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The Agricultural Emergency in Iowa, II. The Causes of the Emergency

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The Agricultural Emergency in Iowa

II. The Causes of the Emergency

By Geoffrey Shepherd

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MECHANIC ARTS

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AGRICULTURAL ECONOMICS SECTION

AMES, IOWA
FOREWORD

This is the second publication in the series dealing with the present agricultural emergency in Iowa.

The first circular in the series, "The Situation Today," presented the main facts of the case. The present circular deals with the causes of the present state of affairs.

These two circulars will provide the foundation for the subsequent publications in this series, which will deal with remedial measures. The next circular will deal with the voluntary domestic allotment plan.
The Agricultural Emergency in Iowa

II. The Causes of the Emergency

By Geoffrey Shepherd

The close of the year 1932 finds us in the grip of the worst depression in history. Our whole productive and distributive machinery seems to be out of gear. Industry is running at less than two-thirds capacity,\(^1\) a large number of our factories are shut down, and 11 million men are out of work.\(^2\)

Agriculture is suffering from a different sort of trouble—not so much from unemployment and closed factories, as from ruinously low prices. The United States index of agricultural prices has fallen from 138 (the average from 1925 to 1929) to 56 in October, 1932.\(^3\) This is a decline of 60 percent. On Iowa farms, hogs that used to average $9.00 a hundred are selling now for $3.00,\(^4\) and corn that used to be worth 70 cents a bushel is now bringing 10 cents.

What has brought us to this pass? We need to know, because a clear realization of the way we got into this trouble should help us to plan the way out. This depression is not a catastrophe of nature, like an earthquake or a tornado. It is a man-made affair, the result of our own actions and policies. We did not do it intentionally, but somehow in fumbling with our economic machinery we pulled the wrong levers and got ourselves into trouble. If we can go back and discover what we did that was wrong, we will be in a better position to get the machinery going again. The way into trouble should give us some idea of the way out.

If the cause was overproduction, we ought to know it. If it was Wall Street, we ought to know that. If it was an unstable monetary and banking system, we should get our ideas clear as to the defects in that system and prepare to remedy them. If it was because we got involved in European financial difficulties, or if there has been something wrong with our trade policies—whatever the reason or reasons, the sooner we chart the obscure paths through which we got into this depression, the sooner shall we find the way out.

THE GREAT DECLINE IN THE GENERAL COMMODITY PRICE LEVEL

What, then, is the cause, or what are the causes, of the present emergency in agriculture?
The immediate cause is the devastating decline in the general commodity price level that has taken place during the last three years. Measured from 1925 to 1929 average levels, the general level of wholesale commodity prices in the United States has fallen 34 percent, or one-third. Similar declines have taken place in the other countries of the world.

A reduction in the general price level of this magnitude bears down with especial force upon agriculture, for two reasons.

**Costs of Distribution Lag**

The first reason is that the costs of distribution from producer to consumer do not decline as rapidly as wholesale commodity prices. Manufacturers', processors' and retailers' wages and rent always fall more slowly than commodity prices; freight rates change very slowly (they have remained practically unchanged since the present depression began). Changes in the cost of distribution lag so much behind changes in commodity prices that the heaviest part of the burden of a decline in the general price level is passed back to the producer.

A simple illustration of this is the way declines in hog prices at the central markets are passed back to the producer. It costs about 75 cents a hundred pounds (freight and handling charges) to ship hogs from central Iowa to Chicago. When the price at Chicago declines from $4.00 a hundred to $3.00, the farm price in Iowa declines by the same amount, from $3.25 to $2.25. The reduction in the Chicago price is one-fourth, while the reduction in the Iowa farm price is nearly one-third. In this case the full burden of the price decline is passed back to the producer.

**Agricultural Production Continues at Full Capacity**

There is a second reason why a major decline in the general commodity price level hits agriculture hard. A great price decline generally brings on a business depression, and during a business depression the general demand for goods and services diminishes.

Many industries react promptly to this situation; they cut down their production, in line with the reduction in demand. The steel industry, for example, has reduced its present output to about 20 percent of its full capacity. In the automobile industry production has been cut to about one-third. Industrial production for the United States as a whole has been cut more than a third. Manufacturers who follow this policy generally have to accept somewhat lower prices, and their net income usually declines still more than their prices. But by
reducing production they avert a large part of the effect of reduced demand, passing a major portion of it on to the shoulders of the employees that they discharge.

