE VI

(61)	Fixed Cost—$6,800 @ 100 =	$ 68 per point
(62)	Margin @ 100—90—105—$13,200 =	132 per point
(63)	Total. . .	$200 per point
(64)	Per cent margin per point—66%	
(65)	66% of volume increase 82 = 54	
(66)	Q.E.D. Necessary Volume = 154	
(67)	Sales. .	$110,900
(68)	Cost	90,600
(69)	Margin. .	20,300
(70)	Burden Over-absorption	3,700
(71)	Total	$ 24,000

If you now want to insert the dollar figures in Table VI, sales under this combination will be $80,000 × 90 × 154, or $110,900, line 67. Costs will be $56,000 × 105 × 154, or $90,600; put that on line 68. This leaves a margin of $20,300, line 69.

In addition, however, burden will be over-absorbed $68 for each point of volume over par, which is 54 × $68 or $3,700. Insert that on line 70. When we add the two we get $24,000, which is the objective. By this simple calculation you can bring out clearly what is the effect of an increase in volume as a burden carrier.

Let us have one more illustration of these uses of standard costs.

We find that price is down 4 per cent. Volume is down 12 per cent. The conditions are bad. "At what cost must we manufacture these goods" asks the superintendent, "in order to make $20,000?" This is Table VII.

TABLE VII

(72)	Price	down 4%	(76)		96
(73)	Volume ...	down 12%	(77)	25 ÷ 88 =	28
(74)	Margin	$20,000	(78)		70)68
(75)	Cost	?	(79)		97
(80)	Sales	$67,600			
(81)	Cost	47,600			
(82)	Margin..	$20,000			

Well, we know price, which is 96. Price off four points, line 76. We know how much we will need to recover out of price for profit, before anything is left to cover costs We want to make $20,000, which is 25 per cent of our basic budget of sales of $80,000. Insert 25 in the first space on line 77. But, we must remember that we are not going to sell all that we expected to. Our volume is down 12 points. In other words, it is at a level of 88. So we must make more than 25 per cent in order to make $20,000. Insert 88 to the right of 25. 25 ÷ 88 = 28, line 77. We find that margin of 28 must first come out of price of 96 before there is anything left for cost.

If you will make the subtraction on line 78, you will find there is 68 left for costs.

We know, however, that the weight of costs is 70. Divide 68 by 70 and put the answer, 97, on line 79. Thus we find that cost must be reduced to the level of 97 if we are going to sell 12 per cent less volume at a price 4 per cent less and still make $20,000.

I hope that these examples will serve to bring out—and to bring out in a way you can take home with you and study over and review—the truth of what Mr. Greer said yesterday. There is no collusion between this and what he said. I had not the faintest idea what he was going to say.

But it is true that you never can separate or isolate the three factors of price, volume and costs in any of your calculations, and you absolutely need under present-day conditions some adequate machinery in your cost accounting procedure for making calculations such as these. They seemed long and round-about as I had to recite them in detail. Those of you who are familiar with the calculations will realize that once the principle is understood you can make the calculations and give the answers very quickly.

If there are any questions, I should be glad to answer them later, if time remains. I feel I have already overrun my time.

CHAIRMAN KNAPP: In spite of the weather, I am sure you were all very much interested in the brain exercise that Eric has brought to you this afternoon.

When the Program Committee was confronted with the problem of securing a speaker for the next subject, we spoke to Prof. Sanders of Harvard Business School, and he said he had in mind just the man, if we were fortunate enough to get him We got in touch with the man suggested, Dr. Hettinger, and I am very happy to say that we were able to click to such an extent that he is with us this afternoon.

Dr. Albert J Hettinger is President of the Investment Research Corporation of Detroit. As I understand it, it is a company that does a great deal of research in connection with the statistics and other important information necessary for a number of our large investment trusts.

Dr. Hettinger formerly was at the Harvard School of Business Administration with Professor Sanders. He was in charge of the Department of Statistics while there.

For the last ten months, up to very recently, he was a member of the N. R. A. group in Washington. I believe his official title was Economist to the Department of Research and Planning.

We heard a wonderfully straightforward talk by Dr. Haake yesterday. He did not mince matters at all. He told us exactly what he thought of the N. R. A., and I know we all enjoyed his talk very much and admired him exceedingly for his courage in making the statements he did make.

However, from what I saw in a publication the other day, with regard to Dr. Hettinger, he must be that fellow we sang about before the session today. I think he must be the "daring young man on the flying trapeze" all right, because this article in the paper told how they marveled at the courage of a morose economist of a department of N. R. A. who had the courage to confront General Johnson right to his face with a number of his theories that Dr. Hettinger said were all wrong. So I am sure, if you admired Dr. Haake yesterday for his willingness to talk here to us, you must admire Dr. Hettinger even more for being willing to do that right in Washington.

Having had luncheon with him today, I can assure you the noun "economist" is perfect, but the adjective "morose" does not apply at all, because he is most genial.

Members and guests, it gives me great pleasure to introduce to you Dr. Hettinger, who will talk to you on "The Problems of Statistical Reports on the Codes."

THE PROBLEMS OF STATISTICAL REPORTS ON THE CODES

Albert J. Hettinger

President, Investment Research Corporation, Detroit, Michigan

VERY frankly, I am going to say relatively little about the particular subject that was handed to me, because there is little to say about it. In order to appreciate that fact, it takes a good bit of background. I am simply going to talk, as frankly as I know how, about the situation in Washington as I see it, starting with the situation as a whole, narrowing down to N. R. A. and then to the particular segment within N. R. A. dealing with the specific problem assigned.

I am going to say exactly what I think, with no assurance in God's world that I am right, but it will be a lot more reasonable treatment I think than if I endeavor to gauge what is completely expedient and end by boxing the compass and saying next to nothing. Consequently, all that I would ask any one to label my speech at best would be "interesting, if true." Time will have to tell whether any considerable portion of it is true.

In the first place, I believe very throughly in the Roosevelt Administration. You can term that an unreasonable bias, if you care to, or characterize it any way you desire. This is not meant in a political sense, and the statement is made with a full recognition that if I were to enter down into two columns the specific acts that I felt were sound and those that I felt were not sound, I am not at all certain but that the negative column would be the longer. But the net result would be that I do believe in it. I believe in the Administration.

I believe in it primarily for two or three very simple reasons. I think that Mr. Roosevelt has qualities of leadership, and I believe that he has unusual facilities for testing a thing out pragmatically and profiting by mistakes that have been made. He stated very frankly in the early days of his administration that in his experimental attack he expected to make errors, would recognize those errors and endeavor to correct them.

If you were to characterize his administration, as I see it, the initial crisis period was superb. President Roosevelt restored a degree of confidence in the country that, looking back upon conditions as they existed in March of 1933, would have seemed impossible prior to his inauguration.

The second period, without trying to think in terms of dates precisely, would be that running from possibly the first of May until October, when a great many of these experiments were initiated by a new, unseasoned administration, with a new personnel frequently entering into fields that no administration had previously entered. In the pressure of time there was a tendency to think more nearly in terms of immediate consequences than ultimate consequences, there were frequent conflicts as between the various experiments, tending to cancel and reduce the anticipated returns and resulting finally in a pretty acute situation in October of last year.

We had had a monetary experiment started very largely on the theory that the country was so burdened with debt that it was insolvent at existing price levels for real estate, securities and commodities and that unless that price level were lifted rapidly there was no way out.

There was a tremendous emphasis on price level and the necessity of lifting prices in one way or another. Almost anything we do in this world has a price attached to it. We can gain certain results at the expense of certain efforts. We lifted prices with extraordinary rapidity into the summer boom—commodity prices, prices of stocks, inventory values, things of that character. But along with this we have had monetary instability, together with a Security Act, whose purpose was sound but whose teeth were so strong that they practically precluded any considerable volume of new securities. Thus, we checked a great deal of what small amount of potential increase in activity might have occurred in our capital goods or durable goods industries. And these industries are a focal point in recovery.

We created a National Recovery Administration, with some very broad principles concerning which one can only have extreme sympathy. There was a feeling that if business could be freed from certain of the most onerous burdens of the Sherman Act and business men be permitted to work together through so-called self-government in industry, with permission to eliminate unfair trade practices and uneconomic price competition, that this would immeasurably strengthen the business structure. And along with that, during the spiral of declining business, which had gained momentum over a period of years, culminating in the summer of 1932 or in the spring of 1933, depending upon whether you are a Democrat or a Republican, wage levels had been reduced competitively in a number of industries to such an extent that many of the actual records were pitiful, indefensible and yet apparently necessary.

The philosophy of N R. A hinged pretty largely on the fact that by putting order into a situation where chaos had existed, by creating a substantial degree of self-government in industry, along with which went the concurrent assumption of social responsibilities on the part of industry, to provide living wages by shortening hours and reabsorbing as large a proportion of the unemployed as possible, a great deal of industrial progress could be made toward recovery.

At the same time a third attack began—dealing in this case with the agricultural situation. Actually the situation was acute. Politically it is always dynamite, for the simple reason that you have far more Senators per agriculturalist from your agricultural states than you have per industrial worker or business man from your industrial states. In the Senate there will be a top-heavy weighing of agriculture and mining, and in any government that is political—and all governments are political—that has to be recognized.

Mr. Hoover had recognized the situation when he endeavored to maintain grain prices, and Mr. Legge, head of the International Harvester Company, went down to Washington in charge of a stupendous movement to endeavor in so far as possible to attain that end. Mr. Wallace tackled the same job.

The Agriculture Department's thinking has been somewhat as follows: in a major depression the industrial procedure tends to be a restriction of volume and maintenance of price. Of course, industrial prices decline, but primarily the decline is a volume decline, much greater than a price decline. In agriculture, on the other hand, with your agriculturalists and individualists scattered pretty much all over the country, you tend to have a maintenance of volume and a slaughtering of price. And the Agriculture Department's belief was that to restore a balance on a crisis basis as rapidly as possible what we should do would be to stimulate industrial production and endeavor to retain as moderate price increases in industrial products as possible, with emphasis on building up the demand and the volume that the markets could absorb.

On the other hand, with agriculture, since we had tremendous accumulations of farm products, what was necessary was a short, sharp, intensive effort to curtail agricultural production in a minimum length of time in order to lift agricultural prices to a point high enough to restore agricultural purchasing power. That was the basis of the A. A. A., the Agricultural Adjustment Administration, which had received a mandate from Congress to endeavor to restore agricultural prices to a relationship with industrial prices such as were maintained during the pre-war period, of 1901, 1910, and through 1914.

When Mr. Roosevelt came into office, agricultural prices were just half the desired level. At the peak of the July speculative crest last year, when agricultural prices had had the full benefit of an inflationary spree, I think they reached seventy-one per cent of that goal, and at the present time they are about sixty-one per cent.

An additional recovery measure was to be the Public Works Program, for which Congress had allocated to Mr. Ickes $3,300,000,000. Mr. Ickes will spend that with an honesty such as probably few administrators in a government have ever been able to attain, but as far as pump-priming characteristics are concerned, there will be none. It will be a rounded affair, slow and cumbersome in getting under way, with no concept on the part of that department that it would be possible, after five years of depression, to have $3,300,000,000 wait for useful projects and not have a sufficient number of takers.

The Interior Department did not plan effective methods of getting that money out and accordingly found that the great bulk of the applications were "shoestring" projects such as had been the bane of the speculating froth of 1929. Rather late in the game, desperate efforts were made to get the money out, substantial portions of it being allocated to one or another of the governmental departments for their expenditure, a large sum for increasing our navy, and another large amount to supply the wherewithal to Mr. Hopkins for his Civil Works Administration. Actually, while they will point to the rapidity with which the $3,300,000,000 was allocated, if you look up the daily treasury statements appearing in detail in most of the metropolitan papers, you will find that the actual amounts spent, other than for gifts to the Civil Works Administration, have been relatively small. A great deal of employment has been provided but not of the pump-priming type.

There has been the conflict between internationalism and nationalism, with Mr. Hull and Mr. Wallace feeling that we can get no considerable amount of recovery in any relatively brief period of time without reopening the markets of the world to American products, especially agricultural products, and that this cannot be done unless we are willing to purchase. And to your average industrialist the thought of having an increased flow of goods coming in to compete with the goods he produces is anything but pleasant.

Throughout this whole period we have had a budgetary problem, with the federal government constantly assuming a great proportion of expenses for relief, due to the inability of states and cities, with relatively inelastic tax systems and impaired credits, to provide funds for relief. If my memory is correct, as far back as last autumn about two-thirds of the total relief expenditures were being provided by the federal government, simply because the government had the credit, could get the funds, and states or municipalities in a large part could not.

With all those different shows starting in the period following May, starting under intense pressure, with each particular group honestly working to the limit of its ability, you very soon had a several-ring circus with an extreme lack of coordination between the groups and the efforts of one group tending to cancel the progress of another.

It has been extremely difficult for Mr. Wallace to increase his agricultural prices with all of the actions of the Agricultural Adjustment Administration, acreage curtailment and bonus to farmers, at a rate sufficient to gain anything upon the rate at which the prices of industrial products have advanced due to General Johnson and the N. R. A.

The last figures I believe—those for the month of May—show that today agricultural prices are sixty-one per cent of their goal, and a year ago agricultural prices were sixty-one per cent of their goal. Much action, much movement, and yet the same net result in so far as that goal is concerned. Up appreciably from the fifty bottom, but for one year no progress.

By last October we had had our breaking stock markets, our breaking bond markets, our declining commodities, a decline of considerable proportions in man-hours work. I am not saying fewer men to payrolls because hours have been cut. A semi-crisis in government credit. When mortgages were foreclosed, a delegation of southern congressmen and governors came to Washington demanding a very liberal guarantee for cotton prices. A delegation of five governors from the Northwest descended upon Washington with a request for regimentation such as no one, even in Washington, had conceived. The Commitee of the Nation bombarded the Administration with demands for a still cheaper dollar. Winter was approaching. The unemployment situation was acute And Congress was coming in during a very unsettled period.

To the extent that my thinking may be right, I feel that October will be looked back upon as a turning point in the Administration. I believe that there was recognition at that time that a number of the experiments had not worked out in the way that had been hoped, that while it was possible that the primary consequences had been carefully thought out, there had been so much emphasis on the operation of each plan that the coordination had been lacking. There was a tendency for the actions, however sincere, of one branch of the recovery movement to interfere with the hopes and desires and progress of another.

That month of October has impressed me as being a little bit like the periods in the Dempsey-Tunney fight in which the famous long count occurred—the periods in which the Administration was groggy and realized that certain changes would need to be made. The Administration began then to do exactly what the President stated that he would do; that is, when one thing did not work out, he would shift his emphasis. From October to December it was a gradual revamping program

The gold-buying policy, continually bidding up the price of gold, was discontinued, and beginning shortly after the turn of the year we had a 59.06 dollar, which is exactly what we have today.

There was a pretty careful audit of the economic situation, with the conclusions tended to be reached about as follows:

1. We believe that business has reached its low point, or substantially that, for the late autumn or early winter. We have absorbed a great deal of accumulation of inventories that had occurred during the monetary inflationary spree of the summer and the spree to get as much stuff out as possible before the higher N. R. A. costs came into effect.

2. We think we can count upon a continuation of the gradual worldwide recovery, and conditions in this country are such that we should participate.

3. On this hypothesis, we can have and should have a recovery in the spring of appreciably better than seasonal proportions.

4. The great danger is that of another spree in the spring, such as occurred in the summer of 1933. If we have that spree the aftermath will be the same as the autumn of 1933, compared with the summer. And that at all costs must be avoided.

Mr. Morgenthau, in the last few days, in speaking of the silver policy, emphasized the necessity of avoiding anything approaching a speculative spree, and referred to that of last summer as having set back a recovery movement by at least six months.

Now, rather empirically, there was the feeling on the part of men working with the determination of the policy, that it should be possible, taking the Federal Reserve index of industrial products of seventy-three, late last autumn and early winter, to have that carry up well into the nineties toward the close of this year, and have it done on a sound basis, provided one could avoid speculative sprees.

This spring the thought was that if business advanced from seventy-three to a point well in the nineties, it would be safe. If you ran to ninety that was the best rough guess of a known safe figure of rapid recovery, inevitably a recovery primarily of consumer goods because we did not have the capital markets to stimulate heavy construction. Actually that recovery has continued from seventy-three to either eighty-six or eighty-seven, on the preliminary estimate of the Federal Reserve Board for the month of May, and I think there is evidence that we have reached our spring crest.

There was a desire to exercise some little restraint and cautionary influence in the spring, and it was felt that an early announcement of the discontinuance of C W. A. would do that; that if merchants and industrialists felt that you were actually going to take a large number of men off the payroll of the government this spring, there would be more caution in accumulating inventories; and that in the introduction of the stock market bill there would be a cautionary influence in the spring.

After the normal spring peak, after Easter, there was also the thought of what rational measures for stimulation could occur, and of the two logical measures proposed there was first the modification of the Securities Act, if the higher bond prices existing did not bring out new issues. It was then a matter of dispute as to whether the absence of new issues, which would provide capital for recovery, was the result of the Security Act of last summer or of a level of the bond market too low to bring them out. The bond market lifted; the new issues did not come out. The Act was modified.

Second, there was the Housing Act, which I think has been by far the most carefully prepared piece of legislation that the Administration has yet put across. It will have a character of management that I think will bring better results than most movements and, personally, I have a very substantial amount of confidence in it.

