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The national industrial recovery act and its administration have a three-fold interest to professional accountants. First, as citizens we must follow closely any movement which so greatly affects business and the welfare of the nation; second, in our professional capacities we shall be called upon to help trade associations in developing uniform cost-accounting systems and in "policing" under the codes and trade-practice agreements; and, third, our advice will be sought by clients as to what they should do for their own best interests in reference to various activities and proposals under the act.

Recently, some one who was rather disgusted with the situation, stated that the initials N. R. A. stood for "Nuts Running America." While many of us are far from satisfied with the act, and particularly some features of the administration of the act, I believe a better meaning to us of the initials N. R. A. is "New Responsibilities for Accountants."

It will perhaps help to a clearer understanding of the present situation if we review briefly some of the events leading up to the passage of the recovery act. It was undoubtedly the intention of the administration and congress to improve the rather serious business and social condition of this country. Any discussion as to causes of the depression reminds me of the tale of the three men who were arguing as to which profession was the oldest. The doctor mentioned the story of a rib having been taken from Adam and turned into a woman, Eve, and asserted that this operation was the earliest example of professional work. The engineer, however, pointed out that the Good Book referred to the world having been made in six days out of chaos, and that this, the most wonderful engineering feat ever recorded, proved that the engineering profession was the oldest. But the banker settled the argument by merely asking the question, "Who created chaos?"

The bankers are blamed for much of the trouble which we have been through, and undoubtedly must share a considerable portion

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of responsibility, but some of it at least must be laid at the door of management engineers and cost accountants. Many of these men, in advising individual manufacturing clients, have pointed out that an increase in volume of production and sales beyond a certain point would very substantially increase the net profit. Many so-called "stop-loss charts" have been devised, showing a point at which the production has absorbed all the overhead or burden cost, and beyond which any production and sales at prices above direct material and labor represented clear profit. With such a chart it was very easy to demonstrate mathematically that the client was well advised to take an increased volume of business at any price greater than direct material and labor, as the regular business had already absorbed the total burden.

This type of argument appeared sound on the surface, but those making the argument and those applying it to actual business failed to reason out the effect of cutting prices to get the increased volume. There often was an immediate gain but in nearly every case it was merely temporary. Competitors who saw an increasing share of business going to the concern which cut prices promptly met the new prices, and usually went one step further, so that the final result was practically the same volume of business being done by all concerns in the industry but all of them selling at a loss instead of a profit.

Unfortunately this idea, that volume in itself is a cure-all, still prevails. The president of one of the large New York banks within a year stated that the farmers needed better prices in order to cure their ills, but that the manufacturers did not need better prices but merely increased volume. The facts coming under my observation, were quite the contrary. Manufacturing prices in general were then so low that an increase in volume would merely increase the total loss, and to save the manufacturing situation there must be a definite improvement in the price level.

Some years ago I was privileged to see a clear illustration of the results of the policy of attempting to get volume irrespective of price. An accounting firm was employed to develop a uniform cost-accounting plan for a group of paper mills, making similar products. One mill out of the group had made a slight profit in the depression year of 1921, when all the other mills showed losses. In response to inquiries to determine the cause, the treasurer said that the mill had four paper machines and, with the dropping off in business at the end of 1920 and the beginning of 1921, the company saw it would be impossible to get satisfactory business in sufficient volume to run the mill at full capacity. Accordingly, the management of this mill decided that it should become a two machine mill. The people in charge would forget that they had the other two machines. They would work out a careful budget of operating expenses based on running two machines and, computing costs on that basis, would refuse to take any business the price for which did not at least equal the cost.

The result of this policy was that, by considerable sales effort, they were able to obtain sufficient business to run the two machines most of the time, and they ended the year 1921 with a very slight profit. On the other hand, those mills that attempted to run all their paper machines full time all the year lost money, and those that tried the hardest to run full time lost the most money, in some cases running up into millions of dollars.