This policy is very effective in well organized industries. The clearest example is the steel industry, which, by cutting its production schedule heavily, has been able to maintain its price schedule almost intact. The price of steel rails has been $43 a ton for years; it has remained unchanged all through the present depression, until two months ago when it was reduced to $40. It is easy to imagine how low steel prices would have fallen had the steel industry kept operating at full capacity!

But that is exactly what agriculture has done. During the years 1926-1932 the total output of farm products in the United States has remained practically constant, at a level about 15 percent higher than during the years 1919-1921. In the face of a reduction in demand, agriculture has continued to operate its plant at full capacity. This is the second reason why agricultural prices have declined so heavily during the past three years.

Changes Within Agriculture

There is a further consideration, though it is not connected with the depression. Changes have been taking place in the technique of agricultural production, and these changes have been slowly altering the outlines of the agricultural picture.

Some of these changes have helped the United States farmer, some of them have hurt him. The increased use of tractors, trucks, combines and other large scale machinery has helped to the extent that it has reduced the costs of production on the farm. Yet these tractors and trucks have displaced many horses and mules; and as a result, a good-sized portion of the market for corn, oats and other feed grains has disappeared. This has correspondingly weakened the prices of these grains.

Whatever their net effect may be, these changes work slowly, and they are of small moment compared with the terrific decline in agricultural prices that has taken place during the past three years. This decline bears down with great severity upon farm operators, because the costs of running a farm—debt and interest charges, taxes, machinery costs and the multitude of small running expenses—have not come down in any corresponding measure with the prices of farm products. The farmer's income has been reduced 60 percent, but his expenses have been reduced only about 20 percent. The farmer is ground between the upper millstone of descending prices and the unyielding lower millstone of comparatively fixed costs.
WHY HAS THE GENERAL PRICE LEVEL DECLINED?

It is easy to say that the immediate cause of the present agricultural emergency is the great decline that has taken place in the general price level during the past three years. But that only raises another and more difficult question. What was it that made the general price level decline?

The answer to this question is full of controversial points, but the broad outlines can be blocked out in a few pages. The root causes of the present depression and deflation of prices trace back to the World War.

Before the war, monetary conditions were comparatively stable, both within each nation and between the nations. The leading nations played the parts for which they were fitted, and these parts dovetailed with one another to make a well balanced whole.

The United States, for example, was the world's greatest debtor nation. That is, she paid huge amounts annually to other nations for interest on borrowed money, for tourist expenditures and for immigrant remittances abroad. She was also a great net exporter of goods. These two policies, her financial policy and her trade policy, fitted in well with each other, for her payments abroad were made in the form of her exports of goods.

Great Britain, on the other hand, was the world's chief banker and creditor nation. Other nations paid her large amounts every year for interest on borrowed money and for shipping charges. Furthermore, she was a free-trade nation and received large net imports of goods. Here was another example of harmonious financial and trade policies.

Between the nations, equilibrium was maintained through the action of "the automatic gold flow mechanism." If one nation, for example, developed an export surplus of goods, services and loans abroad, this excess would cause that nation's exchange rates to rise, and gold would flow in until the exchanges were corrected. This inflow of gold would raise prices in that nation and make it harder for her to sell her goods and services abroad and easier for other nations to sell to her. This would reduce her exports to a point where they would again be balanced by her imports. Gold flowed wherever needed to redress balances, and in flowing raised or lowered prices so that equilibrium was maintained.

Beneath the surface of this apparently smoothly working world, however, politico-economic forces—population growth, the ambitions of the different nations for control of the world's markets and productive resources, etc.—were exerting terrific
expansive pressure. The world was like a smoothly running steam engine, but the boiler pressure was so high that the machine was likely to blow up at any time. When the explosion finally took place in 1914, it threw the different parts of the machine out of relation with each other, and set up opposing forces which have led to a breakdown during the last three years.

The Effects of the War

Let us try to get a clear grasp of the nature of these opposing forces, set against each other as a result of the war explosion.

The belligerent nations could have financed the war either by monetary inflation or by heavy taxation. Disregarding the advice of economists, the United States, along with the other nations, chose inflation, and thereby sowed the seeds of our present trouble.

As a result of this policy of inflation, prices during the war roughly doubled. For four years, from 1917 to 1920, the general level of commodity prices at wholesale in the United States ranged between 175 and 225 percent of pre-war.

When peace was declared in 1919, our heavy expenditures for war purposes declined, but they were replaced for a time by heavy purchases by foreign nations who were recuperating from the destructive effects of the war. The war-time scale of production and prices continued for more than a year after the war had ended.