Now, to take just a word for my own guess, which can only be a guess, as to what is likely to be ahead of us—and after that I want to get down to the N. R. A.

Personally, I believe that the fifty-nine-cent dollar is going to hold and that there will be no shift upward. I believe that the recovery will come through holding that fifty-nine-cent dollar which after all is using a yardstick forty per cent cheaper, forty per cent smaller, than that which we had before. Inevitably over a period of time this shortening of the yardstick will result in materially higher commodity prices.

As a London economist in the *Manchester Guardian* put it, when you do a thing of that kind, it is like a balky horse: it will not go when you want it to go; it starts when you are not expecting it; and it is rather difficult to control once it gets going; but it will get going in time.

With the modification of the Securities Act, I believe we shall have a reopening of the capital markets, starting slowly and gradually gathering momentum. This will provide the capital to get your durable goods industries going and absorb unemployment.

I believe that we shall have a refunding of the bulk of our government debt on a three to three-and-a-quarter basis; these will be the longer range determinings, a monetary stability, a reopening of the capital markets, and a refunding of the debt to a lower interest basis.

For your shorter range, you have a P. W. A., which at the present time has a very real financial control over expenditures and which can move flexibly and rapidly. This will decline as the housing development gets under way. It will be a much more significant thing than the country expects as a whole, I think, but it will take some little time for the housing development to get under way.

Now to get to the N. R. A. The National Recovery Administration has really been General Johnson primarily. He is a most unusual man; personally scrupulously honest, hardworking and courageous. I do not think I ever saw a man take more punishment physically than he did during the early months of the Administration. A man able to inspire a degree of enthusiasm that would be difficult to equal, but from my point of view at least, a man whose economics has a good many air pockets in it. A man who is a lone worker and who finds it difficult to use his advisers and to develop a policy.

The N. R. A. policy has been General Johnson, and his policy very largely has been one of shortening hours as fast as possible, reemploying men as soon as possible, increasing wage rates as rapidly as possible, and hoping by that to so stimulate purchasing power, drawing temporarily upon the working capital of corporations, that purchasing power in dollars would advance more rapidly than the cost of living, enable a greater volume of goods to be absorbed, lower overheads, and thus eventually return to corporations profits that temporarily they were asked to forego.

The process of codification was to me a rather startling and weird affair. There was almost a feeling that the main object was to codify all of American industry as rapidly as possible. That was a creed, a religion, and there was a feeling that in doing it you could bring tremendous pressure to bear.

I am afraid the amount of voluntariness in some of the codes is much smaller than the General himself would believe. I feel that his famous goldfish bowl for holding public hearings and creating codes on the basis of them degenerated at an early date into a condition where all parties at public hearings spoke for the records—whether trade-association secretaries or labor-union secretaries—and the actual code-making was carried on over a period of days and weeks and months, through private conferences of the parties interested and conferences that represented honest horse-trading affairs.

Labor, after the early days, asked for the moon on a silver platter in code hearings, frequently with no thought of what was involved. If you would take the business of the telegraph companies and assume that their executives would work without salaries, assume that they had no rental charges, no maintenance, and no depreciation, no taxes, literally no expense except labor, and empty the cash drawers each night into a labor pocket, there would not have been enough money to have met the labor demands.

Along with that, I want to say that I have no opinion whatsoever that labor was any more unreasonable than industry, but there was the recognition that you were speaking for the record, the actual work was done out of the goldfish bowl, and the more you asked for the more trading points you had.

Now in the actual making of codes, after the open hearings, which were a matter of record and the records published and available, you would have a conference with an N. R. A. Administrator, a representative of the Industrial Board, the Labor Board, the Consumers' Board, and the so-called Research and Planning or Economic Division, and the code committee desiring to get the code.

Your deputy in charge of the proceedings felt the pressure upon him for results. He wanted to get the code through. The N. R. A. had nowhere during those early months developed an underlying policy of codification, no real policy on labor, no real policy on prices, no real policy on fair trade provision. A large number of deputies, operating individually, not well coordinated, were doing their level best to get codes out under pressure and trading. As a result of that, I think you will find the economics in those several hundred codes so diverse and so wonderful that in some code or another you will find every sound piece of economics and every unsound heresy that one might imagine.

I am not equally capable of making a statement with any degree of authority in so far as the accounting field is concerned, but it would be difficult for me to conceive, having sat through these sessions and seen the procedure and knowing a little about accounting, any other conclusion possible with respect to accounting.

A fair proportion of the codes are substantially unenforceable. Your labor provisions will start with a basic forty-hour week or what not, and you will get a page or a page and a half of qualifications, exceptions, stated in a way that is difficult to interpret You have seasonable demands, emergencies and all manner of things. Your trade practice provisions are somewhat the same.

The cost formulas vary tremendously from code to code, and in a great many cases have represented an effort to attain security and cost recovery almost irrespective of volume.

Your labor interests and your industrial interests on the whole were pretty well cared for for the short-term viewpoint. Your consumer interests were nothing like as well cared for. You had in your Consumers' Board a clean, hard-hitting board. I do not know of any better men essentially in N. R. A. than Mr. Keiser and Dr. Edwards, but anything of this kind is a thing in which political or economic measures are likely to be determining factors.

No man can underestimate the pressure of the American Federation of Labor and allied labor movements, and no man can underestimate the pressure and skill and ability of a code committee of industrialists, negotiating an agreement thoroughly vital to their particular industry, their profits and the employment of their employes. Those committees were well staffed with legal advisers, and had excellent accounting advice as a rule. The men knew their line of business, and as a truism, I will back a good professional against a good amateur any time. Your industry representatives were the professionals, and we in N. R. A. were the amateurs, and your codes got through.

As I have said, with the tremendous industrial pressures and the tremendous labor pressures, both of those groups were reasonably well protected over a short period of time by introducing their own brands of economics. Very frequently you can not generalize about anything, because the codes run from one extreme to another. You can guarantee brands of economics which can endure and obtain only if you can repeal the laws of gravity or the laws of supply and demand That kind of economics just will not and can not work, and never has worked over a period of time, and never will work in the kind of world that we are in now.

I want to emphasize the fact that your organization down there, especially during the last half of last year, was as hard working, as clean, as sincere, as honest and as non-political an organization as I ever expect to find anywhere.

I want to recognize very fully the fact that the General, once you accept his basic philosophy (which I can not) did almost a super-human job. But we ran on. There was an habitually chaotic situation in the Recovery Administration, because it was so busy grinding out codes. But it was necessary to be busy grinding out codes, if you were going to codify all of American industry by Christmas or February or March, and there was not an opportunity to have a common ground on which the divergent elements of the Recovery Administration could meet and work together.

Personal relations were friendly, but actually you had a Labor Board that was frequently at sword's points with, we will say, our Division of Research and Planning. You had a Consumers' Board that very legitimately felt that, lacking political and economic pressure, it had very nearly an impossible assignment; and you had a situation in which you began to apply a very weird definition to an industry.

I think no man in the early days would have conceived of there being a great many hundreds of codes of fair competition, but we actually degenerated to the level of treating as industries and dignifying with negotiations, code conferences, public hearings and horse-trading afterwards, what were really small segments of small segments of industries, a great many of which employed only a few hundred men and no small number of whom employed less than a hundred men.

I know a long while ago I did what I could, as one individual who had a staff position and no line authority, to burlesque the ridiculousness of having a code of fair competition for toll bridges, for the fly swatter manufacturing industry, and things of that sort. Finally, after the Code of Fair Competition for the Fly Swatter Manufacturing Industry was scheduled, if I remember rightly, for a hearing in the ballroom of the Willard Hotel under Deputy Administrator Horner, on the ninth of May, I remarked, getting nowhere else any other way, "All right! Hold the damn thing! I am going to go over and take minutes on it, buy a copy of the record, and write the thing down, with footnotes referring to the Toll Bridge Code and certain others, and send it up to *The New Yorker*." I told them I thought it was just too good to pass over.

There is no code of fair competition for the fly swatter manufacturing industry. It really required I think something of that kind to break the ridiculousness there.

Along in March, at the time of the code conference, and preceding that in January and in February, the first opportunity was given for consumers to come down to Washington and register complaints against the breed of economics that we were creating, and they came down and did not do a bad job. In March industry was called down. The General felt the necessity of shortening hours still further and increasing wages still further. His hope was to obtain an additional reduction in hours of ten per cent and an additional increase in pay rates of ten per cent. That movement did not go through.

You had a break in the frontal attack at that time. The rear was beginning to close in, with the results of a series of making decisions that can remind one of nothing quite so much as the story from mythology in which one of the labors given to Hercules by the gods consisted of the slaying of the many-headed hydra, a beast so constituted that when you cut one of its heads off two heads took its place. We had made our decisions in a way that created more decisions. We ran into inter-code difficulties. We ran into difficulties in our accounting. We ran into difficulties in handling the labor provisions. And you have had relatively recently a gradual drawing in of N. R. A.

One thing for which I have felt thankful was the Cleaners' and Dyers' Code, officially promulgated on the eighth of November last year. It was a thing utterly unsound, opposed but put through, and I think a turning point which threw into relief somewhat more prominently than would have occurred otherwise, a great many of the code difficulties.

I believe the N. R. A. is now making some progress. I think that it is beginning to think much more clearly than before. The trouble is that we have a tangled situation that will not be easy to unravel. Industries have bought their codes at high prices, and are being asked in modifying those codes to give up things that in many instances they do not like to give up. Certain of the labor provisions will be of the same category.

A great deal of guessing was done. We had no sound factual basis for making our decisions on differentials in wages between North and South, as between a small city and a large city. This work has been done on a horse-trading basis. It was honest and as good as possible.

I want to say one thing very specifically, and that is that Mr. Henderson, who is heading the Division of Research and Planning—it is essentially the statistical division, but it is much broader than that—and has been heading it for three or four months I think, has been doing one of the cleanest, hardest, most courageous jobs in God's world. He got in there at about the time when things were beginning to come home. He has had the job of trying to build to meet them. He had the job of being thrown into a great many of the emergencies—the coal emergency, the tire emergency, the textile emergency. I can not imagine a better man for that type of thing. I have made a great many criticisms that I have made honestly, whether soundly or not, but I think that he is doing a splendid job.

Now as to the statistics in connection with codes. I think I have indicated the utter impossibility of generalizing. Had you started this process of codification by endeavoring to lay out the scope that was reasonable, centered on a few major industries, and not endeavored to determine the price one should pay for cleaning a suit in every hamlet in the country, endeavoring to set such rigidities in the code that were impossible of attainment; had you started with an operating philosophy and a certain circumscribed field that would have enabled you to get somewhere, you could have had an underlying policy running through the process of codification that would have permitted a reasonable degree of common-sense standardization of statistical records. And the relationship between statistics and accounting is close, because after all your statistical records very frequently will be drawn from accounting records.

In the absence of that, no two codes are essentially the same. Your statistical problems are different in each. You have a large statistical organization that has been so swamped in trying to get into the economics involved and gauge the economic soundness or unsoundness of hundreds of small codes which should never have been born, that there has not been the time to try to develop a scheme of statistical records. And even had there been the time, it would have been very nearly an impossible assignment because of the many breeds of economics that we have had.

Right now the effort is being made to do the job, to build up a statistical organization, to watch the progress of codes and be able to meet the problems involved at least to the point of providing the General with an analysis. That will be a slow task.

Actually, the main problems involved will be those in connection with wages and hours. That is what labor is vitally interested in, and in whether the so-called equitable adjustment above minimum has been maintained. It is tremendously difficult. To me it has always seemed it would be a far more common-sense approach to have had a simple statement of forty or forty-four hours a week, and then allow one to run beyond that by paying a fair, moderate punitive overtime rather than putting in a tremendous number of exceptions difficult to administer. But the equitable adjustment of wages and hours is likely to be the problem that labor is interested in, and the statistical division, in so far as it is operating in connection with code authorities, will have to base its attack, its analysis, largely on that.

The other group of practices relate to fair trade practices. These will center largely around price. One of the most difficult problems in connection with price may well turn out to be the so-called emergency provisions. We have had emergencies in the tire industry, in the silk industry, in the cotton textile industry, and applications for other emergencies. Frankly, there was very real danger that those emergencies might degenerate into rackets, which would mean that whenever, with a bit of overproduction, prices slipped and the profit margin was threatened the industry would come in and ask to have production curtailed, machine hours reduced or minimum prices placed upon their product.

In order to do a decent job on those emergencies—and I think on the whole probably a creditable job was done on the tire emergency, the silk emergency substantially went by default, the industry took what it wanted, with no adequate proof; and I think if I were thoroughly honest, I would say that the cotton textile industry more nearly approached the silk than the tire—to pass upon those emergencies, it is necessary to know something about costs and price margins. A unit is being set up to try to handle that as well as possible. It will obviously be impossible to cover anything approaching the broad range of codes. Certain key sample codes can be singled out and that is about all.

I have really come to the end, but I do want to make just one additional statement. There is a most unorthodox business man in this country by the name of Henry Ford, and I believe that that most unorthodox business man has on two key matters of public policy and economics been sounder on public policy and sounder in economics than almost any of us.

The first was last autumn at the time of an emotional Blue Eagle campaign that came tremendously close to being one based upon terrorism. He simply refused to sign. He paid full code wages and lived up to it, but was not stampeded. What he did was admired by no small number of responsible men in Washington with a great many people hoping to God he would have the courage to see it through.

And this spring he has recognized the fact that probably far more important than any monetary policy, far more important than any question of price margins, was the fact that to attain the President's goal of abundant life you had to increase production. He avoided the urge to jump the price of his product and preached a very simple, common-sense economics of building up your volume and endeavoring to get away from extreme price-fixing.

I have no doubt in my own mind, that regardless of the economics of the thing and regardless of what one may believe or what one may wish, extreme price-fixing or cost-protection or whatever you want to term it, is on its way out, in Washington. It will not be in a day or in a week; it may not be in six months. It may continue in certain of the natural resource industries, but in so far as that mad urge for it is concerned, it is on its way out. Our emphasis is going to be placed upon stimulating production rather than introducing artificial economics, repealing the law of supply and demand and juggling our way out in some fashion other than by hard work.

CHAIRMAN KNAPP: I am sure I express the thoughts of all of you when I say to Dr. Hettinger that we are all extremely grateful for his coming to Cleveland to address us on this subject today. He has been both critical and praise-giving in connection with the history-making affairs that have been going on in Washington, and we thank him for his honest, straightforward portrayal of things as he sees them down there.

One thought that I like very much in connection with his talk was the note of optimism with respect to the future. I think Dr. Hettinger is in an unusual position to be able to forecast an opinion as to what we might expect, and it is nice to know that he thinks that this country is eventually going some place.

We may stay here until five o'clock, if you so desire. I am sure Mr. Camman and Dr. Hettinger will be glad to attempt to answer any questions that you may have in the discussion period.

Do you want to have a discussion period or has the heat of the afternoon been such that you would rather adjourn the meeting right now?

. . . The members were in favor of adjourning, and the meeting adjourned at four thirty-five o'clock. . . .

SESSION V

OPEN FORUM DISCUSSION

THURSDAY MORNING, JUNE 28, 1934

CHARLES REITELL, Staff Member
Stevenson, Jordan and Harrison, New York, N. Y.
Chairman

DR. CORWIN D EDWARDS is at present on leave from his position as Associate Professor of Economics at Washington Square College, New York University and is serving N R A. as Assistant Director of the Staff of the Consumers' Advisory Board After receiving an A B. degree from the University of Missouri, Dr Edwards continued his studies at Oxford University where he received the B Litt. degree, and then at Cornell University where he received the Ph D degree He reports that his chief interest for a number of years has been in "bridging the gap between economic theory as it is taught in academic departments and marketing and cost accounting as they have been developed in schools of commerce" He is co-author of *Economic Behavior* issued by Houghton Mifflin Company in 1931 and of *American Labor Dynamics* issued by Harcourt Brace in 1928

CHARLES REITELL was graduated from the Wharton School of Finance and Commerce of the University of Pennsylvania in 1910 Following his graduation he worked as cost accountant for the Pennsylvania Steel Company for two years, spent two years as a professor of economics at Elmira College, and four years in Washington with the Bureau of Standards and the War Department. In 1915 he received his M A at the University of Wisconsin, and in 1917 his Ph D. at Pennsylvania. Following his government service, he became a Professor of Accounting and Industry at the University of Pittsburgh, and in 1923 he entered the employ of the State of Pennsylvania as Director of Accounts. In 1925 Dr. Reitell returned to the University of Pittsburgh where he became the head of the Department of Accounting and Industry. In 1931 he obtained a leave of absence from the University and became Chairman of the Greater Pennsylvania Council, a state-planning organization In 1933 Dr. Reitell went to Washington as Chief Accountant of the Licensing and Enforcement Division of the Agricultural Adjustment Administration. This year he became a staff member of Stevenson, Jordan and Harrison, which position he now holds. He is the author of a large number of books and articles on accounting, the most recent book of which is *Cost Accounting: Principles and Methods,* published in 1933. From 1925 to 1928 Dr. Reitell held several offices, including that of President, in the Pittsburgh Chapter, and since 1931 he has served as National Director in charge of Education.

