[Accounting Historians Notebook](https://egrove.olemiss.edu/aah_notebook)

Volume 20
Number 1 *April 1997*

Article 6

April 1997

National Industrial Recovery Act of 1933 and the National Recovery Administration: The cause of the disconnect of management accounting from reality

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THE NATIONAL INDUSTRIAL RECOVERY ACT OF 1933 AND THE NATIONAL RECOVERY ADMINISTRATION: THE CAUSE OF THE DISCONNECT OF MANAGEMENT ACCOUNTING FROM REALITY

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Prior to 1933, accounting literature about capacity expressed great concern with realistic, or engineering-based, accounting. During eight years of working on a series of projects on accounting for capacity, the writers observed that a breakaway from realistic accounting for capacity occurred about 1933. McNair believes that this was the great disconnect that ultimately led to the decay of management accounting until its revival in the mid 1980's. Vangermeersch, who had conferred with Tom Johnson on this matter during the writing of *Relevance Lost: The Rise and Fall of Management Accounting*, believes that the disconnect was probably caused by the rise of accounting standardization due to the Truth and Securities Acts of 1933 and 1934. However, no hard evidence of the role of the S.E.C. in regards to management accounting was ever found. Thus, Vangermeersch had little to prove or disprove McNair's disconnect theory.

While researching the subject of "Uniform Accounting System" for *The History of Accounting: An International Encyclopedia*, Vangermeersch noted that a general belief exists that the National Recovery Administration (NRA) failed to succeed in its accounting efforts, especially on the issue of selling below costs. For example, Charles F. Ross commented in *NRA Economic Planning (1937-1971)*: "As a member of the NRA staff once remarked, 'If the NRA had only adopted price fixing through cost formulas in all codes, all the unemployed would have been needed to check compliance' " (p.276).

Vangermeersch's research which suggests that perhaps NRA codes represented McNair's great disconnect point has led both to research the theory. The FDR Library was visited and numerous books on the National Industrial Recovery Act (NIRA), the National Recovery Administration, Franklin D. Roosevelt (FDR), the New Deal, and Hugh S. Johnson—the first director of the NRA—were studied. Numerous discussions of the disconnect theory have been held, and it has been presented at many conferences including: the 1995 Third Managerial Control System Symposium in London; the 1996 Seventh World Congress of Accounting Historians in Kingston, Ontario; and the 1996 American Accounting Association meeting in Chicago.

The writers realize that their theory is not amenable to the very high standard of proof needed for an academic journal. They realize that there was no deliberate disconnect of management accounting from engineering realism taken by Hugh Johnson and the NRA, nor do they think that FDR had an inkling of the effect the NIRA would have on management accounting. However, the writers are convinced that they can offer a chronology of events that certainly offers significant support for their theory. What remains is a formal venue for it. The writers would like to offer to the readers of the *Accounting Historians Notebook* a chance to debate in writing the topic, much as the point/counterpoint feature recently initiated by Wanda Wallace in *Issues in Accounting Education*.

The NRA was established to stop the downward wage/price spiral of the early 1930s. Whereas the War Industries Board (WIB) used "full cost plus" pricing to encourage a massive use of capacity, the NRA used "full cost plus" pricing at a very low level of production. Wages were increased, in the hope of stimulating demand so that prices would stabilize. In order to determine full cost, most of the countless industry codes included a relatively uniform cost system based on expected, not ideal, capacity. Pricing below cost was an anathema. However, as already noted, this provision was truly unenforceable.

Like most ideas, the NIRA and NRA had definite antecedents. Many historians agree that the NRA sprang from the WIB founded during the U. S. participation in World War I. It is interesting to note that: FDR was the Assistant Secretary of the Navy from 1913-1921; Bernard Baruch headed the WIB and General Hugh Johnson was assigned to the WIB: Robert H. Montgomery played an important role with Baruch at the WIB and later at the NRA; Hugh Johnson worked for Baruch after the war; and FDR appointed Johnson head of the NRA in 1933.

The men that Baruch led in the WIB met annually and remained in contact with each other. In 1931, they were instrumental at forming through Congress the War Policies Commission with Baruch, Johnson, and Montgomery back together formally. The NRA was set to go immediately when the NIRA passed in 1933 and probably never did any U. S. federal agency get going so quickly. The NRA could not maintain its quick and popular start and soon experienced the difficulties of FDR, Johnson, and the NRA micromanaging trivia. R. H. Montgomery quickly got off the boat (really a sinking ship). Mussolini was not sure that the NRA would achieve success, as he felt the Italian fascist state had. Henry Ford was the most significant "nay-sayer" in industry. Clarence Darrow led the fight for small businessman against the NRA. The U.S. Supreme Court in 1935 in the infamous Schechter (Sick Chicken) case found the NRA unconstitutional. FDR probably made his mind up then to "pack the court," as he railed against the decision. In the Congressional debate to extend the NRA for two years to allow it to clean up after the Schechter case, Senator Huey Long of Louisiana gave his infamous 16 hour filibuster against the extension.

FDR did not reconstitute the NRA, but Congress did provide him with the laws needed to maintain the wage/price stability that the NRA tried to achieve: (1) the Wagner Act, or the National Labor Relation Act, put the collective bargaining provisions of the NRA into law; (2) the Robinson-Patman Act of 1936 disallowed unjustified price cutting to large buyers; (3) the Miller-Tydings Act in 1937 legalized retail maintenance in interstate commerce; and (4) the Fair Labor Standards Act established a minimum wage and maximum work week before overtime must be granted. By the late 1930s, both the S.E.C. and the American Institute of Accountants' Committee on Accounting Procedure were issuing promulgations on accounting. By the end of the 1930's the economy and the country started getting ready for war. During World War II, full cost plus pricing was back in vogue. In 1942, Maurice Peloubet very carefully documented these five changes: (a) the influence of the S.E.C.; (b) the influence of Revenue Laws; (c) the influence of stockholders' requests for more information; (d) the influence of an expanding national defense and (e) the expectations of the public accountant from cost accountants. The Cold War, with its Korean Conflict extension, kept demand up in a world in which the U.S. was number one.

The writers posit that the direct cost movement of the 1950s and early 1960s had, as its root, but unstated cause, dissatisfaction with accounting for capacity. If you were a "direct coster," you did not have to worry about capacity cost allocations, as they were avoided. The writers also posit that the view of "how many fixed factory overhead variances can dance on the head of a pin" dominated the rest of the 1960s and 1970s. It was only in the early to mid 1980s that accountants began to be interested again in the engineered based ways of the 1900-1932 time period. Activity Based Costing and a rekindling of interest in "ideal capacity" took management accounting to the forefront on accounting for capacity matters. Hence, the writers claim a "reconnect" was made then with realistic accounting for capacity and, after about 50 years, management accountants were reconnected.

Vangermeersch and McNair plan to prepare a monograph on this particular theory. They solicit comments along the lines of Tom Tyson and Dick Fleischman in their "The Golden Age of Cost Accounting?: The Unfilled Promise of the National Industrial Recovery Act of 1933." They believe that, at the least, doubts have been cast on the old and easy answer to the disconnect due to the concerns over financial accounting of the early 1930s. The writers realize that final proof for their point may never be found, but audience response and much research appear to lend credence to it. Please join them in this research quest.

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Somethimg to think about...

"A man without mirth is like a wagon without springs, in which one is caused a disagreeable jolt by every pebble over which it passes."

—Henry Ward Beecher