If all the mills in this industry had looked the situation in the face and refused to make sales below cost, while the carrying charges for unused capacity would undoubtedly have kept the profit near a minimum, there would have been no large losses. The policy they did follow of trying to run full time and pushing on to the market a greater tonnage than could be consumed under the then current business conditions left a heavy inventory hanging over the market, which had to be used up before prices could get back to a reasonably profitable basis. This policy of attempting to run full time not only caused large losses in 1921 but carried the losses forward and reduced the opportunity for profit in the two succeeding years.

Another cause of the bad business situation is the increase in the operation of the larger companies by "hired men," who have little or no ownership in the business. A man who is running a business which he owns is vitally interested in net results, but a man who is merely hired on a salary naturally attempts to make a showing in his particular job. For example, the sales manager properly considers it his job to get sales. If he succeeds and the company still loses a large amount of money, he can always blame the failure to earn net profits on the high costs in the factory.

In addition to the foregoing causes for the bad business situation, the great expansion in plant capacity during the war period caused many manufacturers to break into new markets in the hope of utilizing part of this capacity. This served to unsettle the price situation in industries which otherwise might have continued to operate at some profit. Improvement in the situation in many trades, which might have been made by coöperative action, was restrained or prevented by fear of action on the part of the government under the Sherman or Clayton acts.

The Sherman anti-trust act, as its name implies, was an attempt to prevent the large trusts from crushing the small individual competitor. It was never intended by congress to restrain business men in a trade from agreeing on reasonable trade practices to stop unfair competition, but unfortunately such ideas have been read into it by court decisions. The Clayton act, of a much later date, prohibits various means of restraining competition. The tendency of both these acts and decisions under them has been to prevent business men from joining together to improve trade conditions in their industry.

In considering the national industrial recovery act, it is very important to bear in mind that this is a political law. While it is true that all laws are political, this one is especially so. Moreover, it is an attempt to serve two purposes in one act.

The country was faced with a large number of men out of work and very low rates of wages being paid to those who were at work in many industries; and it seemed essential, if we were to live through this coming winter without serious social disturbances, to develop a plan for unemployment relief. On the other hand, most businesses had for a year, or two years, been operating at a loss, and business was properly clamoring for some relief or some change in the situation whereby it could, on the average, operate at a profit. The first purpose, unemployment relief, led to the introduction of the Black thirty-hour bill, and the second purpose to agitation for the repeal of the Sherman and Clayton acts, in order to allow business to stop by itself some of the unrestrained competition which these laws not only encouraged but required. The recovery act, therefore, attempts to carry out both purposes: to give unemployment relief through shorter hours and generally higher wages, and on the other hand to give employers the opportunity of combining through trade associations to stop ruthless competition and endeavor to restore each industry to a profitable basis.

The recovery act has gone a long way in the right direction in suspending temporarily the action of the Sherman and Clayton acts, not only allowing business men to develop proper trade practice agreements for a whole industry, but providing, through the licensing section of the recovery act, for the assistance of the government in enforcing these trade practice agreements. With proper administration, this act can go far in correcting some of the competitive evils that have grown in intensity since the world war.

The way of presenting the movement to the general public, however, can be adversely criticized on account of the fact that the administration has put the cart before the horse—it has attempted to put results ahead of causes. The administration has stressed shorter hours, higher wages and greatly increased costs of production, at the same time requesting business men not to increase selling prices. Considering the fact that most businesses have been operating for two years at substantial losses, we may wonder where the administration expected the business men to find the money with which to pay these increased costs.

The business man who fails to be carried away by "ballyhoo" and insists on keeping his business going, is really rendering the greatest service to the country, as his failure would throw more people out of work. It is not the spectacular addition of employees here and there that improves the whole situation, but a more general and widespread increase of employment which comes only with an improvement in business conditions.

Fundamentally the emphasis must be on profits. No business man will enter into a transaction, buy materials or employ labor unless he believes by so doing he will make a profit. He may be incorrect in his judgment, and the result of the operation may show a loss rather than a profit, but at the outset he hoped for and planned to make a profit. I realize that during temporarily depressed conditions a man may consciously transact business at a loss in order to keep a nucleus of his organization together pending the restoration of more normal conditions, but such an expedient can only be undertaken during a temporary depression and for a comparatively short duration of time.