OPEN FORUM DISCUSSION

CHAIRMAN MARSH: In formulating the program this year, the Committee decided on an innovation As you all know, it has been the practice in previous conventions to have the discussion period immediately following each session. Usually there has not been enough time for that discussion, so we decided this year to have a whole session devoted entirely to the discussion of papers.

There has been given, however, an opportunity for each of you to present questions which will be discussed. In addition, it will be perfectly proper this morning for any of you to ask additional questions.

The Chairman for the session today does not need any introduction. You all know Charlie Reitell better than you know me. He has been very, very active in all our conventions. I shall, however, tell you a few of the things he has been doing in the past few years.

He has been head of the Department of Accounting and Industry at the University of Pittsburgh, Chairman of the Greater Pennsylvania Council, Chief Accountant for the Licensing and Enforcement Division of the Agricultural Adjustment Administration, and is now a member of the staff of Stevenson, Jordan and Harrison in New York.

I am very pleased now to turn the meeting over to Dr. Reitell.

CHAIRMAN REITELL: I think in opening our meeting today we face a situation quite different from what we faced last year, and certainly much different from any that we have faced previous to the last two conventions.

In the rapid changes which have characterized American industry, none has hit with such a thunderbolt shot into our field of cost accounting as has the coming of the codes under N. R. A.

In analyzing the fifty-eight questions submitted, I notice a very interesting thing: eighty per cent of them are in the field of economics. In short there seems to be a very decided interest shown regarding those phases of costs that have a bearing on general economic questions.

Therefore, as I open up the discussion this morning, we face a new field of activity for cost accounting. The only service cost accounting rendered in its initial stages was to give a better check on marketing. We attempted to segregate profitable from unprofitable lines. In short, cost accounting was a breakdown of our operating statements into sales analysis, and very little more than that. I think we will all check on this statement.

Following this first period we had that very excellent development of costs as a tool to management. Cost accounting broke away from its books and got into the plant and measured performance, measured capacity, or in other words became a real influence in controlling the managerial features of our operations. I think we can all look to that as a very important stride forward.

Goodness knows where we are going in this new and third stage of our development! I do not! But we must admit that we are getting into a much broader field than indicated by the other two divisions of our work. We are getting into problems of economics, price-fixing, open-price plans and problems of selling below costs. Therefore, I think it behooves us to do some very careful thinking in the year to come, in the general field of economics into which cost accounting is now forging quite rapidly.

After Mr. Stevenson had read his paper at the Washington Chapter about a month ago, he came back to New York and told me about a man who opposed him. You know as well as I that Mr. Stevenson enjoys opposition. There was a very definite desire that we try to get the gentleman who challenged Mr. Stevenson here to our meeting so that he could be placed where he would be a real challenge to us. That gentleman is Dr. Edwards, who is Assistant Director of the Staff of the Consumers' Advisory Board at Washington.

It was with a great deal of pleasure that I found he would be willing to come and, if you please, try to stir up trouble. I do not think you are going to agree with all he has to say. He is going to open up for you new channels of thought, but I know of no better start for our discussion program than to have Dr. Edwards give his point of view, which is somewhat different from our accepted ones.

Dr. Edwards is tainted, like I am. He happens to be a college professor. He is Associate Professor of Economics at the Washington Square College of New York University. He is a graduate of the University of Missouri, took graduate work at Oxford, England, and also at Cornell University. He has several books to his credit. He is co-author of *Economic Behavior*. He is also very much interested in American labor dynamics.

If I might state his chief interest, it would be this, that Dr. Edwards is very much interested in bridging the gap between economic theory and the more practical fields of cost accounting and marketing. Therefore, if I am right, that cost accounting is forging out into much broader fields, and if those fields are in the general field of economics, then we have a prize with us this morning.

I am not going to take up more time, except to introduce Dr. Edwards and present him to you. I think from that time on this meeting will hum.

DR. CORWIN D. EDWARDS (*Assistant Director of Staff, Consumers' Advisory Board, Washington, D. C.*): I felt, when I came down here, as tainted as Dr. Reitell's introduction has suggested. That feeling was increased when I heard Mr. Greer say that as one who is admittedly a professor and has been called an economist, he felt he was sticking his neck out. Since I am open to additional epithet as a member of the staff of N. R. A., I felt I was sticking my neck out a very long distance.

I do not feel so any more. Gilbert K. Chesterton has a book called *The Man Who Was Thursday,* which tells the story of a government spy who worked his way gradually into the central council of the secret anarchist organization in England, a group of seven people. He was taking his life in his hands, he thought. As the book develops you discover that each of the other six was also a government spy set there to watch the working of the council.

As I listened to Mr. Greer and Mr. Camman and Mr. Elliott from your own group, and noticed that you brought in Dr. Lyon and Dr. Hettinger from the outside, I began to see that, far from sticking my neck out, I am going to speak this morning along lines acceptable to the trend of the thinking of this group. I am pleased and somewhat startled at what seems to be the very rapid accommodation of accounting ideas to the new field which accountants have before them.

One more preliminary word. As a member of the Staff of the Consumers' Advisory Board of the N R. A., I suppose I may be expected by some of you to be interested only in the lowest conceivable price. That is not my position, and I think I may say it is not the position of the Consumers' Advisory Board. We are concerned for the long-run interests of the consumer. In a capitalistic society such as ours we believe that those interests are consistent with moderate profits for efficient business, and in any society we believe they are consistent with an effort to get the best possible organization of productive industry.

In what I am going to say, then, I think that despite my position we have the common ground of trying to find those principles in the relation of cost to price which will be consistent with good industrial organization.

I speak, of course, on my own behalf. I represent my own point of view, and I have no doubt that part of what I say would not be concurred in by the other members of the staff of the Board.

The thesis I want to set forth is that it is sound business and economics, upon some occasions, under some circumstances, to sell below cost; or, turning it around the other way, that the principle of forbidding sales below costs, as accountants conceive cost nowadays, is dubious from either the business or the social point of view.

Let us take first a few of the cases, recognized by business opinion, in which it is obviously wise to sell below costs.

Some years ago I stopped at a haberdashery in a little English town. I went in to buy a pair of socks. The man produced a very nondescript pair. He said, "These will be three shillings sixpence."

I said, "That is absurd! I have gotten socks that good for half the money! What is the idea?"

"Well," he said, "I know it is too much, but I bought these socks three or four years ago, and that is what I paid for them. I can't sell them below cost. I haven't gotten rid of these, so I haven't been able to buy any cheaper ones."

That, of course, is an absurd illustration of an idea which accounting generally has cast aside. We all recognize that you clear out remainders, that when you have made a bad judgment you do not hold to the figure which may be necessary to save you from suffering as a result of your mistake. Even the codes which go furthest in the direction of cost protection nearly always include in the cost clause a proviso that remainders, dropped lines, seconds, various unfortunate parts of one's stock, shall be cleared out regardless of cost or below cost.

A second provision has not been so general, but I think will become general by business pressure, regardless of what governments or economists or cost accountants say about it. This is that you may sell below cost if you must do so to meet the other fellow's competition. We had an interesting small code quite early in the process of code-making, which included the provision that no member of the industry should sell below his own individual cost. When the members of the code committee went home, one of them wrote a letter to all the other members of the industry, somewhat to this effect:

"Gentlemen, you all know that my costs are the lowest in the industry, well below yours. I suggest that you discontinue manufacturing this particular line of products, for I want to point out to you that I am going to base my prices on my costs and that you can't match me unless you choose to violate the Code."

Within a few weeks, the code committee, with the exception of the one gentleman, was back in Washington clamoring to have inserted in the code permission to sell below cost to meet the competition of such members of the industry as were not violating the cost provision. Unless you want to get kicked out of business by legal fiat, business salvation requires that you be able to sell below cost in so far as your costs are higher than the other fellow's.

Again, take the case of a concern which is losing its sales and which decides that it is not covering its costs now, that something must be done to save it, and that for its particular trouble one of the things to do is to launch a large advertising campaign. Under some of the cost systems which I have seen introduced by code committees, any concern faced with those conditions would be forced immediately to regard its advertising campaign as an increase in its costs, and since its sales now leave no margin above costs, immediately to increase its prices to cover the additional outlay. In other words, on a shrinking market, while doing its best to restore public demand, it would offset its new appeal by an immediate coordinate increase in price. I suspect that the advertising agency managing the campaign would be likely to feel that it was being asked to pull the business out of the hole while handcuffed and with weights tied to its feet.

The principle underlying these various examples is an exceedingly simple one: that when you have made a mistake or when, through no fault of yours, you have gotten into difficulties, instead of throwing the whole thing away you try to salvage what you can. A mistake should not, if one can prevent it, become a total loss.

There are economists who have made a career and a salary over a period of years by translating that simple statement into formidable language. The first time I heard it stated, for example, in a graduate course, it was put in the form that the reservation price of a sunk cost is zero. This merely means that, having committed yourself, having sunk your money, if you can get some of it back you have just so much more than nothing, and if the alternative is to get some or none, I suspect that it is sound business to get some.

It seems to me that this principle, which is not contradicted in the field of inventories, must be recognized on both social and business grounds in the field of productive equipment. You do not believe it is good business to dump your inventories into the river because you can not sell them for what you hope to get. Do you believe it is good business figuratively to dump your factory or some branch of your factory into the river because it will not return what you hoped for when it was constructed? A great deal of the thinking about the relation of overhead charges to prices, it seems to me, amounts to a proposal to dump factories into the river.

You commit yourselves nowadays to a productive program which runs far into the future. I would like to make very clear what I am not saying. I am not saying that at the time you are considering such a commitment you should fail to take into account every item of cost and to set the total against the prospective sales volume and the prospective prices. I am concerned only with a later development which is typical in American business.

We have a dynamic technology and a changing system of habits of life. After plants have been constructed, when the machinery can no longer be converted or scrapped without considerable expense or loss, we often discover that new inventions have produced simpler, more efficient and cheaper means of production, that new products have appeared and superseded the ones which existing plants were set up to manufacture, or that habits of life in our changing economic system have reduced the demand for the product—more probably all three.

At this stage what are we going to do? We may say, "The equipment cost us a million. The charges on a million, estimated over the physical life of the plant, are costs." We would not have said that at the beginning. If we had foreseen that the plant would last physically for twenty years but that it was to be superseded technologically in ten, we would never have thought of depreciating it on a twenty-year basis.

Now we discover that instead of being superseded in ten, it is superseded in five. We have suffered from bad investment judgment. If in our productive policy we choose to make that five-year-old mistake become a reason for not using the plant for what can be gotten out of it now, it seems to me that we are confusing investment and investment planning with production and production planning. The principle of writing off bad investments, excessively conceived sunk charges of any kind, ought to be applied considerably further than many plants now apply it.

I am not speaking iconoclastically; certain cost accountants and certain cost accounting systems would agree in principle. But I am asking for further development of ideas which, though current in many sound cost accounting systems, have not yet been adequately worked out in practice.

All this implies that unless you re-interpret costs, you very frequently cannot afford to base prices on costs. Prices, after all, have the function of selling goods. They must be keyed to demand. With your productive equipment already in existence, the fundamental question is: What price will make the best possible use of the equipment in the light of demand?

In other words, cost accounting provides a rather bad guide for price policy, unless it is specifically keyed to the problems of the market. It is no criticism of cost accounting to say that it is not now so keyed. The function of cost accounting historically has been, as Mr. Greer pointed out the other day, to guide management in internal problems. Its use in the problems of the market is recent, and it seems to me surprising that so much and so rapid progress has been made in accommodating cost ideas to the new job. Nevertheless I think further adaptation is required before one can rely upon cost accounting for market strategy. Cost accountants need to do more intensively and more self-consciously what I feel they have done in part for a considerable time with some tendency to deny that they are doing it—that is, to adapt costs to market conditions, instead of trying to base prices and market policy upon costs.

I say I feel this is partly done. Let me illustrate. It is commonplace in most large plants to sell by-products. Some years ago, when I was hunting for a definition of a by-product, the best definition I could find was, "a product which is treated favorably as compared with other products in the allocation of joint costs; a product which is relieved of some part of the cost burden which other products are expected to carry."

How do you select a by-product? How do you determine which of a whole series of things made by a plant shall be relieved of costs? I suspect that the heretical truth is that you find out what you can get for the product, you find out what products must be low-priced to sell in sufficient volume, and then you allocate your costs accordingly.

I think it would be interesting to ask Mr. Elliott, if he is here today, to tell us whether there was not a conspicuous change in the cost accounting system of the oil companies from the days when kerosene produced for lamps was the chief product of the industry, and when gasoline was either sold very cheaply or hauled out to sea and dumped, to the present time, when gasoline is the main product of a refinery. Here you have a situation in which—I am guessing—kerosene was once the product and gasoline the by-product or perhaps even a cost to the industry, and in which gasoline is now definitely the product which must carry the chief burden of the industry's cost.

Again, I suspect that you base your costs upon your markets in determining the valuation of any equipment which is not manufactured, —water sites, land sites, etc. And I suspect that when you determine how rapidly you will depreciate any equipment, manufactured or not, you ask yourself, not how long will this last physically, not how much would I like to get back per year and over how many years, but how soon will the market force me to discard this in the interest of cheaper and more efficient productive equipment, how long have I got as a result of market conditions over which I have no control?

It seems to me, however, that we have not gone quite far enough. In the philosophy of standard costs, as I, as a layman, understand the term, the idea has developed that you should not deliberately run your prices counter to the market trend; that if you are allocating fixed charges at the rate of $1,000,000 a year and your unit sales drop from a million to $500,000, you should not raise your price a dollar for the sake of still covering your overhead. Instead, you use the concept of under-absorbed burden. You treat your burden charge per unit as a standard charge, which over a period of time is expected to come in at about such-and-such a rate, but which in any one period is unchanged per unit, regardless of whether sales are fluctuating downward or upward.

This is one point at which accounting seems to me to have gotten away from agrarian superstition; or rather what was once agrarian common sense but with the development of industry is becoming a superstition. The annual accounting period, like the monthly or weekly accounting period, is for many purposes not anything more than the basis for an interim report. We are coming to recognize that if this year's sales are higher than last year's sales, and both the height and the depth have been anticipated, there is no particular reason to treat each year as a separate fiscal unit for cost purposes. Rather there is good reason to adopt a policy in allocating overhead which will allow in advance for these anticipated sales fluctuations.

There is, I believe, one suggested system which would allocate so much equipment cost per unit of product over the total anticipated output during the life of the equipment. Thus in a year in which you produced 500,000 units you would say that you covered all your fixed charges if you got back that amount per unit of product on those 500,000 units. In a later year, when you produced a million units, you would expect to get back exactly twice as much toward these equipment fixed charges

That, of course, does not go far enough. It is only one of a number of different proposals, all of which aim, it seems to me, at one central idea: that it is not the function of accounting to encourage the establishment of high prices or avoidance of price concessions at a time when demand is calling for price concessions; nor to encourage a policy of low prices or a policy of avoiding price increases at a time when demand is calling for price increases. To fully express the principle we should adopt cost systems which will encourage price changes with, rather than against, market trends—which will make the equipment charge in prosperity heavier, not only per period but per unit, than in depression. Such a system would encourage the use of facilities off-peak while recognizing that since much equipment is built chiefly for peak business, the peak should logically carry the heavier burden.

All this means, as I see it, that there is room for considerable development, which I hope will take place rapidly, in the concepts of accounting as applied to market control I hope that this development will include a recognition that, as Mr. Greer said the other day, prices are guides to values. In so far as we have control over the economic process, whether by codes or otherwise, I hope that this development will recognize price variations as symptoms of what is happening, highly valuable symptoms, which should not be destroyed. In a market in which consumers can not buy goods, to raise prices is almost inevitably to restrict demand. In a market in which the producers can not supply goods, failing to raise prices is almost inevitably an encouragement to waste scarce resources.

The old idea in almost any technical field is that you attack the conspicuous, alarming symptom of what is wrong, as we once did in medicine. Rapidly falling prices, I take it, are ordinarily a symptom of something wrong. Price control promises, not to get at the something wrong, but probably to change the direction in which the disease breaks out.

It may be that we need market control. In many lines I am sure we do. But it seems to me that there is a third alternative besides the two Mr. Stevenson stated the other day. We are not limited to unregulated competition or planned economy in the form of price-fixing. The initial issue is · Shall you regulate and how far? The second issue is: In what direction shall you regulate? Shall you regulate prices, or shall you try to go underneath the price structure and regulate the basic situation of production and demand out of which prices arise?

I am suggesting that cost accounting will be doing a very bad service if the businesses which employ accountants and the industries which follow their advice try to establish prices as an inflexible element in our economic life, and so throw all our failures of regulation or our failures of competition into the form of fluctuation of demand, fluctuation of employment, fluctuation of output, fluctuation of the basic productive activity which is the excuse for business.

So long as prices or productive activity must suffer, it is far better that we have commodities, employment, an actively working industrial system, even if investments are not fully returned and write-offs have to be considerable, than it is that we preserve the apparent sanctity of investments, costs, and prices, and in the process sacrifice volume, production and employment. Either alternative means business losses. Collapse of output merely produces losses by means which do not so clearly appear upon the cost accounting records as cost accounting records are now set up.

That is the burden of what I had to say. I want to make one more remark, along a slightly different line.