Then, in 1920, the war and post-war boom came to an end. Foreign nations ceased buying from abroad and began to build up their own industries; governments ceased floating their war bonds, and the policy of cheap money was ended. Prices crashed, and a severe depression ensued.

The depression was severe, but it was comparatively brief. Within a year or two the country began to recover. Industry struggled to its feet again, and began to proceed, haltingly at first. Most of the price and debt maladjustments carrying over from the war inflation period were reduced, some by the expiration of contracts, others by default, others by voluntary agreement, and others by the gradual action of competition. But many maladjustments remained, and although industry was able to overcome her obstacles within a year or two, recovery in agriculture was slow.

The United States Changes from Debtor to Creditor

Prosperity returned to industry by 1923. The United States greatly improved the technique of mass production, thereby reducing the costs of industrial production, and embarked upon
an aggressive policy of expanding its exports. Overriding the protest of economists, it also decided to raise its tariffs and keep out foreign manufactured goods. We were not alone in this; the movement was, with the exception of England, worldwide. But we were one of the worst sinners in this respect, for we were a large nation and had large world responsibilities.

Then, from 1924 on, a strange new influence began to make itself felt in the world. During the war, the European nations had borrowed enormous sums of money from the United States to finance their fighting forces. These foreign borrowings were so great that they reversed the debtor position of the United States. When the war was over, the United States emerged, not as the world's largest debtor, but as one of the world's leading creditors.

This change in the world position of the United States meant that she would be receiving huge payments every year instead of making them. These payments to the United States would have to be made in goods or services, or else in gold. Our tariff, raised higher in 1922, made it difficult for goods to enter. So gold flowed in instead. It flowed in so rapidly that the stocks of gold in this country increased from roughly 2 billion dollars in 1914 to 4 billion in 1923.19

It then became clear that the United States' new role as banker conflicted with her traditional role as a large exporter of goods. Her new financial policy ran counter to her established trade policy. For as a banker, she required huge payments to be made to her each year—nearly 200 million dollars annually in governmental war debts alone.11 At first these payments could be made in gold. But there is only a limited supply of gold in the world, and sooner or later goods would have to flow in instead. The United States would have to become a net importer of goods. But that ran directly counter to her trade and tariff policy, which aimed to make the United States a large net exporter of goods.

**Europe Pays Her Debts by Borrowing More**

There was the situation, and it would quickly have brought about a deadlock in world affairs had not a new element suddenly entered the picture. European nations began to float huge issues of securities—stocks and bonds—in the United States. In other words, we in the United States started to lend vast sums abroad. We demanded that the European countries pay their debts, and pay them in gold, not goods. And when they could not pay us any longer, we loaned them the money to do it. We loaned them so much money that they were able to
pay their debts and buy large quantities of goods from us as well. The amounts are shown in table I.

**TABLE I. AMERICAN EXPORTS, IMPORTS AND FOREIGN LOANS**

In millions of dollars

<table>
<thead>
<tr>
<th>Year</th>
<th>Exports</th>
<th>Imports</th>
<th>Excess of exports</th>
<th>New foreign securities sold in U. S.*</th>
</tr>
</thead>
<tbody>
<tr>
<td>1922</td>
<td>$3,832</td>
<td>$3,113</td>
<td>$719</td>
<td>$630</td>
</tr>
<tr>
<td>1923</td>
<td>4,108</td>
<td>3,702</td>
<td>376</td>
<td>267</td>
</tr>
<tr>
<td>1924</td>
<td>4,591</td>
<td>3,619</td>
<td>981</td>
<td>1,047</td>
</tr>
<tr>
<td>1925</td>
<td>4,910</td>
<td>4,227</td>
<td>683</td>
<td>1,078</td>
</tr>
<tr>
<td>1926</td>
<td>4,808</td>
<td>4,431</td>
<td>377</td>
<td>1,145</td>
</tr>
<tr>
<td>1927</td>
<td>4,555</td>
<td>4,185</td>
<td>680</td>
<td>1,562</td>
</tr>
<tr>
<td>1928</td>
<td>5,128</td>
<td>4,091</td>
<td>1,037</td>
<td>1,319</td>
</tr>
<tr>
<td>1929</td>
<td>5,241</td>
<td>4,399</td>
<td>842</td>
<td>759</td>
</tr>
<tr>
<td>1930</td>
<td>3,843</td>
<td>3,061</td>
<td>782</td>
<td>1,010</td>
</tr>
<tr>
<td>1931</td>
<td>2,424</td>
<td>2,091</td>
<td>333</td>
<td>255</td>
</tr>
<tr>
<td>1932**</td>
<td>1,189</td>
<td>1,015</td>
<td>174</td>
<td>0</td>
</tr>
</tbody>
</table>

*I.e., new foreign loans.
**First nine months.