Granting that the stimulating force for business and an increase of business is the hope of making profits, we see that the way to improve conditions is to help and encourage the making of profits. A manufacturer does not discharge employees on whose labor he makes a profit, but on the contrary will add to his payroll and keep on adding as long as he can make and sell goods at a profit. On the other hand, if he can not sell goods at a profit, he will either discharge workmen or reduce wages, or both, to reduce cost so that the goods that are made can be sold at a profit. If he can not carry this process, plus a saving in expenses, to the point where he does make a profit, he will eventually have to go out of business, throwing all his employees out of work.

The efforts of the administration, therefore, should be devoted to helping to change trade conditions from a point where transactions result in losses to a point where transactions result in gains, as every gain, no matter how small, builds up a fund out of which further expenditures can be made, further transactions undertaken and more labor employed. We need not worry about excessive profits, as the normal forces of competition will keep these down in practically every instance; and a large share of really excess profits can properly be taken by the government through taxes.

It is perhaps unnecessary for me to point out that the continuation of the capitalistic system is dependent upon the operation of businesses at a profit. We know that any one concern can operate at a loss for only a comparatively short period before it must cease entirely, but perhaps we do not realize fully that the welfare of the nation is affected by the profit or loss of individual concerns. It is only through the accumulation of profits of thousands of businesses, at a very large total of profits in excess of losses, that the nation as a whole can continue. The business man who makes a profit, not only helps himself but helps the nation. On the other hand, the man who makes losses, not only hurts himself but does double damage, as he also makes it more difficult for his competitors to transact business at a profit.

There are three general causes for selling below cost: (1) ignorance of costs, (2) the desire to attract profitable business through the offer of one or more outstanding articles below cost, and (3) an intention to make low prices so as to drive competitors out of business, in the hope of recouping the losses through higher prices after the competitors are gone.

Whichever one of these three causes may be controlling in a certain case, the result is economically bad for the nation. From the standpoint of the good of the whole country, it is much more reasonable to prohibit by law the selling below cost than to restrain so-called "profiteering." High profits in themselves are good for the whole nation rather than bad, and these high profits can very fairly and properly be made the means of raising part of the heavy taxes that are required at the present time and will undoubtedly be required for the next ten years. The excess-profits taxes, that we formerly had, yielded large sums to the United States treasury up to 1920, and an excess-profits tax at the present time at a much higher rate than 5 per cent. would undoubtedly be popular.

Considering these fundamentals which will prevail as long as we have a capitalistic system and allow any freedom of action to the individual man, we can see that the greatest force for good in the recovery act is the encouragement given trade groups to govern themselves, eliminate unfair and unjust competitive practices, and put the whole industry on a profitable basis. The repeal of the Sherman and Clayton acts would have been of considerable help in this same direction; but the N. R. A. movement, if properly directed, can go further, through its authority to compel all members of an industry to conform to a reasonable code of fair competition. Competition is not eliminated, but it is put on a higher plane, whereby the industry as a whole makes some return on the capital invested. It is this feature of the N. R. A. movement which is most hopeful and valuable, and it is the one that must be emphasized and helped by all intelligent business and professional men.

Another feature of the administration of the recovery act which seems open to considerable opposition, is the handling of the labor situation. Although it is always true that there are increases in strikes when a country begins to recover from a depression, the wave of rather serious strikes which we have seen recently has undoubtedly been stimulated by the false ideas which the recovery administration has spread or at least has allowed to be spread.

While in most cases business men are willing to work in close coöperation with the present heads of organized labor, the history of labor unions in this country and others gives little assurance that, when the unions once have full control, the present leaders will not be deposed in favor of those much more radical, who can be elected to office by promising all kinds of impossible things. Few intelligent executives object to high wages and good working conditions, but they do object to unreasonable operating rules set by the union, which unfairly increase costs.