Suppose you assume that accounting is adequate to the job of market control. Suppose you assume that further development of the basic ideas upon which cost accounting rests is not needed. Suppose you assume then that it is sound to set up an inflexible system of basing price upon costs. There still remains a question as to whether it is sound to do it in codes by law.

There have been occasional code committees appearing at Washington whose codes could really have been boiled down into two clauses:

Clause 1: Every business man at all times shall use the best possible business judgment.

Clause 2: The Code Authority shall have the power to enforce Clause No. 1.

I think there is a very real and important distinction between those principles which merely may be sound and those principles which should become the basis of a code, which are so sound that you propose to take away a man's market or fine him or in extreme cases send him to prison for a violation.

With cost accounting in its present rapidly developing condition, with price control as dubious a means of industry regulation as it seems to me to be, I think it is unsound even for an individual business to adopt a rigid policy of basing prices upon costs. But if it were sound, it would seem to me still dangerous to say that those who do not agree are to be branded as law-breakers, subject to the penalties of a federal statute. If you say this at the present stage of opinion, you are inviting trouble, because there are a great many who do not believe that it is very important to make people do what you are trying to make them do. There are a great many who, in serving on juries or in buying from Blue Eagle establishments, are not going to have the same fervor of conviction that the codes must be supported as if these codes were confined to clearly common-sense principles.

It is for that reason that the Consumers' Advisory Board has been saying for some time that we believe you should distinguish in submitting cost clauses and cost formulas between those principles which are sound cost accounting for an individual enterprise and those principles which are a sound basis for writing criminal law, and that you should include in the second only matters about which there can be no reasonable doubt.

We have on occasion, as Mr. Stevenson said the other day, gone so far as to suggest that in a particular industry if you are going to use this principle all you can safely include is labor and materials. In other industries we have gone further, but we have urged rather consistently that those items in cost accounting about which there is the greatest confusion, the greatest disagreement, the most rapid development of new ideas, the greatest variation from one plant to another—that at least those ideas shall not be frozen and given in their frozen form the status of law.

CHAIRMAN REITELL: Either that college professor is wrong or I am. I do not know which. He certainly has attacked my sacred idols. I still must have enlightenment, Dr. Edwards.

Let us see what he has told us. I have tried to jot it down. In the first place, he says that our attack on selling below cost is not sound.

Secondly, he says that prices should set costs and not costs set prices.

So I think, Dr. Edwards, you and I had better get armed for a fight. But we are not going to do all the fighting. We will let the rest of the crowd get in.

I think much of the confusion about prices setting costs and costs setting prices misses one important point; namely that every cost price is a selling price. To keep our thinking straight we must consider the unit, the enterprise, and see how the interplay takes place between the cost prices and selling prices in each concern.

Taking a long-time sweep and considering the stability and maintenance of a successful enterprise, I for the life of me can not see how in the final analysis you must not have your selling schedules based upon your basic cost data.

But there is a more important thing, a thing on which I would like to question Dr. Edwards further. Of course, perhaps I do not see his point clearly. Maybe I am wrong. But my experience has been that when a new design is proposed by an industry we are all careful to make certain that before the design is adopted we are going to see what is its cost. And, Dr. Edwards, I have seen design after design set aside, simply because a careful cost analysis portrayed that the profits were not in the bag and could not be gotten into the bag.

I like to look upon costs pretty much as a careful indicator for shaping selling policy. I am going to ask Dr. Edwards to clear up my trouble because maybe some of you are in the same boat as I. How are we going to say a selling price must determine our cost, if the selling price, after analyzing the cost factors in the plant, is such that no profit is seen and if our policy is thereupon shaped so as to exclude that line from further consideration?

Yesterday morning I was in a plant and saw a whole row of designs, all very attractive ones. I asked the president why he was not going into two or three which I thought were extremely attractive for the market. His answer was very definitely this, "Because we can not get our costs down to where we can make a profit. We are now having engineers redesign so these units may be made successful items for us to market."

I would like to have Dr. Edwards show me where I am wrong when I hold that one of the functions of cost is to give a careful guide in the establishment of our lines and in the establishment of our sales possibilities.

Will you do that, Dr. Edwards, just briefly, so we can get along?

DR. EDWARDS: I feel that your criticism, Dr. Reitell, is of my exposition rather than my idea, because I find myself agreeing with all you say and still holding my point

I tried to say, and apparently did not succeed in saying, that before a new project is undertaken it is thoroughly appropriate to take all items of cost of all kinds, compare them with the prospects of the product, and shape one's policy on this anticipated cost basis. Of course, the anticipations may be "all wet," and to that extent you are basing your judgment not merely upon costs but upon a whole series of interpretations of unknown variables.

But ignoring that, the term cost as used today is an amalgam of a series of quite different conceptions. On the one hand, there is what you speak of—actual outlay, purchase prices, about which at the time they are made there can be no disputing. You know what they are. If then you are working, say on a job system, and have had these prices quoted to you as firm prices, they are as nearly facts as a person can get.

There are other conceptions of cost, however, which are based upon the notion of what you once spent and hope you still have, which you may or may not have. Costs of that sort are more properly treated, to return to one of these high-flown terms my old professor used to use, as "opportunity" costs. The real question is: What could you do with this thing, if you did not use it here?

Let me illustrate by a household problem, just for the sake of trying to persuade you where you have no technically formulated opinion. Suppose that relying upon my salary in N. R. A. I take a certain apartment upon a two-year lease at so much money a month. Then my salary gets cut forty per cent. Obviously that apartment is not worth its cost to me, in the light of my new income; but equally obvious if I can not break my lease I would be a fool to move into the bedroom and the kitchen on the ground that I can no longer afford a living room.

That is essentially what it seems to me you do when you regard any charges to which you are committed as a limitation upon what you are going to produce, if the alternative is to produce nothing. There may be cases—extreme cases—in which that is true even of labor, but typically, of course, I am thinking of various forms of overhead.

Let me give you a labor illustration from an acquaintance of mine in New York. He was running a job printing establishment. Every evening at 7:30 he had a half-hour job which could not be begun before 7:30 because the copy did not come until then. His labor quit at 5:00 and he paid them time-and-a-half from 5:00 to 7:30 to sit around and smoke in order to be available from 7.30 to 8:00. But the job was so highly profitable that it bore the extra labor cost.

Somebody came in and wanted a job done which would take about a half hour a day and could be done starting at 6:30 every day. This acquaintance of mine calculated materials plus profit and figured it paid him to take the business even at a price so low that it covered none of his productive labor, on the ground that he was paying them anyway. The alternative was for them to sit around smoking.

Now you may make the point that in getting the business on that basis he was making it very difficult for someone else to get it who would have had to hire his labor anew. And there it seems to me you are in a conflict, not of cost principles, but of economic principles. Do you think it wise to keep certain equipment or certain labor sitting idle when it might be productive, for the sake of spreading the business thin over as large a number of producers as possible? If you do, you can set up a cost system which will achieve that result. If you think that our drive toward modern industrial efficiency has consisted largely in finding ways of using idle time, idle resources, scrap materials, idle labor, and idle equipment, in getting production where the alternative is waste, then you may say that we would better use equipment which is in existence, if the alternative is to keep it idle, and that if price concessions will let us use it we would better have price concessions.

That is an entirely different problem from the problem of whether we should take on new equipment, construct new plants, make new designs, launch new products; and on the second problem I agree entirely with you, Dr. Reitell.

CHAIRMAN REITELL: It is still not clear to me; I am sorry. I see where Dr. Edwards and I had better get together and continue debating.

The first thing we should tackle this morning, because there are several questions on the subject, is this new Treasury decision on depreciation.

I am not going to read all the questions on this subject because many of them are duplicates, but to get you acquainted with the issues, I shall read some of the more outstanding questions.

Question.—"Considering the fact that the Treasury Department has instructed large companies of the necessity of maintaining and submitting depreciation schedules—that is, T. D. 4422,—which is a compromise between the Department and Congress in order to relieve litigation and arbitrary assessment, what is the opinion of this body as to the preparation of these schedules, considering their essential importance to all tax returns and proper costs analyses?"

Here is one much more to the point—

Question.—"These new depreciation problems, what are they?"

And another—

Question.—"What should the policy of the National Association of Cost Accountants be toward T. D. 4422? Is not the utilization basis more scientific?"

I think it is just a smart professorial trick that when a man puts in a question we ask him to speak on the topic. Our Mr. Tucker is very much interested in this problem. Mr. Tucker is President of the Boston Chapter. I see his charming countenance down there, and I am going to call on Mr. Tucker to open the question.

CHARLES W. TUCKER (*Controller, H. P. Hood & Sons, Inc., Boston, Mass.*): Dr. Reitell, in view of the fact that I submitted that first question, I would prefer, at least temporarily, to reserve my comments. I am looking for information.

CHAIRMAN REITELL: Who is the person who has been working on taxes and is in close touch with this ruling? Have we one here?

E. K. REDFERN (*Public Accountant, Main & Company, Pittsburgh, Pa.*): I understand that in Pittsburgh the revenue agents are having classes daily on this question, and although I am not sure, I am also informed that each of them is supposed to have a letter from the Treasury Department and the Secretary of the Treasury asking him —that is, the agent—whether he understands the principle back of the decision.

The purpose, as I understand, was for a compromise between Congress and the Treasury Department, Congress wanting to reduce depreciation, cut it out entirely, and the Treasury Department objecting. Finally the Secretary of the Treasury offered to reduce the depreciation somewhat to accomplish the purpose in mind in Congress. As far as I can determine, the sole idea behind it is to get revenue.

In the two cases I have come across the agent has deliberately cut the rates, placing the burden on the taxpayer to substantiate the rates they used as well as the per cent of normal operations. What the final outcome is going to be, I do not know. That is the extent of my knowledge.

CHAIRMAN REITELL: Mr. Armstrong, you have had some difficulty with this problem. Do you want to say a few words on it?

W. C. ARMSTRONG, JR. (*Treasurer, Rockbestos Products Corporation, New Haven, Conn.*): I could read in a few minutes just what this article is, which would make the whole proposition clearer I imagine:

> Art. 205. The method of computing depreciation allowance: The capital sum to be recovered shall be charged off over the useful life of the property, either in equal annual installments or in accordance with any other recognized trade practice, such as apportionment of the capital sum over units of production. Whatever plan or method of apportionment is adopted must be reasonable and must have due regard to operating conditions during the taxable period. The reasonableness of any claim for depreciation shall be determined upon the conditions known to exist at the end of the period for which the return is made. Where the cost or other basis of the property has been recovered through depreciation or other allowances no further deduction for depreciation shall be allowed. The deduction for depreciation in respect of any depreciable property for any taxable year shall be limited to such ratable amount as may reasonably be considered necessary to recover during the remaining useful life

> of the property the unrecovered cost or other basis. The burden of proof will rest upon the taxpayer to sustain the deduction claimed Therefore, taxpayers must furnish full and complete information with respect to the cost or other basis of the assets in respect of which depreciation is claimed, their age, condition and remaining useful life, the portion of their cost or other basis which has been recovered through depreciation allowances for prior taxable years, and such other information as the Commissioner may require in substantiation of the deduction claimed

I have before me a pamphlet issued by the United States Appraisal Company which sums up briefly what T. D. 4422 will mean to us—

> 1. By reduction of rates of depreciation on depreciable property, thus increasing earnings upon which additional taxes may be levied;
>
> 2 By requiring taxpayers to furnish documentary proof of "remaining useful life" of depreciable assets and "reasonable" rates of depreciation to be applied to original costs, thus shifting the burden of proof of reasonableness of rates to taxpayers,
>
> 3. By requiring taxpayers to segregate assets which have in the past been completely depreciated

The instructions by the Internal Revenue Department indicate that so far as the pamphlet shows, any method of depreciation that can be substantiated will be accepted, but what they are apparently aiming at are those plants that have been fully depreciated, reappraised, depreciated on the appraisal basis, and then when that is all "depreciated," reappraised and "depreciated" all over again.

CHAIRMAN REITELL: Thank you, Mr. Armstrong. Is there any more discussion on this point?

JOSEPH C. PATRICK (*Kellogg Switchboard & Supply Company, Chicago, Ill.*): Is there anyone here who knows suggested rates that Washington expects to establish?

CHAIRMAN REITELL: The gentleman asks if anyone here knows the suggested rates Washington expects to establish?

WILLIAM MARSH (*Pittsburgh*): Dr. Reitell tells me there are a good many questions on this subject. I am somewhat surprised because I had the impression that the questions would mainly be on the papers we have had.

I might explain a little bit about the situation. I thought it was common knowledge, but it does not seem to be. As I see Treasury Decision 4422, it does not shift the burden of reasonableness of deductions for depreciation on the taxpayer. I think most taxpayers have heretofore assumed that responsibility, but the regulations do not so provide. Now all they have done is in the regulations put the burden of proof on the taxpayers.

Possibly it might be of a little interest to know how that came about. I think it is known that when the new Revenue Act was being drafted the Ways and Means Committee decided to put into the law a provision whereby all depreciation deductions would be decreased twenty-five per cent on the regular basis that has heretofore been in existence. They met with legal difficulties and could not do that. So the Secretary of the Treasury agreed to do the very same thing administratively. That is the reason, as I see it, for T. D. 4422

I have been informed in Washington that this Treasury Decision will result in abandoning the rates that have heretofore been fixed. If you recall, five years ago the Bureau of Internal Revenue made an extensive study of depreciation rates and published those rates. They tell me now they will be discarded and they also say the trick is to require the taxpayers to show the remaining undepreciated book value and the estimated life from the time they are taking and depreciate on that basis.

CHAIRMAN REITELL: Valued at what time, and on what basis?

MR. MARSH· On the cost basis, the basis to which they are entitled.

CHAIRMAN REITELL: Is there any other discussion on this point?

MR. TUCKER: I would like to ask Mr. Marsh if in his opinion this requirement of presenting to the government an affirmative evidence of the depreciation, of the reasonableness of the depreciation deduction, does not involve the preparation and maintenance of a well-defined equipment and depreciation register.

MR. MARSH: The answer is: Yes, if they enforce it. I have an idea they will not be able to enforce it completely.

The first step they took, of course, you probably know. They circulated to all taxpayers this questionnaire, requiring them to submit schedules showing complete data for all depreciable assets classified. I have heard that the U. S. Steel Corporation is now doing the job, and that it is going to cost them a quarter of a million dollars to do it. I do not know whether that is true or not, but I doubt if that will go to the extent that you in your own mind think it will.

I do not think they will be able to go through and require the information from all the taxpayers they are now asking. But if they do, very probably everyone will have to have a plant ledger, because the data now required can hardly be secured except from a plant ledger in some form.

MR. TUCKER: It is my understanding also that the effects of this Decision 4422 will extend to all unsettled cases before the Department.

MR. MARSH: Yes, that is true. It is retroactive to all cases not now settled. If your taxes are not settled as far back as 1924, it affects all those years.

MR. TUCKER: Have we any right to assume the Department will not enforce this Treasury Decision?

MR. MARSH: No, I did not mean to imply they will not, but it is a practical matter after all. I think it is, in a good many instances, impossible to supply the particular information which the detailed schedules require. They are now asking for it. I think some compromise will be reached whereby each individual taxpayer will be able to supply information necessary to prove only one thing; that is, the reasonableness of his depreciation deduction.

All they are trying to do is to decrease depreciation allowances. I do not know whether you know it or not, but the depreciation deduction of all corporations in the United States—I think it was for 1929—was exactly equal to the taxable income. I think it was in the neighborhood of $4,000,000,000, so if they deduct twenty-five per cent that means $1,000,000,000 in deductions, and obviously a lot of tax. Having in mind the purpose of it, I think you can readily see they will compromise with each individual taxpayer in order to get that result.

CHAIRMAN REITELL: We have to make a decision here. We have not yet opened up the questions dealing with the papers, and you see what time it is. It is now almost half past eleven. I propose, if this suggestion meets with your approval, that we close the morning session at 12:15 and then return at 2:00.

The alternative is that we keep on going until we are finished, and then get luncheon when that time arrives, but Miss Shaw must know at this time how you feel about it.

. . . It was decided to recess for lunch and return. . . .

CHAIRMAN REITELL: I do not think Mr. Stevenson is in the room, and I hope he is not because he may fire me after what I am about to say. But after listening to Mr. Stevenson's speech, I felt very definitely that there is going to be needed a tremendous amount of necessary machinery to operate the plan he has in mind, and several questions coming from you fellows indicated that you were of the same opinion as I.

One of the questions, which I think sets up the problem for discussion is this—

Question.—"Mr. Stevenson: Under your proposed plan of price-fixing within the industry, where would the final authority for the establishment and operation of these prices rest, and would there be any government supervision?"

Another question of similar type asks, very bluntly—

Question.—"How are you going to control, Mr. Stevenson, this whole price-fixing throughout all industry of all products?"

I am going to ask Dr. Edwards if he will not take a broadside at these questions. Will you, Dr. Edwards?

DR. EDWARDS: I heard Mr. Stevenson answer a somewhat similar question when he spoke in Washington before the Washington Chapter.

As I understand his answer—and, of course, there is danger that I may have misunderstood it—it was that he would set up a series of government commissions, somewhat like the Interstate Commerce Commission, that he would rely upon these commissions to prevent abuses of the price-fixing power, and that except where abuses appeared prices would be fixed by the code authorities of the industries concerned.

The question was asked at this Washington meeting whether he did not think that would take a considerable personnel. It was pointed out that the Interstate Commerce Commission has a very large number of employes. I do not know what it is, but I have the figure 1,700 in my mind. If I remember his answer correctly, it was his belief that a total personnel of perhaps 1,000 people could do the job, and that it would be very much worth having this personnel for the sake of the ends to be achieved.

My own acquaintance with the problems involved comes almost wholly from working with the Consumers' Advisory Board in attempting to exercise our obligation of following prices under the codes to see that they are fair to the consumer.

We run at once against the fact of very inadequate information. In the first place, there is no adequate price information, except as it is now being created in industries which have open-price systems. The other price information available is spotty. Where you have prices from several different points in the distributive process they are not necessarily comparable. The products selected are not the same, or one price will ignore terms of sale and another will be reduced to a net basis, etc. So there is a very large job of knowing what prices are, of which we have just begun to scratch the surface. This is obviously involved, it seems to me, in any regulation.

Second, we have run across the fact that where you have price control you almost inevitably have to have standardization, standard labeling and quality control. There is one illustration with which Dr. Reitell is familiar. He and I were discussing, some time ago, a small industry which introduced an open-price system in an effort to avoid price discrimination. The number of filed brands in that industry since the first filing has gone up something like 400 per cent, so that we infer that every time anybody wants to cut a price and discriminate toward some customer, he files a new brand.

I think an illustration like that makes it rather obvious that you can not regulate a price until you know what you are pricing, and that you can not know the article until you have established grades and labels which will identify the product sufficiently to indicate whether the price is being observed or not. The work of the Bureau of Standards, the American Society for Testing Materials, and the American Standards Association will illustrate for those of you who are familiar with it, the problem involved in getting standard grades and labels.

Again, it is almost impossible to have price control without having a fairly close control over the channels of distribution of an industry, the various forms of discount which prevail, the arrangements which in the language of recent months have come to be known as the merchandising plans. You set a price. but if you get all sorts of peculiar cash discounts or if you find the trade discounts are varying in amount from one concern to another. with no appreciable relation to the quantity or the customer class in which the buyer belongs, the price becomes an illusory quotation.

Those of you who are familiar with the steel code will remember the elaborate quality and quantity extras and basing point systems as means of handling freight. which were evolved in an effort to assure the maintenance of a price structure in which a man does not cut at some point to some customer.

There has to be a geographical price structure. There has to be determination of what you are going to do about freight rates, shipping costs, etc.

Supposing you have all that, then all you have is the price. You must go on, if you are to follow Mr. Stevenson's plan, to the question of cost, to determine, by settling the issues which have been raised by the various speakers here and working out the cost system necessary for your settlement, whether the prices as established are in proper relation to the costs as determined. This will involve, I take it, supervision of the cost systems of particular industries and particular enterprises.

I suspect that it will require some power of access to the books of particular enterprises. There is a recent case under one of the codes, not yet determined, in which Standard Brands, Inc., is accused of having violated the code by selling its coffee unduly below cost. Now that requires a determination of what Standard Brands' costs were, what Standard Brands' cost accounting system was, whether that system corresponded to the general principle set up in the code. It involved the fact that Standard Brands distributes by a somewhat different marketing system from most other producers in the industry. When you have gotten the facts, you can then make your determination as to whether Standard Brands sold below cost.

I take it there will be no lack of occupation for accountants, if we are to see any very large use of this principle. I have not the slightest idea what the personnel required will be, but I suspect that there will need to be whole new informative services of which we have just the beginning.

I suspect, too, that the problem of regulation will be serious, that if private agencies are to fix prices and determine costs there will have to be somebody checking their actions. This is because any large scale scheme will inevitably be perverted here and there by human greed or human misunderstanding. We have had cases, particularly in codes which have been administered in regional divisions, in which it has been quite obvious that the customers of the industry or members of the industry or code authority officials or even government compliance officials have not accurately understood the meaning and intent of the code.

There have also been repeated charges that cost figures have been padded. Now regardless of the truth of such charges, I think it is obvious that any such system of control can not work unless the public at large is fairly well convinced that on the whole it is not developing into a racket. And that requires sufficient regulatory supervision to make it difficult for a man to run wild in reporting costs or in juggling the manner in which they are summarized.

This may take the form of government intervention in the process. It may take the form of customer intervention. I do not pretend to predict all the various forms it can take, but I want to suggest that you watch carefully one experiment that seems to be interesting.

The newsprint people want price-fixing for newsprint. They have introduced a code in which a special price committee is set up to fix the price, and on that committee they have an equal number of representatives of newsprint manufacturers and newsprint buyers. An equal number! If you are willing to go that far for industrial self-regulation, regarding the buyer as a part of the industry who should participate in the decisions, then it may be you can hold government regulation down to a minimum. If the buyer is not to be found or is not informed, or if he is not to be given a voice in the price-making and cost-determining processes, then I suspect you will have to accept more government regulation as a substitute.

It seems to me a very considerable job. Personally, I find it of appalling proportions. So even if I were thoroughly in sympathy with the principle I would question seriously the administrative practicability of trying to do it on a nation-wide, industry-wide scale.

CHAIRMAN REITELL: Another question similar to the one Dr. Edwards just discussed.

Question.—"Mr. Stevenson, is not your philosophy that of a Socialist, with the exception that the code authority or some such group will assume industrial control instead of the state? Under your plan, just who would control?"

I am sorry Mr. Stevenson is not here today to answer these questions. He is tied up in trade association work and simply could not be here, but I have talked the thing over with Mr. Stevenson quite at length, and I know he is not in any sense of the word trying to put over a socialistic program.

As a matter of fact, it is just the opposite and reverse of that. I know that down in his heart, he sincerely feels that either you will take some form of price and allotment control or you will get some type of socialization that smacks of socialism.

I agree with Dr. Edwards. My experience in Washington has been just as Dr. Edwards has told us. It builds and builds and builds up the personnel without limits and with all the political patronage that goes with it. Yes, and with all the inefficiency that political patronage entails. There is a big tax bill involved.

I am sure we have time before lunch for one more question that points to Mr. Stevenson's paper.

Question.—"Mr. Stevenson suggests that industry be allowed to fix prices based upon the average industry cost. How does this reflect the public interest? This gives a low-cost producer a higher price than he would obtain under the competitive condition. Is it not reasonable to assume that if the government permits price-fixing it will require government regulation of business under some commission determining fair values of productive assets, and also the recapture of excess profit of low-price producers earning more than a fair return due to fixing of prices?"

I think really that breaks down into two questions. As regards the first, the A. A. A. had a very interesting experience along the lines of this question dealing with costs and selling prices of rice millers. After a study of the costs of many rice millers, you found a very large range of cost figures. You had the lowest costs far below those at the margin. Where was the A. A. A. going to set the price? Where would you set it?

If you used the low-price fellow, you would immediately form a monopoly for him because he could shut out the other fellows. If you took, as Mr. Stevenson suggests, the average, you would shove out—counting noses now, i.e. the number of enterprises—seventy-five per cent of the number, but not on volume. So that would not work so well.

We hit upon a plan, and it at least worked for one year. We set the selling price so that the spread would bag seventy-five per cent of the enterprises. If, through studying their costs, the high-costed twenty-five per cent could remedy their situation, fine—if not, then we are just "out."

I know of two plants who were unable to meet the spread the A. A. A. established, but who came within the spread after their association pointed out where their high cost and bad operations were keeping them out of the field of competition.

Now as to the second part of this question, I think Dr. Edwards has given you Mr. Stevenson's point of view on that matter.

Are there not others in the audience who have a point of view on this matter of the machinery for operating a plan such as Mr. Stevenson suggests, or some other plan of a similar nature which calls for careful regulatory influences, not only at Washington but I imagine through the state governments?

C. OLIVER WELLINGTON (*Partner, Scovell, Wellington & Company, New York, N. Y.*): I have made enough notes during the session so that I could talk for twenty minutes or a half hour. I announce right now I am not going to, but there have been so many of what I believe are economic fallacies connected with many of these schemes that perhaps I can sum up my position best by saying that it seems to me that Dr. Haake's talk brought out very, very clearly what I believe are the practical aspects of the situation as contrasted with many of the so-called economic theories.

Take, for example, this one matter of the Treasury Decision that was mentioned this morning. Here we have a suggestion by Dr. Edwards in his illustration of the $1,000,000 plant that was supposed to last twenty years, and then was reduced to ten years, and finally, through obsolescence, comes down to five years. On the one hand, one of the members of the Consumers' Advisory Board is talking about heavy obsolescence on the part of the equipment, which obviously means that during these early years of the operation of that enterprise you must charge off very heavy depreciation; and on the other hand we have the Treasury Department, which is frankly planning to take millions of dollars out of the pockets of the taxpayers by reducing the allowance for depreciation.

It seems to me that is very clear. Industry is being attacked from one side to take its capital away by asking it to charge off and assume its burden of what are called bad guesses or obsolescence; on the other side, an attempt by industry to charge in the costs and deduct on the income tax return whatever amount would be reasonable to preserve the capital invested is being attacked by the Treasury Department by refusal to allow even the comparatively low average rates that have been promulgated in the past. It seems to me it is that kind of thing that industry in this country is up against today, and I see no hope at all, except to go down to Washington and fight and keep on fighting.

In this connection, one of the important things in my opinion—at least one which I wanted to mention today—is the fact that tomorrow in Washington there is to be a hearing in connection with a revised code of one very important industry, the paper and pulp industry. That industry is the first one I believe of any important size to go down to N. R. A. to request a revision of its code, and it is anticipated that they will be faced with a plan whereby if they expect to get the revisions which they believe are proper and necessary in their present code, which was approved last November by the President, they must at the same time swallow all of the provisions suggested by the so-called Economic and Planning Section in Memorandum 228, with which I believe most of you are familiar So they will undoubtedly—at least we have been so advised—be faced with a request to take out of their present code all of the teeth. You remember Dr. Haake very definitely pointed out the necessity of having some teeth in these codes if you ever expect them to give any sensible business results; that is, to have some control over the price competition.

This industry, recognizing that situation, has sent out notices to a number of other large industries, suggesting cooperation at this hearing. I am mentioning it here today in case some of you have not heard of it and in case any of you find it possible for you or your associates to be in Washington tomorrow, to attend that hearing and definitely put industry on record as opposed to the removal of what few teeth there are in the present codes, and the possibilities for industry of really getting a part of what was promised to it by the President when the National Industrial Recovery Act was being considered and was passed.

You remember that industry, by allowing the regulation of labor, paying higher wages and reducing hours, was promised that it would be given the opportunity to save some of the very bad competition by the ten per cent fringe who would not play ball. It seems to me that that promise is now proposed to be entirely broken, as many other promises have been broken, by the present administration, and that the only way that industry can expect to get or keep anything it now has is to go down and fight.

CHAIRMAN REITELL: I think we can get through a few small questions here. Dr. Edwards has promised to stay with us the early part of the afternoon and all questions having to do with codes or federal work will be brought up the first thing after luncheon. We can cover two or three short ones here:

Question.—"Do the codes which prescribe uniform cost systems permit the inclusion of interest, cash discounts, and quantity discounts on sales items of cost?"

I believe you will find that interest on investment is out, with the possible exception of one or two codes. The Lumber Code has it in, does it not, Doctor?

DR. EDWARDS: I believe so.

CHAIRMAN REITELL: As regards cash discounts and quantity discounts, I read an opinion which rules them out. So from the information I have, charging interest as cost or cash discounts as cost, quantity discounts on sales items as costs, as far as the codes are concerned, are all out. Does anyone else have more enlightenment on that point?

MR. TUCKER: Dr. Reitell, as regards interest on investment, do they make any distinction between interest on investment and interest on working capital, as to whether that should be included?

CHAIRMAN REITELL: I do not know. Do you, Dr. Edwards?

DR. EDWARDS: I think you will find some codes which have interest actually paid out included in its costs.

CHAIRMAN REITELL: You mean on borrowed capital?

MR. TUCKER: No, just working capital.

DR. EDWARDS: I do not know of any such thing.

MR. TUCKER: What is your conception of interest on funded indebtedness?

DR. EDWARDS: That depends upon your code. Your code which provides against selling below cost usually provides for the introduction of a cost formula and cost accounting system. If the cost formula and the cost system as finally approved contain an interest charge, then, of course, it is in the code from that time on. The industry brings in its formula and system at a later time, having in the code only the statement, "Sales below cost are forbidden as cost is to be defined by this formula." Then the system comes in for later approval.

There is a wide variety in what gets approved.

MR. TUCKER: I raise the question as to whether it is proper to include interest on funded indebtedness.

CHAIRMAN REITELL: I think we have heard that argued before.

Here is one on standard costs:

Question.—"In establishing uniform accounting systems for trade associations, will not standard costs suffer a serious setback? The fact that probably eighty-five per cent of the industries at least know little or nothing of standard costs means an actual cost must be used to gain uniformity."

If I understand the question rightly, this gentleman fears that because a large percentage of the industries in any group know little about or do not have standard costs, they, the slow-pacers, will set the stride and that standard costs therefore will be shelved.

I used to share that opinion a while ago, but I am getting cheered up. It is the first time the standard cost fellows, who have gone ahead in progressive ways, have had the opportunity to meet and talk to the backward fellows and get them educated. So although there might be a temporary holdup, I see no real slighting of standard costs by industry.

I do not know of any industry group that has established standard costs as a uniform cost system for their use under the code. Do you know of any, Dr. Edwards?

DR. McLEOD: There are none.

CHAIRMAN REITELL: Is there any further discussion on that point?

Z. L. AUGUSTINE (*Cost Accountant, Taylor Instrument Company, Rochester, N. Y.*): It has been stated that eighty-five per cent of the business men do not know anything about standard costs. I would like to know how many know their actual costs!

CHAIRMAN REITELL: Here is another one.

Question.—"In my company the president has been in Washington seventy-five per cent of his time during the last year on code work. As a result, his internal problems of the company are not receiving proper consideration. How can an accounting system help in having this condition corrected?"

Dr. McLeod, will you answer that?

DR. McLEOD: Accounting for the time of presidents has never been one of our simplest problems. I am inclined to the opinion that at least some of that seventy-five per cent of your presidents' time is more profitably spent in Washington. From what I have observed I think that the N. R. A., if it has accomplished nothing else, has served as a splendid training school in some of the fundamentals of business practice.

T. B. DUNN (*Auditor, Kansas City Structural Steel Company, Kansas City, Mo.*): Just another question, another thought in connection with that seventy-five per cent of time spent in Washington. The codes of the N. R. A. do not provide any means of covering that in an item of cost. There is a special item of cost.

CHAIRMAN REITELL: Dr. Sanders has a question on that very point, but we can not consider it now. I will read it, however, but I think we had better start the discussion after lunch. He asks—

Question.—"How far has N. R. A. actually affected the nature and quantity of work required of the accounting department?"

But not only the accounting department. I think Dr. Sanders will extend it to read, "What has been the penalty that N. R. A. has placed upon industry costs all along the line?"

Here is one for our able economist from Washington.

Question.—"Would you say foreign exchange has a material effect on our economic structure? What encouragement is there for an exporter under the present set-up?"

DR. EDWARDS: I think the best way to answer the second half, on the encouragement for an exporter, is just not to answer it.

The importance of foreign exchange depends on the volume of export and import trade you have. Hence to the United States it is a much less significant aspect of depression and recovery than it is for the British Isles.

You have here as a matter of policy somewhat the issue which we have been facing in another form in the discussion of price-fixing under codes. It may be highly desirable not to try to regulate foreign exchange, for the sake of letting it fluctuate rather than letting an effort to peg exchanges interfere with the volume of export trade. Various countries at various times during the depression seem to have come to that conclusion. It is fairly obvious at least that an effort to peg exchanges in one country without reference to how the other countries are deciding may be merely to sacrifice one's trade for the benefit of some other country.

The pegging of exchanges I am inclined to think—and here I am sticking my neck very far out because I am certainly not an expert on foreign trade—must be an international decision if it is to have any virtue at all.

It may be that there is merit in being able to forecast the conditions of sale in foreign countries or purchase from foreign countries sometime in advance by removing the speculative element of exchange fluctuations. It may be that that is important enough that it is worth while to undertake it by international action. That is an exceedingly general answer, but I do not have many useful ideas on the subject.

CHAIRMAN REITELL: Thank you. Here is a short one I think we can answer before lunch.

Question.—" Several references have been made to methods of allocating substantial operating costs on the basis of dollars-of-sales value. How can such apparent cost accounting heresy be justified?"

I think that question should go from whence it came, Boston. I am going to ask Dr. Sanders if he will not take a crack at that. Personally I think it is "phoney" accounting.

T. H. SANDERS (*Professor, Harvard Graduate School of Business Administration, Boston, Mass.*): I will read the question again: "Several references have been made to methods of allocating substantial operating costs on the basis of dollars-of-sales value. How can such apparent cost accounting heresy be justified?"

I am thankful for the word "apparent." I personally do not call it heresy. In cases of joint costs, which is the place where this sort of thing arises, I think it is a perfectly justifiable thing and not a heresy.

When a producer buys raw materials, out of which he intends to get several products, he certainly has in mind those products which he is going to get when he pays the price, and therefore I think he is justified in allocating that price to those products on the basis of the value which he expects to get out of them when he pays the price.