During recent years the federal trade commission has held numerous trade-practice conferences at which business men have joined together to work out plans for the good as a whole industry, especially in restraining unfair competition through unsound methods of doing business. There were 52 conferences held by the commission in the period from October, 1928, to January, 1932. Under the laws in force prior to the recovery act, however, neither the federal trade commission nor the trade associations could go very far in correcting a bad price situation. In general, the federal trade commission considered as an unfair trade practice, "the selling of goods below cost with the intent and with the effect of injuring a competitor, or where the effect may be substantially to lessen competition or tend to create a monopoly or unreasonably restrain trade." Selling below cost in itself was not an unfair trade practice but, to make it unfair, a definite intent or effect had to be proven.

Under the recovery act, many of the codes already filed go much further than the federal trade commission practice conferences and make it an unfair trade practice to sell below cost. In stating this general policy, there is a great diversity of ideas and especially of wording. The administration so far has not attempted to establish any standard wording on this subject, but appears to be interested primarily in having each group agree within itself. Some of the code provisions refer to "reasonable cost," others to "cost to the seller," "base price having regard to cost of manufacturing," "current weighted average cost of production," and still others to a "reasonable cost of production and distribution." One code refers to "cost as determined without any subterfuge in accordance with sound accounting practice." Several provide for no sales below cost, several mention a return on the capital invested as one item of cost, and some refer similarly to the use of plant facilities as an item of cost. Some provide for a cost determined on an average basis or an "average weighted cost," and some also provide that no sales shall be made below cost plus a reasonable profit. The attitude of the administration appears to be rather generally opposed to any provision requiring a profit above cost and to any determination of costs on an average basis, but the theory of prohibiting sales below the individual cost of each business unit seems to have substantial support.

With this development of codes and trade practice agreements under the codes it is especially important to know what is cost. There is here a great responsibility and opportunity for accountants to work with individual clients, trade associations and the federal administration to guide along sound lines the thoughts and the wording of any agreement. It seems to me that it is especially important that any reference to cost must be to a total delivered cost. Any consideration of cost which is limited to "cost at the plant," "manufacturing cost" or some similar phrase will defeat the purposes of the agreements, which are, fundamentally, to put the business as a whole on a profitable basis and to prevent one company from injuring not only itself but the whole industry by selling below its cost. Cost should be the total cost delivered to the customer, and no item of cost or expense should be allowed to be overlooked.

After an agreement is designed to cover total cost, there is still much work to be done. The total cost means little in actual practice unless a company is making merely one product. If, as in the average case, there are several products, it is necessary for the industry to agree upon the best method of allocation of the costs and expenses to the different products made and sold. I can not emphasize too strongly that no one method of allocation can be arbitrarily used to fit all expenses in one company or one industry and, especially, that no general plan can be applied to several industries. It is essential that each trade develop a uniform cost accounting plan which is sound in principle and practical in operation, so that under it cost elements will be handled by each company in the same way, costs can be compared, and "policing" of costs and selling prices can be conducted in a practical manner. It is not necessary nor desirable that any two trades have exactly the same cost-accounting plan, but the way in which costs are built up should be so clearly defined that it will be possible to reconcile the costs of two or more industries, especially those which may compete with each other.

This emphasis on uniform costs obviously does not apply to uniform books, sheets, cards or other records, but only to the classification of accounts, the resulting uniform analyses of expenses and in general to the principles and methods of building up the costs.

It is hardly necessary to point out that determination of cost on a proper basis for an industry will be of great value to that industry in its contacts with labor, the government and the general public. Facts when known give a sound basis for correcting any injustices there may be, and, on the other hand, if a condition is reasonable, it will be proven so by the cost figures.

In helping trade associations to work out uniform cost-accounting plans, there are certain questions of principle on which there may be some difference of opinion. Shall there, for example, be included in costs, or in the cost calculations, any provision for a return on the capital used or on the plant facilities? Shall the cost as developed be actual cost or shall it be normal cost; and if the latter, shall we use as a normal a fair average of production for the industry or some other basis? Shall there be a separate classification for administrative expenses, or shall such expenses be analyzed and those that are primarily manufacturing be included with manufacturing costs, and those that are primarily selling be included with the selling costs? Shall depreciation be included on the basis of replacement values of the plant assets or on cost of the assets or some combination of the two? Shall depreciation be at uniform rates for all plants in an industry? How shall we reconcile the different practices of different concerns as to handling expenses for repairs, upkeep, etc.?