CHAIRMAN REITELL: Wait! That is operating cost, not material.

DR. SANDERS: You keep making this harder. The question about allocation of costs still implies that they are joint costs, that they are costs applied jointly to the products which are being made. I think the same line of reasoning still applies.

CHAIRMAN REITELL: A very interesting point on that is the matter of making coke from soft coal. Take your coke costs. What percentage of your material costs should go to the coke, and what percentage to the by-products, which far exceed, of course, in volume of revenue that which is received from coke? If one of those by-products happens to be a gas which you are going to sell to municipalities, the first thing you know you are headed into public utilities regulation with this problem.

MR. TUCKER: Dr. Reitell, in certain branches of the chain store industry the idea seems to be held that costs of handling individual items through the retail stores should be allocated on the basis of dollars-of-sales value.

I have in mind rather a striking illustration which it seems to me indicates the fallacy of that sort of thing. Under this theory a fifty-cent can of tea would carry five times the cost of handling through the store as a ten-cent bottle of milk. It does not seem to me that it takes very acute accounting to determine that the facts in the case might be just the opposite, that instead of a dry fifty-cent can of tea, which requires no refrigeration to handle, costing more to handle it costs less than a ten-cent bottle of milk.

By giving this illustration, it might appear to some here who know me and my connection that I have an ax to grind, but it seems to me it is an apt illustration to show the fallacy of allocating items of operating costs on the basis of dollars-of-sales value.

We had reference to this same sort of thing in connection with the exposition that was given us on the accounting plan for the Laundry-owners' Association.

CHAIRMAN REITELL: Thank you very much.

Gentlemen, I do not believe we should tackle another question at this time. There are a few here that we might answer in a certain period, but I do not want to chance it.

Dr. Edwards has promised to be back with us at two o'clock. The questions which we are going to take up first this afternoon have to do with our sessions' papers which discussed codes and the federal situations. At two o'clock sharp we shall start with those questions. Dr. Edwards will be with us.

. . . The meeting recessed at twelve-ten o'clock. . . .

SESSION VI

OPEN FORUM DISCUSSION

(CONTINUED)

THURSDAY AFTERNOON, JUNE 28, 1934

CHARLES REITELL, *Chairman*

OPEN FORUM DISCUSSION
(CONTINUED)

CHAIRMAN REITELL: Gentlemen, I am going to arrange our program this afternoon so that we will be through not one minute later than 4:30. Within three-quarters of an hour we can cover the questions that are directly concerned with the codes and their operation and after that we can cover the miscellaneous questions which are more definitely related to our specific field of costs.

Dr. Edwards, I have a special question that has come in:

Question.—"Do you advocate that costs should be based upon what the traffic will bear?"

DR. EDWARDS: That is one of these "yes and no" questions. In so far as the element of costs are new outlays, in so far, in other words—to take the clearest example—as you are hiring new labor or buying new materials for particular jobs, it seems to me perfectly sound under any theory of accounting to ask these jobs to bring back their expenses.

My talk this morning was directed to items of cost which are tied up with a whole series of situations, a whole series of products or of successive increments of a product. In these cases, I should like to see approximated as nearly as possible a treatment which would write off these costs quickly and keep the equipment in use. I recognize difficulty in such a program, and where it is not possible I should like to see these costs written off at the times and on the products most consistent with maintaining the volume of sales.

This is similar to the principle of charging what the traffic will bear, but it is also very different. The principle of charging what the traffic will bear is often stretched to mean using the price principle of a long-sighted monopoly, restricting the output for the sake of getting higher unit returns and larger total profits upon a smaller volume. If I am convinced of anything in the field of economics, it is that modern technology stands or falls and modern business organization stands or falls by its ability to get volume operations, to make adequate use of tremendous technological resources. So I would like to divorce my statement clearly from that particular meaning of what the traffic will bear. Every possible twist of a cost accounting system to avoid the necessity for a limitation of the output—that is what I am driving at.

CHAIRMAN REITELL: Here we have another question.

Question.—"Assuming that the object of the N R. A. is to build up not only an immediate greater purchasing power among the masses but also to keep up a consistent closer coordination between consuming power and the values produced by industry, how does industry, as umpired by government, expect to assure such an economic balance without providing maximum prices for commodities in addition to fixing minimum wages?"

There is another question closely related to the above. I think we can cover them together.

Question.—"We cost accountants have consistently argued for budgetary control in individual units of industry. Is a planned economy for an entire industry anything other than an enlargement of the field of budgetary control by means of which we expect to balance production and consumption more effectively? Is national planning to be condemned merely because it is budgetary control on a larger scale backed by a larger vision of social service and economic security for all factors involved?"

DR. EDWARDS: I, personally, hope that national planning, if and in so far as we get it, will be much more than budgetary control. It seems to me one needs to make a sharp distinction between the purpose of a particular business enterprise and the objective of an economic system The business lives by money and must make money if it is to live. But I think no one would argue that an economic society as a whole lives by money and must get money if it is to live. If that were true, then the most extreme inflationary theories of how to get to prosperity would be open to no criticism whatever.

A business in trying to get money is trying to establish its right to live competitively as against the rest of the business system. I get money, which means you do not get it. And that establishes a kind of rating as between you and me. But an economic system must be judged by what it contributes to the life of the people, by the physical flow of commodities and services, not by a monetary standard.

Now it so happens that a monetary standard is sometimes a good measure and sometimes a bad measure of whether an economic system is soundly contributing to the aim which it should have. For example, the most generally approved purpose of the N. R. A. has been to prevent sweatshop competition in exploiting labor. In such competition you may get more and more monetary efficiency, plant by plant, if you can only be successful in driving the wages of labor down, yet we have come to accept today the idea that from the point of view of national economy the more successful you are along that line the worse off the country is.

This is only one of many possible illustrations of the fact that a national economy must have objectives much broader than those of a balanced budget It may conceivably deliberately unbalance its budget, as we did during the war, for the sake of an objective which is considered so great, so important, that sacrifices of financial security, financial ease (and in some cases countries have interpreted it even to mean sacrifices of financial solvency) are worth while for the sake of the end in view.

I am glad to have a chance to answer the second question, the one that was read first, because I have had a feeling that what I have said here today has been quite negative in tone. I have said two things. I do not particularly like price-fixing, and I do not stand for the old-fashioned kind of free competition.

Of course, nobody in answering a question can outline a program of industry control to his own satisfaction, much less to the satisfaction of his audience, but one or two illustrations may serve to indicate that my dislike of price-fixing does not mean that I think there is nothing to be done.

In the first place, it seems to me we have just begun to touch the possibilities of inventory control. It has been recognized for some time that one of the easiest roads by which an industry approaches trouble is for a series of business men, operating separately and without knowledge of what the others are doing, to pile up speculative inventories and then find themselves overloaded. That is not only bad business; it is bad social accounting. It is bad use of resources from the consumer's point of view.

This morning I was trying to say that if you have made this mistake, then you would better use the inventory for whatever it can be used for, but I would like to add there is no reason why you need make the mistake nearly as often as has been done.

Statistics as to the size of inventories need a great deal of development. There are also one or two codes, to which I look with great interest as experiments, in which it is provided that a member of the industry shall regard such-and-such a percentage of his past sales over such-and-such a period as his maximum inventory, and that when his inventory exceeds that figure he must within so many months get below it again.

Such a provision seems to me to have merits of flexibility, such as some of the other proposals for stabilization do not have. A man is free to expand his share of the market if he is in a growing business. He is free, if he is in a hopelessly inefficient and obsolescent business, to get gradually driven out of the market. He is asked merely to recognize what the trend of his sales is and to accommodate his production to that trend. He is free, if it is a situation in which price reduction is desirable, to lower his prices and get more sales in the process if he can. He is free, conversely, to raise his prices. But he must not pile up future disaster by accumulating inventories in excess of some determined amount.

These are experiments. They may have weaknesses which are not apparent on the surface, but I should like to see more experimentation along this line.

Second, it seems to me that a great deal can be done in the interest of consumers, of business, and of the public at large, by the grading and standardization of products.

We have one industry, for example, the cleaning and dyeing industry, in which notoriously much of the trouble is the fact that the consumer can not very well tell just what he has gotten when he has bought a job of cleaning. There are certain plants in which the clothes are stuffed into the cleaning machine as tight as they will go, whirled around a few times, no matter how dirty the fluid is, and hauled out. Then they are passed to the spotter. The spotter is a man with a pail of water and a brush. He dips the brush in the pail and gives a couple of rubs to the spot. The suit is then pressed, and that is a cleaning job.

There are other establishments in which the cleaning fluid is flowing continuously out of the cleaning vat through purifiers and strainers. The clothes are kept in the vat until the fluid coming out is absolutely clear. The clothes are segregated according to type of fabric and each batch is treated separately. The spotter is practically a chemist. He uses a whole series of bottles, and after analyzing the spot applies the particular chemical that is appropriate.

Both of these processes are called cleaning. One may be worth nineteen cents or less and the other may be worth a dollar.

It seems to me that it is much simpler and wiser to get a notion of what sort of plant people have and to prevent those people who are obviously not equipped to give a quality cleaning job from describing their job in the same way as the people who are, much simpler to do this than to try to discover whether those who go in the door of the cleaning establishment are actually charged seventy-five cents or get a discount.

A great deal of what industry has called chiseling has been the exploitation of the ignorance of the consumer as to just what he is getting for his money. A great deal of it could not have gone on had there been facilities for informing the consumer about what he is getting. And it is noticeable that at this point, unlike some others, the interests of the consumer are entirely in accord with the interests of business men who are doing a quality job.

There are well established facilities, both industry controlled and government controlled, for the working out of the commodity standards, and, where standardization is not possible or desirable, for the working out of informative labeling. A good deal more of such work could be done than has been done.

These are only illustrations. I might generalize by saying that aside from price-control there are many tools of sound management, sound production, sound forecasting, sound statistical knowledge and accounting knowledge of what others are doing. There is every chance, if we turn our attention to it, that we can improve the business structure in ways which will serve not only business men but consumers, labor and the general public.

CHAIRMAN REITELL: Here are two definitions asked for, that are of the same nature:

Question.—"Under the new open-price policy recently announced by the N. R. A. the price may be reported only through the facilities of an impartial agency. What is to be construed as an impartial agency for this purpose?"

Question.—"With reference to price filing, what is meant by a confidential, disinterested agency? Have you a definition of such an agency?"

DR. EDWARDS: Rather than attempt a formal definition, I would like to give you the thought which, as I understand it, underlies that particular phrase.

Prices come in. They give in considerable detail the terms and the price structure of particular members of an industry. Now at best if those prices are filed with the code authority, the members of the code authority have access to such facts as they contain some days in advance of others in the industry.

It may be that in certain industries, widely spread and with fairly small plants, it is impracticable, either to circulate the prices to all the members of the industry because of the bulk of the job, or for the members of the industry to get, by inspection at the central office, information which they need; whereas it may be that certain larger units can and will do just that. In other words, there are possibilities of differentials in time and differentials in information.

You may also have heard before, if you have followed the price hearing and complaint work which N R. A. has conducted, of the use of the waiting period as a period of persuasion, in which a man who has filed an uncomfortably low price may find he is under a certain amount of pressure to change his mind.

The thought, as I understand it, behind this new version of the open-price system is that it should be just what it pretends to be—an agency for the free and equal distribution of prices to all concerned, and that if you are to have any powers of price-control they ought to be inserted specifically as such, so that one knows just what they are and has them limited as it may be wise to limit them.

For that purpose it is desirable that all members of an industry be treated alike, that there be no particular advantage of prior information or of any other sort in being on a code authority, and that if an industry is to press its members to maintain a certain price, it do so by powers specifically granted and not by using in a roundabout way powers which were ostensibly granted for some other purpose.

Taking all those considerations, it seems best that the prices should be filed with some one who has no direct financial interest in knowing what prices are and knowing it before others in the industry.

I am not suggesting that this prior knowledge has been subject to widespread abuse. There have been complaints of abuse, a few. But it is desirable in any such a situation as this that there shall not be the possibilities or the belief that abuse may be there, even if the integrity of the men concerned is great enough to prevent the belief from having any fact behind it.

The nature of the outside agency is deliberately left open because there is no desire for the government to interfere more than the minimum required to set up the practice on sound lines.

The outside agency would be expected not to have a personal interest in these prices and not to reveal them to any part of the industry, except at the same time as to all the others.

H. F. GOLL (*Cost Accountant, Prest-O-Lite Storage Battery Company, Indianapolis, Ind.*): Who pays the impartial agencies?

DR. EDWARDS: Presumably the code authority.

CHAIRMAN REITELL: Which in turn is distributed among all members of the industry in question.

I promise that this is the last question I am going to ask you, Dr. Edwards. I do not know, however, whether I can keep the rest from asking you questions. You have been very kind to us but I think this needs an answer from you before we say "good bye."

Question.—"Cannot price be fixed in the meat industry if prior to the purchase of live stock and the packing of meat the demand for meat be determined through research and the quantity of live stock needed be coordinated therewith? In other words, in a plant economy along industrial lines, would not the entire gamut of costs from live-stock raising to delivery of meat to the consumer nearly approximate a sound basis for price-setting? Are not these matters more readily determinable in a planned economy as proposed by Mr. Stevenson than they are now under uncontrolled competition?"

DR. EDWARDS: That is no small order. In the first place, I would suggest that the question be referred, after I say what little I have to say about it, to the speaker who was an expert in the meat industry, to whom I imagine it was addressed.

CHAIRMAN REITELL: Mr. Greer is not here.

DR. EDWARDS: I suppose when one uses the term planned economy, he is likely to think sooner or later of the Russian experiment in that direction. It is true they fix prices and fix costs and fix all sorts of things. And I suppose it is certainly true that the more you get fixed, the more readily you can make the calculations in terms of which you want to fix the rest. But in an experiment which I regard as very much more regulatory than anything which I imagine Mr. Stevenson had in his mind, they did not succeed in fixing things so they all nicely dovetailed and there was nothing to carry and nothing left over.

They determined how much they wanted to produce. Then they set prices and wages. They kept their prices low. They tried to set their wages high. They ran up against shortages of goods. People had money to spend but there was nothing to buy.

In part, the result was a change in the habits of the Russian people. They spent their money where they could always squeeze in one more person. They went to the show because at least there was more standing room. Or they traveled. Observers returning from Russia said Russia had become a nation of travelers. I should imagine it was partly because the pay envelop was not empty, the workers had some vacations, and one more person could always get on the roof of a train.

Further than that, the government could not make the receipts of industry balance with the income of industry, and at the same time accomplish the other objectives which the Russians had in mind. As nearly as I understand it, here is what they did Each state trust was assigned a certain production quota and a certain budget. At the end of the year if the trust was in deficit the state transferred to it a part of the profits which had been made in other state trusts. But the whole system generally showed a deficit. To meet this shortage the state transferred new government credit to the books of the consolidated state trust system to an amount sufficient to start the new year with the books balanced again.

This was a peculiar system of controlled inflation. If you are going to have inflation, I think there may be something to say for doing it on this basis rather than by more haphazard guessing. As a result of this inflationary process and of the high wages, people got more money, a development which in other countries might have produced higher prices. Prices did not increase; instead incomes piled up. The index of inflation became, not the height of prices, but the length of the queues in front of the state stores, standing in line to get the limited supply of goods which were available for distribution. In other words, even so complete a system of state planning in an economic system relatively so simple as the Russians' did not produce a completely coordinated, balanced, easily operated result.

The thing which I feel you can do, and about the most which we probably dare to think of, is to determine that if you are going to have trouble you will take it in a certain direction. That was what I was driving at this morning. I should say, if you are going to have trouble, it is probably sounder to take it in the form of price change than in the form of employment change or reduction in the output of commodities. We live by bread rather than by money if we have to make a choice.

CHAIRMAN REITELL: Dr. Edwards, I want to thank you, on behalf of the National Association of Cost Accountants for your time and the generous consideration you have given us in the last three days. We appreciate it very deeply.

DR. EDWARDS: May I say that I have enjoyed this convention a great deal. I have greatly appreciated the courtesy and hospitality which I have everywhere met. Your kindness in padding the brickbats which have been thrown today is very great, and I am completely delighted with the experience.

CHAIRMAN REITELL: Before taking up the next question, I have a little surprise in store for you. It is this: I talked with several of our National Directors at lunch today. I felt that we ought to have someone strike the keynote of this convention, particularly in the light of the interest shown in the field of the codes. As I looked over the luncheon group, the National Board, I noticed one man who has been in this code business over the last year with all of his heart and soul. I know he has given a considerable amount of his time and thought to code problems and I did not give him a chance to outline his story this morning.

I am particularly anxious that he give us, if he will, a sort of summary of what in his opinion is the next step for us as cost accountants in facing this all-important problem of codes and prices.

I would like to have Mr. Oliver Wellington come up. I am very sure he can give us an excellent picture of the situation from the cost man's point of view.

MR. OLIVER WELLINGTON: I did not expect to say anything further, and as long as the time was so short this morning, I did not cover some of the matters I had very much in mind, but I did want to point out particularly this paper industry hearing which I mentioned. I possibly gave you the impression that I was very pessimistic about the whole situation when I spoke of the necessity for industry in keeping what it has, to go down to Washington and fight.

I have not changed my opinion particularly on that, and yet I do want to say there is much in what has happened in the last year that I think can be made of great benefit not only to management and industry but to the country as a whole.

I think that the criticisms—and of course we have heard many at these various sessions—of things that have been done or left undone in connection with the National Industrial Recovery Act have been aimed at specific matters and not so much at the general philosophy which is back of the Act.

I still feel, in spite of things that have happened and in spite of others that may well happen, with which we do not have much sympathy, that there is a great possibility for good.

Dr. McLeod mentioned this morning that one of the good things that had happened as a result of the N. I. R. A. and the codes has been the great education to many executives in many businesses, and while they have to devote what seems an unreasonable amount of time to the handling of codes and various controversial matters, I do think

The other twenty-seven concerns, on the contrary, lost in the hundreds of thousands of dollars, and those who tried hardest to run their mills 100 per cent full by cutting prices and going out and getting the business, disregarding the cost, lost most money.

That to me was a very striking illustration of the difference in the two points of view. One management recognized the situation, decided what was possible, and made the decision that they would not sell below their own cost on that reduced basis. They made a little money, while the concerns that still tried, in the face of depressed conditions, to run 100 per cent full lost the most money.

I think if American business, as a result of this period we have been through since 1919, can learn the lesson and the fallacy of volume, of large volume, that we will have accomplished a great deal, and I think that all of this trouble possibly will not have been in vain.

I remember an illustration given at a recent meeting of the American Management Association about the oil companies. One man said that as far as he could see in his industry the executives were not interested in making money, in making profits; each one was interested in keeping his place in the industry. He spoke about the fact that as we all know there are already many more retail gasoline stations than any reasonable need of the public requires. And yet his particular company had several million dollars appropriated for the purchase of additional retail gas stations, and every other large oil company had the same large appropriation for additional and unnecessary gas stations. The excuse for that is that each one must keep its position in the industry.

Now if, as a result of N. R. A. and as a result of the codes, as a result of the trade associations formed to carry out the spirit of the Act, we can stop some of this foolishness, we can come closer to balancing our production and our sales with a reasonable requirement of the public, I think we will have done a lot of good.

That also follows along the same suggestion made by Dr. Edwards as to inventory control. That is nothing but common sense. It seems to me we are in a position now where most of the executives of these companies are sick enough of what they have been through so that they can begin to apply some common sense to the problem as an industry problem, not as an individual problem, and think in terms of industry.

I was somewhat amused by the question regarding the meat industry, because it seems to me perfectly obvious that if you attempt to regulate the meat industry on any unreasonable basis, and you put the price of meat beyond what is a reasonable, comparative figure, people are going to begin to eat more fish or more eggs or more vegetables. We always have that inter-industry competition.

I am not a bit worried about price-fixing or profiteering. There has been a lot of talk about price-fixing and profiteering under these codes.

Dr. Henderson, the head of the Economic and Planning Division of N. R. A., made several statements at this American Management meeting that I attended about price-fixing and undue profits. I challenged him at that meeting to mention one single industry where to his knowledge there had been unreasonable profits made by the industry. He did not mention one. I do not know whether he forgot the question; at any rate, it was not mentioned.

I do not happen to know of any industry that has made unreasonable profits. I do know many industries where prices have been heavily raised, but I happen to know in all those cases all members of the industry were selling below cost a year ago, so the increase was necessary to bring them up to cost, even before they made any increases in wages and shortening of hours, thereby increasing their labor costs, and before they had to pay increased prices for their own raw materials. So the mere fact that there have been heavy increases in prices in certain industries does not to my knowledge, in the few cases, represent profiteering or any unreasonable profits that the industries are now getting, but is simply a recognition of facts.

It seems to me that, starting with what we have now, we can go a long way following the same sound lines that have been followed by some industries in the last fifteen or twenty years. I have been rather closely associated with the trade association movement for a period of over fifteen years, and I have seen some very great good accomplished without any help from the government. The only effect that the government had on a situation of that sort was to always hold over these business men the threat of the Sherman Act and the Clayton Act. One of the hopes of many of these trade associations was that because of the National Industrial Recovery Act there would be an opportunity to do things publicly and openly and honestly, without any question of collusion, to do things that the industries believed to be sound but which it previously did not dare to do because the threat of the Sherman and Clayton Acts was there.

I think with a cooperative and friendly attitude at Washington much can still be accomplished under the Act that will be of great benefit to industries, assuming that there is the proper spirit in each industry and they are willing to cooperate to work out their own salvation.

I believe that that is the only way that we will ever accomplish real results, through the Acts or otherwise, to go ahead, recognizing the sound laws of supply and demand, expecting less from law (that is expecting less help or hindrance from the legal end of it) but working ourselves, the business men in each group, sitting down, working out our own problems for the better interest of our own industry, and to that extent getting away from what might appear to be a selfish temporary advantage for one concern against another.

I think it is largely a question of point of view. I believe it is perfectly possible for much good to be worked out. I know of some industries that have come through the whole depression period without as an industry losing any money and without charging unreasonable prices to the consumers, merely because as a group they have had previous experience with the value of trade association activities. They knew what their inventories were, their overhead from week to week and month to month, what their production was, they knew what they were doing, and they kept their heads.

I believe their experience can be and will be used by many groups to develop the same kind of cooperative effort, and it is through that cooperation, through the trade associations and through the code authorities, acting of course with the trade associations—the distinction between a code authority and a trade association should not be particularly important—and working along those sound lines, of getting a maximum of facts and acting sensibly on the facts, I believe we can work out a situation that will be thoroughly satisfactory and very fair to all concerned.

CHAIRMAN REITELL: Thank you very much, Mr. Wellington. The next question:

Question.—"Will there be a general merging of standard N. R. A. codes under say ten major N. R. A. codes?"

That question interests me very much, particularly in the light of what Mr. Wellington has just said.

My contact with Washington, particularly with Deputy Administrators, leads me to feel that there is a pretty wide feeling that the thing to do is to concentrate on a comparatively few large national codes, letting go by the board—as they have let go the service codes—a lot of smaller ones, the feeling being that if we can successfully enforce and get proper compliance with the large national codes, we will have laid the basis for future consideration of the smaller codes.

I had the pleasure of proof reading Mr. Stevenson's speech. That speech now is in printed form. I want you to read very carefully his suggested solution. He has no broad, wide-sweeping, price-fixing plan for all industry to be put at work tomorrow morning. Rather he suggests that we take a few of the larger industries and start with them, and from the experiences there gleaned build for the future.

There is a tremendous amount of persuasion in that procedure, for me at least. I for one prefer the development of a policy in Washington which concentrates on a fewer number of codes, large in scope, and develops them well. If this is achieved the smaller ones can be dealt with later. It is not such a far distance to go in a lot of our large national-scope industries to make applicable some of the suggestions in Mr. Stevenson's paper.

I would that Mr. Stevenson were here, so that he could bear me out on this. But I at least venture the guess that he does not have in his mind a sweeping price-fixing plan to come about hurriedly, but rather step by step, to start with a few of the major industries and use them as examples, or if you please as experiments.

I wonder if we have someone here in the audience who wishes to express himself on this all-important situation. To me it is one of the most important things open for discussion. It has come up rather often on our program. I know it has stimulated your interest as it has mine. Deep down in your hearts you probably are thinking as I am thinking: "Where are we going?" Some of you have had contacts in Washington and experience of one sort and another and can lend more light on this problem. Will you take advantage of this opportunity, stand up and give us your point of view so that we may all have it?

C. MILTON CLARK (*Secretary, Washington Chapter, Washington, D. C.*): I think the thing which has appealed to me most in Mr. Stevenson's plan is that it is a plan which can not be handed out tomorrow and the statement made, "This is the rule from tomorrow on."

I think Mr. Wellington and Dr. Reitell have spoken words for good thought on what it means. We have to set before us certain ideals toward which we are working There is always that question, when any person has established an ideal, as to whether it can be worked out immediately, what the difficulties are going to be to working out that ideal, and whether they can be met.

If we try to decide that we will tomorrow do this or we will do that, we immediately place ourselves on the horns of the dilemma, and I do not think we are in that position today.

It was my privilege to work for a number of years as the chief accountant of a large industrial concern; and I know that during that time there were many things which we planned ahead. There were things which we could not possibly put into effect today, but we were not going to pass them by and say, "We do not ever intend to put them into effect." There are a great many things for which we have to work gradually. I think that this is one of them and that we will have a good many faltering steps as we work toward it.

I think there is also this question that we must bear in mind—I do not know how many of you people have had contact with the government regulations as they are interpreted—we must remember that when a thing is written into a national law, it draws a line, and the question then becomes: "Is a particular set of facts on this side of the line or the other side of the line?" That is where the difficulty lies in government regulation. In government work or in government regulation we have that problem to deal with; that a law is specific and it means a specific thing.

There is one other point I think in regard to this question, and that is that it should work so far as possible from the bottom up and not be superimposed from the top down. There has been for a great many years a great deal of controversy, not only in this country but in Europe, on the question of how the farmer should market his products. There are volumes written for each country abroad on cooperative effort in the marketing of products in order that the farmer could get more out of them. That has had its effect upon marketing in this country.

I think you will find two types of organizations today in the cooperative marketing field: those which grew up within the industry, those where the people at the bottom of it realized what was in it and worked toward a goal; and those which were established after the passage of an act by Congress, trying to attempt the thing broadly over the nation, trying to make it nation-wide and make it possible for the people to go out and organize this movement throughout the whole country.

There have been many of them organized by people sent out to organize them. It has its political side; it can not help it. Are you going to get the type of people who are competent to carry the movement forward, or are you going to get the type of people who by reason of some favoritism, perhaps—

CHAIRMAN REITELL: "Political clearance?"

MR. CLARK: That is a good word for it—"political clearance." I think if we can draw any lesson from that particular type of activity we will see that those which have grown naturally, those which have been fostered by the people who understood the thing from the ground up, are being successful. Those which have been superimposed are having a much harder time of it.

I think we have much the same question to deal with in trying to bring about our ideals in the industrial side of it.

CHAIRMAN REITELL: Are there any other questions?

Question.—"Do some of the codes provide that the work be done by certified public accountants to the exclusion of other public accountants?"

I believe in the earlier code and trade association work at Washington there were stipulations to the effect that the work shall be confined to certified public accountants. However, I understand there are no codes now which carry that provision.

I stand corrected on that if I am wrong.

FRED ELLIOTT (*Public Accountant, Chicago, Ill.*): I might be able to throw a little light on that. I am Secretary of the Public Accountants Association of America, and we have received a number of calls from non-certified public accountants who advised us that they were being seriously discriminated against in the codes. Indeed some of them were, and it was becoming evident that they were going to lose lots of their business.

Something had to be done. Attention was called to the fact also that one of our industries—I will not mention its name—in its code provided that the national association of that industry should do the cost work provided for in the code. There was an added provision, of course, that if they wished to appoint some other accountants they could do so, but that national association had gone into the accounting business and that did not set well with public accountants.

Then we learned that several codes provided that the cost work be done by certified public accountants. I think one of those codes was the boot and shoe code. Another one was the millinery and trimmings code.

So it became my duty to go to Washington and attend the hearing of the code, which provided that the association do all the accounting. That provision was very quickly killed.

I then took up the matter of the discrimination in favor of certified public accountants. Unfortunately, General Johnson was away, so I saw Colonel Lee, who was in charge during General Johnson's absence. Colonel Lee advised me that there had been considerable misunderstanding and that the situation concerning certified public accountants and non-certified public accountants needed clarifying. I probably spent half an hour with him. He said the situation was very plain, and he asked me to take up the matter with Mr. Alvin Brown.

Accordingly, I called upon Mr. Brown, but he would not see me. I called a couple of times, but he would not see me, although I had been sent by Colonel Lee. I was informed by his secretary that an office memorandum would be prepared covering the situation. So the next morning I obtained a copy of that office memorandum. The office memorandum reminded me very much of one of the old Ford stories.

They say that years ago, when Henry Ford put his cars out in one color, black, the dealers went to him and urged him to put out other colors in order to enable them to meet competition. It is said that Henry promised they could have any color they wanted, provided it was black.

When I saw the office memorandum I very naturally thought of that story. The office memorandum provided that in codes which imposed duties on public accountants the work should be done by certified public accountants or by accountants who had the equivalent in qualifications of certified public accountants. In other words, the office memorandum provided that it must be done either by certified public accountants or certified public accountants; it did not make any difference which.

Right here I might say that I am convinced that this office memorandum and the provisions in the codes were not the result of the activities of the certified public accountants. I am sure that the American Society of Certified Public Accountants had nothing to do with it, and I am equally sure that the American Institute had nothing to do with it. The provisions were probably made by certified public accountants who drew up the codes or assisted in drawing up the codes.

We made all sorts of efforts to get that office memorandum changed. The remedy was very much worse than the disease. If that memorandum was not changed, non-certified public accountants, who constitute the largest portion of the profession, were certainly out of luck.

After making every effort in Washington to get the matter adjusted, I was told to go home and write. We had written.

Well, the accountants' societies from coast to coast sent in letters complaining against the discrimination of non-certified public accountants and against this office memorandum which was to be incorporated in all the codes which imposed the duties on public accountants. We could not get one bit of satisfaction. We were about to give the matter up as hopeless. We felt non-certified public accountants were out of luck as far as the cost work of codes was concerned.

I had written the President, but the letters were not reaching him. I was getting replies from the officials of the N. R. A. Finally I sent the President rather a sharp telegram, demanding that this thing be stopped. In a few days I received letters, and other accounting societies received letters, from officials of the N. R. A., stating that the President had intervened and no codes would be signed by him which did injustice to any recognized public accountants.

That was followed by a new office memorandum. I wish I had it with me, but I have not. In substance it provides that the work must be done by certified public accountants, registered public accountants, chartered public accountants, or other public accountants legally entitled to practice public accounting under the laws of their respective states.

So I think, gentlemen, we will have no more trouble with the C. P. A. situation. And in winding up my remarks, let me again say I am sure the organized C. P. A.'s had nothing to do with the provisions in the codes.

CHAIRMAN REITELL: Now we come to a question which I think is very close to each of us and the firms we represent:

Question.—"How far has N. R. A. actually affected (a) the nature, (b) the quantity, of work required of the accounting department?"

Dr. Sanders is making this study at the present time for our Association. Personally, I am very much interested in finding out how much actual data we can get together on this problem. I know of one plant, for instance, that in addition to very exact costs added because of the labor provision, both as to wages and hours, also calculated their costs as to the amount of accounting work burdened upon them because of other payroll data that was demanded—as well as reports on capacity and sales.

No question about it! There is not a solitary firm represented here today that has not been heavily ladened with this additional work, not only in reporting but due to the fact that the attention of the major executives has been taken off of their managerial work and focused on codes.

One of our National Board members, Mr. Fletcher, has been doing some thinking on this problem, and I am wondering if he will not give us his point of view.

F. R. FLETCHER (*Resident Partner, Scovell Wellington & Company, Boston, Mass.*): I think this is a question which each of you men should answer for yourself. It certainly behooves each of us to know what the effect of the N. R. A. has been on our own accounting work and what changes are likely to be involved.

I have been rather interested, in my contact with various groups, in the reactions of individuals to this same question. Many are tremendously upset over the prospect of what seems to be a great amount of additional clerical work. On the other hand I was very much interested in the reaction of another man who, in speaking of this additional work, stated that in his own experience much of this information that had been required had opened his eyes to important statistical data that they had neglected to accumulate in their own plant theretofore.

One difficulty we have encountered is the lack of uniformity and consistency in various questionnaires that have been sent out by various industries at the behest of the Administration. In contacting the Statistical Department at Washington, I find that they are endeavoring to standardize their forms, first as to size, and second as to the classification of information, so that gradually out of this experience and experimentation we unquestionably will have statistical forms and reports which need not be looked upon as altogether additional work, for many of these reports call for information that management should have and which has been lacking in many establishments. So instead of being added work, it will be utilizing work already done in some places, and in others the establishing of information which has been absent but often much needed.

I think that Dr. Sanders is conducting a very worth while investigation and that it is something to which each of you should contribute. One thing that has surprised me in my contact with some of this association work is the apparent lack of understanding, on the part of many members of the group, as to what really is required at Washington under the N. R. A.

Taking the question of hours and wages, we find that even now many members of an association group are not conforming with hours and wage provisions. In one instance there were some twenty-four concerns who were asked to send in questionnaires concerning hours and wages. The answers were so erratic and incoherent that it became necessary to send an investigator to practically every plant to see what each of those members was really doing.

Four out of the group refused to have this man come in and make any investigation of their books. One of the group told the investigator that they were perfectly willing to have him come in and glad to show him everything, but there was no necessity of his spending any time because everything was in perfect order, they had accepted the President's proclamation and applied for the Blue Eagle and put their hours and rates into effect immediately. The agent said that was fine and he was very glad to hear it, but part of his job was to make the investigation and he would have to do it.

Much to his surprise and the surprise of the president of the company, the inspector came back to the office a couple of hours later and announced they had done nothing. The president was very much disturbed and called in the superintendent. The superintendent said, "Yes, we put that in effect the next day. I turned it over to the paymaster."

It so happened that the paymaster had gone out a day or two before with a case of appendicitis, so instructions were held up awaiting his return and, as a matter of fact, nothing had been done. The president had not known it: he believed everything had been done.

In concern after concern, this investigator found inadequate payroll records which lacked information that was really more vital to those individual concerns than it was to the industry making the report to the government.