These questions are not intended to be an exhaustive list of what must be considered. They merely illustrate the kind of questions to be discussed and perhaps demonstrate that the problems of developing a proper uniform cost system for an industry are far from simple.

The attitude of many business men toward the national recovery act and its administration is influenced by the fact that this is emergency legislation. While one may point out that Great Britain has experienced an improvement in business conditions without having anything similar to the recovery act and may feel that today we would be much better off if the act had never been passed, it is nevertheless true that we have gone too far to retrace our steps completely. The emergency phases of the situation will gradually pass, let us hope more quickly than now seems possible, but undoubtedly the idea of restraint on unrestricted competition will continue in some form or another and we shall continue to have greater control over business on the part of the government.

The present administration has again and again stated that many things done are frankly experimental and will be changed if they do not work, so it is obviously the part of wisdom for business men, instead of sitting on the sidelines and watching developments and criticizing lack of results, to take an active part in the movement and to influence it in the right direction. It seems to me that the recovery act gives business men a wonderful opportunity to do what they have hoped to do or endeavored to do over the last ten or twenty years, namely, exercise some control over competitive conditions in their own industry. It is now possible for each trade to govern itself in a sensible way.

Unless a trade succeeds in governing itself, the administration will be forced to step in and exercise more direct control. There is nothing in the history of government control of railroads in this country or in government control of business in any country, which would lead us to look with any satisfaction on such a plan other than as a make-shift to be succeeded as promptly as possible by business control over itself. Therefore, business men are well advised to move—and to move promptly—toward exercise of that proper control through trade associations. I do not know of any activity at the present moment that can more reasonably call upon the time and energy of the principal executives of each business than assistance in building the code and trade practice agreements for their industries. They are not only in that way helping the industry toward an immediate improvement in its financial condition but are also building a sound foundation for the future.

It is not necessary for business men to wait for the acceptance of a code by the administration before putting into effect the trade-practice agreements for the industry. If sound trade-practice agreements are developed and receive the approval of a large majority in the industry, they can by mutual consent be put into effect immediately, with the knowledge that if they are sound they will eventually be approved by the administration and if not they can be amended at a later date. Too many business men are making the mistake of holding off and deferring the benefit they could have now through trade-association activity. They are waiting for the administration to push action on the code and then further push them to do what they should be eager to do for themselves without any pressure from the administration.

We should urge all clients who are not in a trade association to join one, or to form one if there is none already formed, and to work effectively to strengthen the association and make it active and aggressive in the interest of its members. We must emphasize the fact that the government will look after the interests of labor and of consumers, but business men must look after themselves.

Our clients must have in mind that an unreasonable increase in operating costs and resulting selling prices may drive the whole industry out of competition. We must remember that the government can not control the consumer. He will buy what he desires. If the price of coal is pushed too high, people will heat their houses by oil or by gas. There are very few products for which substitutes can not be found if the price goes too high. It is, therefore, essential that each industry watch its own problems carefully and refuse to be driven into a situation where all or a majority of its members will have to close down, throwing large numbers out of employment.

It is particularly important that our clients be not unduly influenced by the publicity that is sent out from Washington. Catchy phrases of high-priced publicity men can not change sound economic laws. It is only as the profits exceed the losses that the nation can go ahead, and these profits must be profits made by thousands of individual businesses. We need not worry about excessive profits, as immense sums will be required for taxation, and unreasonable profits in any one industry quickly invite increased competition.

Many features of the N. R. A. movement are fundamentally sound and will prevail after the present ballyhoo is ended. Without a doubt greater government control of business is far from a temporary policy. It will probably continue for many years. Realizing this, it is the duty of business and professional men to lend their influence to steer this movement in the right direction and to see that the maximum permanent benefit is obtained, not only for each individual concern and for each trade association but for the country at large.