So I feel that in this investigation that Dr. Sanders is asking for, and in the study that each of you can make of the so-called additional work, you are quite apt to find that you are not called upon to do a great deal that is strictly additional if you recognize the importance of such data to you, as well as to your industry.

CHAIRMAN REITELL: I wonder how many of the cost accountants here have set up an analysis of their expenses arising out of code work? Has anyone here done that?

Not one! That is odd! We will measure every penny of costs to make goods, but we leave untouched what it costs to be regulated at Washington.

Dr. Sanders is putting a lot of time and effort on this problem. Any assistance we can give him will be very helpful in keeping Washington informed of the tremendous burdens it is placing on our accounting force.

I hold in my hand a booklet which comes from the Metropolitan Life Insurance Company, which I find is available for all our members here without any charge, particularly those who are interested in getting a summary of uniform cost activities carried on by many of the trade associations.

Mr. Cannero, will you stand up? (He rose.) He is our member from the Metropolitan Life. If any of you want this booklet you can get it free of charge. This is not a sales talk, but I happen to know about this pamphlet.

The next question:

Question—"Is it necessary that the manual of uniform cost accounting for an industry be approved by the Administrator of N. R. A., since Release No. 6700 has been issued? Do you think under the circumstances trade associations may go ahead with their plans for uniform accounting without waiting for approval from the N. R. A Administrator?"

I hold just the opposite view. I think you will get better working arrangements with your N. R. A. Administrator by having it approved first It is just no good to go along and get your system built and then find it does not meet the approval of Washington. There are certain items of cost that Washington is not going to allow. We mentioned a few this morning—such as discounts, interest on investments, and the like. Thus you might as well have your uniform accounting approved at the start.

I believe most code authorities approve my point of view. In fact, I got my slant from several code authorities who are working out their uniform system of accounts that way.

The next question:

Question.—"Is there a trend in the N. R. A. Administration to require weekly payroll periods not only in new codes but also in the old codes?"

I do not know. Is there anyone in the audience who can answer that question?

PHILIP W. SMITH (*American Secretary, International Fixed Calendar League, Rochester, N. Y.*): I happen to be somewhat familiar with the matter of weekly payrolls as far as the N. R. A. is concerned.

I am the American Secretary of the International Fixed Calendar League at Rochester, which is the thirteen-month period outfit of the thirteen-period year. In that connection I have been in Washington and talked with Dr. Lubin of the Bureau of Labor Statistics, who is particularly anxious that payrolls be as far as possible on the weekly basis. He is entirely selfish about it, because where reports come to him other than weekly he has to use the formula of breaking them down to a weekly basis for statistical purposes.

In that connection, about forty of the codes, either voluntarily or because it was prescribed in the codes, are using the four-week interval; that is, the basis of one, two or four weeks for statistical reports. Doubtless as a result of that, a considerable number of the members of those industries will switch over their accounting procedure to that same basis.

As it is, that method has gone very rapidly forward. In some of the larger codes, as for example, Fabricated Metal Products, which includes 136 subsidiary codes, I believe, they also are very anxious to get everything on the weekly payroll basis.

In the eastern states it is pretty generally on that basis now. Throughout the Middle West, the bi-weekly or the semi-monthly procedure is generally used. But I think I can safely say that the best opinion in Washington seems to be directed toward the use of the weekly payroll plan.

CHAIRMAN REITELL: Thank you very much.

Here is a question that comes from Mr. Smith:

"How does the thirteen-month calendar tie in with the N. R. A.?"

I am sure I do not know.

MR. SMITH: I think I covered that rather than the answer to that previous question.

CHAIRMAN REITELL: They will accept the thirteen-month reporting, will they?

MR. SMITH: Under the Central Statistical Board there has been passed a resolution recommending that wherever possible the use of the period of one or four weeks be adopted, recognizing that in some industries, as for example the telephone industry, where everything runs on a monthly basis, it is not practical.

On the other hand, in a vast number of industries payrolls particularly operate on a weekly cycle; sales, likewise, and plant operations. It seems to be the tendency toward uniformity in collecting statistical material to use the periods of one, two or four weeks.

CHAIRMAN REITELL: Many thanks, Mr. Smith.

Now we come to a week's work for somebody:

Question.—"How is plant capacity measured (1) under actual costs, (2) under standard costs, (3) by the government?"

I happen to know that our good friend whose face we have missed at this convention, Charlie James, has completed a rather large manuscript on this subject. He has analyzed capacity in greater detail than I have ever seen before. He very nicely indicates the different types of capacity by definite illustrations taken from industries which he has contacted and with which he has worked.

Within a few moons, I am sure that study will be available. To answer this question this afternoon would mean we would all miss our seven o'clock trains. We might call attention to a few things, however, in this capacity problem, which was mentioned in passing by Mr. Greer, by Dr. Edwards, and I believe touched upon lightly by Mr. Stevenson.

After all, fundamentally, we are not only selling goods when we sell; we are selling our plant capacity. Make no mistake about that! We do not sell what our plant can not produce. What plants we have built up, we have built up quite often to produce different things; therefore, our salesman must be just as well advised as to keeping the different divisions of our capacity at work as in just trying to sell goods.

In the electrical industry it often becomes necessary to make particular lines more attractive to salesmen in order to get a better balanced capacity activity. Things that sold easily and readily were stressed at the expense of other lines. This bulged the plant at one place, brought idleness at other places, and meant serious loss to the industry.

Under actual costs I do not believe it is possible to measure that part of capacity which is idle because of no orders, as contrasted with that capacity cost brought about by inefficiency in operation.

To me there is no more attractive feature in standard costs than that it does make possible for executives to see clearly the distinction between that capacity cost, which is due definitely to no orders, as distinct from capacity costs because the shop is working off standard. Standard costs thus do have that added advantage in analyzing the capacity.

When it comes to the government and how they are going to measure capacity, God knows! I do not!

The next question:

Question.—"Will the unabsorbed plant overhead be allowed as cost to be included in price, which shall not be below cost?"

If I might guess the answer, the government will not recognize any excess capacity to figure in your legitimate costs.

I have a question here on which I am going to ask the person who put it to state his position a little more clearly. This question was put in by Emory A. Austin, Auditor of the Hammermill Paper Company:

Question.—"Referring to any of the papers of Wednesday—say Mr. Moore's—what are some of the practical methods which may be used for arriving at depreciation for cost purposes under a uniform system for an industry, other than those methods which rest on a cost or appraised value of existing plants as a principal basis?"

Emory, will you come up and clarify your question for us and give us your point of view?

EMORY A. AUSTIN (*Auditor, Hammermill Paper Company, Erie, Pa.*): As you all know, this subject could well take a whole day's session. The point, we all know who have had contact with the accounting problems under the code in trying to work out some basic methods by which we can arrive at a cost formula, is that this depreciation problem is almost an enigma.

We know that if we try to use comparative figures in an industry, based on cost, we have a case of the company whose plant was bought at a receivership price compared with a company which may have built its plant during the inflation period. Therefore, from the standpoint of reasonable cost, we are nowhere. From the standpoint of arriving at the values based on appraisals, we know the cost of obtaining the appraisals is prohibitive.

Therefore, I asked this question to see if we could not get some reasonable, practical basis on which to include this very large element in most manufacturing costs.

There have been some suggestions. One of them is to delegate some responsible, independent authorities to set up an ideal plant, factor out the engineering specifications, and from that cost arrive at an average load of depreciation on a unit basis. That, I believe, is the most practical suggestion that I have heard.

What has actually happened in a good many cases under the code, as you know, is that the code authorities have ruled that one basis or another shall be used; that is, cost or the income tax method, which of course is based on cost and has in it elements of danger of which I have spoken; and the other is the appraisal method, both of which are very impracticable from the standpoint of determining reasonable selling price within our industry.

There has been the other suggestion, that the average depreciation for an industry per ton of product be set up.

There has also come to us the suggestion from the talks today of entirely eliminating depreciation as an element of cost, going back to the old school of thought where after your profits are arrived at you set aside for bookkeeping purposes a reserve for depreciation and in calculating costs you ignore the item entirely.

I would like to get some expression on that point.

CHAIRMAN REITELL: I think, if I might add to Mr. Austin's point of view, that problem is becoming rapidly more important each year.

One of our members who is not at the convention this year, Donald

Kennedy, has made a study of the shift in production costs from direct labor costs to overhead costs. That study of his indicates a very definite shift, of course, from manual to machine production, a tendency or a trend which characterizes pretty nearly every industry in America.

I am only acquainted with one of the plans that Mr. Austin suggested, that of setting up a standard form and working it out on a basis of a productive unit. That has always to me had a very strong appeal, but I am wondering if anybody else here has some other method to suggest, or is working on a method that is quite different from those Mr. Austin has outlined for us?

MR. T. B. DUNN (*Auditor, Kansas City Structural Steel Company, Kansas City, Mo*): I just want to make a few comments on this subject of depreciation as it affects the steel fabricating industry.

Just as many other industries have been doing, we have plodded along following the lines of least resistance by deducting depreciation from earnings at the close of the year instead of absorbing it in our costs.

Here, at least, is one good point for the N. R. A. In setting up the code for the steel fabricating industry, the fabricators have come to the conclusion that the item of depreciation shall be included in all cost estimates. Of course, when you think of steel it is only natural that you visualize it as so many tons of steel and of course weight or tonnage is the easiest and most comprehensive unit upon which the industry can base its costs. So we are trying to get some returns on depreciation cost and whatever amount is allowed it will at least be a step ahead of our present method of deducting from earnings, or—as I should say at this time to be correct—adding it to our loss at the close of the year's business.

Another method that has been advocated is that depreciation shall be charged according to the utilization of the plant, and of course that could be determined by the amount of labor that is performed in the plant. The percentage added to the productive labor to cover shop and administrative expense would be increased to secure a return for depreciation. What this percentage will be has not been decided, but whatever the code authorities determine that is what we will be allowed to use.

However, the easiest way to figure it, especially for estimating purposes, is on the tonnage basis. Some idea of what the rate per ton will be can be determined by the amount of depreciation you have used for the past number of years compared with the total tonnage, thereby arriving at some basis of price per ton.

MR. AUSTIN: Basis of what values and what rates?

MR. DUNN: That is a question. No actual values and rates have been determined as far as I know.

We have a plant equipment ledger and have a fairly accurate record of our equipment. We tabulate as to date of purchase, cost of equipment, freight and cost of installation. Depreciation on equipment in the past has been figured on the ten-year basis and charges for depreciation at the close of the ten-year period would automatically stop. But what rates and values will be used in the future I am unable at this time to say.

MR. AUSTIN: I might add, in summary, it seems to me this whole matter of depreciation is just as large a problem as the matter of capacity. I do not think we have gotten near the solution I think what we have got to do is, as Oliver Wellington said, fight for some of these things, because here is a question which is very much a matter of importance and will take our undivided attention from an income tax standpoint. You can be quite sure there will be some cooperation between the N. R. A. and the income tax department on this problem. There is a definite leaning there perhaps.

We know we have that problem, the income tax problem. I submit to you, however, that there is not necessarily any connection between the income tax problem and the cost problem for the reasons brought out today.

While I am up here, I would like to remark on the question of cost of records, etc., under the N. R. A., very briefly. We who have struggled with this matter of setting up a standard or uniform method of accounting under the code for our particular industry know of the problems that we have in assembling data on the basis of which we can arrive at some principles of accounting. So I am more interested in this survey from the standpoint of what we ought to do to put our house in order and what we ought to do to help the N. R. A. to set up these statistics which we and they need to get ourselves out of this mess, than I am in the total cost of what we are now spending, for the reason that we might guess that would cost us a million dollars. Well, what of it? We know we have to do a job, and I think the principal thing that we should do is to get behind the job in our trade associations and work out the methods.

I think one of the provisions we should fight for, as Mr. Wellington so well said, is the provision in our code for some method by which prices will be regulated to costs. I do not think we are ready to surrender that point yet.

A practical method that the pulp and paper industry has used so far is to set up a simple formula. You are probably more or less familiar with that formula. If you are not, you could get it. I have it here. The hearing tomorrow from the cost standpoint is based on the discussion of the cost formula which does not in any way outline the principles of accounting.

I believe further that it is the duty of the trade associations, and further it is the duty of the individual companies, to impress upon their trade associations the necessity, as has been brought out during the convention, of some standard method or uniform method by which we fellows who are seeking light on the cost problem—first, from the standpoint of its use as a tool in controlling itself—could get some help, and also give you fellows help on the problems that you are having, and not sit idly by and wait until the code authorities on some future day may take some action on the matter of accounting, or throw it out entirely, as we have heard might possibly happen.

I think we should press this question of costs.

CHAIRMAN REITELL: Thank you very kindly, Emory. I am very glad Mr. Austin brought out the additional point that, regardless of the cost of carrying on the added responsibility the government has thrown upon us, it is important that we do a good job.

Question.—"Where a company has various operations which come under different codes, what has been the experience so far as to paying the costs assessed by the various code authorities?"

The proportion of business that any given firm has in each one of the codes to the total business under the codes is usually used as a basis of assessment.

I think you will find it is pretty well carried out on that basis in all codes. Theoretically, at least, each code is supposed to be of advantage to the industry. If the industry has thirty-one codes, it has thirty-one points of advantage, and it will have to pay thirty-one different shares in the cost of carrying out the operation of those codes.

MR. TUCKER: Dr. Reitell, as it is apparent that the treatment by one of our members of the morning session of the question of allocation of operating costs to products on the basis of dollars of sales value was obviously the result of very brief consideration and was confined to a limited phase of the problem to which the question was intended to be addressed, I think it is very essential that the question be reopened in order that we may clear from the records an impression which, if allowed to go unchallenged, would be a serious oversight on our part.

I would, personally, welcome and appreciate expressions from a few of our members who believe that dollars of sales value is not a very satisfactory basis on which to work out satisfactory solutions to problems involving the distribution of operating costs of production.

CHAIRMAN REITELL: I most heartily agree with you, Mr. Tucker. I meant to take more time on that question this morning, but as you know, we were running too closely into 12:15.

My own personal feeling regarding the matter is this, that any distribution of costs on sales dollars or sales value is carried on because we cannot find a more satisfactory basis. It is an excuse rather than a sound method. I do not want to be adamantine in my point of view, and I am sure there are others here who would like to discuss this problem. I am acquainted with the distribution of operating costs as characteristic of the chain stores. It may be a method of getting all costs distributed, but when applied to any given lines of goods it is faulty.

What does the sales value of an article have to do with the amount of costs involved? The only justification is, "Well, each line is at least paying its own way." But in paying its own way—as was pointed out this morning in comparing tea with milk—one line is subsidizing the other.

I would like to have other views expressed on this, if I may.

MR. FLETCHER: I do not know that I can add very much that is of value to anybody. I think that the method of distribution of expenses on the basis of sales value is more a matter of expediency than anything else. We know that department stores, which have problems similar to this, allocate all operating and overhead expenses to the departments, and then figure the margin of profit on the basis of mark-up on the merchandise bought. That margin of profit has got to cover in each department the expense of operating that department and show a profit in order that that department may live.

I think that Mr. Tucker's example is right along that line and feel that the only reason for allocating operating expenses on the basis of sales is, as I have said before, one of expediency.

In the jewelry business, where material varies tremendously in value, a manufacturer may use base metals and also solid gold or platinum. It has been the practice for years to obtain the cost of material and labor and overhead and then to add profit on the basis of the total cost, in order to determine the selling price of a product.

The result is that the articles containing the high value material carry a larger margin of profit than those that have the less valuable material.

In those instances where we have allocated profit on the basis of labor and burden, excluding material, we naturally have obtained some very different selling prices from those where profit was figured before on the total cost. This is not exactly an analogous comparison in answer to Mr. Tucker, but it is indicative of the same proneness to expediency, the easiest way, rather than finding and utilizing the best way.

CHAIRMAN REITELL: Thank you, Dick!

I see ten more questions here, and also I see that it is a quarter after four. I fear we must close.

I promised to have this session over by 4:30, and of course I want to turn it back to the Chairman of our Program Committee, who has some closing remarks to make.

I believe this is the third or fourth year I have been handling these discussion sessions. We always like to improve them from year to year I am sure your next year's Program Committee and your next Chairman elected to handle the job would appreciate it very much if you would be so good as to give us some suggestions as to how this discussion session might be improved.

I was very much pleased with the program today, and I am amazed at the large number of members attending. When I realize what the temperature is today and also what the temperature was at three o'clock this morning, I am more than pleased.

I want to thank you very, very much indeed! I had a bully good time, and I am now going to turn the meeting back to the General Chairman, our beloved Bill Marsh.

CHAIRMAN MARSH: Thank you, Dr. Reitell. I merely wanted an opportunity to express my appreciation, my very deep appreciation, of the attention that you gentlemen have given us in these technical sessions.

I have just learned this afternoon that the attendance at the sessions this year was better than it has been for several years, and considerably better than it was in New York last year, when the registration of the convention was far more than it has been in Cleveland

Further than that, we had last year an air-conditioned room, and this year it has been terribly hot. They tell me they do not have weather like this in Cleveland, but they are having it anyway.

With those remarks, we will now close the Fifteenth International Conference of the National Association of Cost Accountants.

. . . The convention adjourned at four-fifteen o'clock. . . .