Our foreign loans were not part of the financial policy of the United States. They were independent transactions, made by business men and bankers as part of their ordinary investment activities. Foreign corporations sold bonds to finance their business, and we bought them in huge amounts. It was obvious that these loans could not continue indefinitely. But while they lasted they balanced the international books and financed a period of insecure but very exuberant prosperity in the United States.

The huge stocks of gold in this country would have given us a very high price level had not a good deal of the gold been "sterilized," sunk in the vaults of the Federal Reserve Banks, so that it could not exert its full effect on prices. This prevented the "gold flow mechanism" from working. Had we and France left it free to work; it would have redistributed the gold where it was needed in other countries. As it was, the majority of the world's gold piled up in the United States and France. Our price level evened out at about 50 percent higher than pre-war.

Similar price levels prevailed abroad, but for a different reason. Their stocks of gold were small; but this did not depress their prices, because their gold stocks were so small that the countries were forced to remain off the gold standard. Furthermore, our loans abroad helped to sustain foreign purchasing power and foreign price levels.
The Period of Prosperity

Gradually, industrial prosperity in the United States developed into a boom. Our indexes of industrial production rose above 1923-1925 levels by 8 percent, 12 percent and finally 19 percent. Installment buying became wide-spread, and speculation in the security markets developed on an amazing scale.

Throughout this period the commodity price level remained fairly even. After 1925, however, points of weakness began to develop. Gold stocks in the United States and France continued to grow. Economic nationalism ran rampant, not only among the leading nations of the world but also among the small new European nations set up by the Versailles peace treaty. Expenditures for competitive armaments mounted rapidly. Partly to restore sound monetary conditions, but also partly to build up a war chest of gold, nation after nation returned to the gold standard. Germany went on the gold basis in the fall of 1924; England and the Netherlands in April, 1925; Belgium, in October, 1926; Italy, December, 1927; and France, June, 1928.13

The return of these nations to the gold basis increased the demand for gold. This increase in the demand for gold began to increase the value of the yellow metal. An "increase in the value of gold" is the same thing as "a decrease in the (gold) value of goods"; that is, it is the same thing as a decline in prices. In the four-year period from early 1925 to early 1929, the level of prices abroad, in the countries that take the bulk of our farm-product exports, declined about 12 percent.14

Besides the general scramble for gold, there was an almost universal move in the direction of higher tariffs. Nations fought to protect their own producers from foreign competition by raising tariff barriers against imports. And many a national government, hard pressed to balance the budget, levied additional import duties in an attempt to increase its income.

Trouble was brewing in agriculture particularly. Wheat production was expanding rapidly in Canada and Argentina. Expansion in these countries subjected our wheat growers to the same ruthless competition that we gave European wheat growers two or three generations ago. After 1924, too, Russia loomed on the horizon with threats of further additions to the world's wheat supply.

Uncertainty Develops

Gradually, these shifts in production, combined with the changes being made in financial and trade policies, began to have their effect upon the markets of the world. Rising tariff barriers
cut down the demand for goods. Our foreign loans began to slacken. Reduced demand led to a piling up of stocks of raw materials. These large stocks began to bear down on prices. These falling prices, in turn, led to more restrictive import policies and to further reduction in demand.

"By the end of 1928, mounting supplies of industrial goods in relation to limited monetary and credit facilities were endangering commodity price levels, and in 1929 that danger was made even more real as the tremendous absorption of more and more funds in the American speculative markets reduced our lending abroad, and as the lure of speculative profits dragged even foreign funds into the American stock markets. At that juncture, the end of 1928 and the beginning of 1929, European industrial conditions became vulnerable to the subsequent crash in worldwide speculation and the unsettling influences that the crash let loose." 14

It was not until 1929 that the truth seemed to become apparent. Only then did the world seem to grasp the fact that nations cannot sell without buying, nor repay loans indefinitely by simply borrowing more. The large stocks of goods began to cause concern, and industrial production began to slacken. This was a disturbing sign. Confidence gave way to caution. Previously, domestic demand had been overexpanded by installment buying now it contracted as people turned from buying to saving. This contraction of demand caused production to contract still further. The stock market wavered and then crashed, feverish optimism turned into uncertainty and then into pessimism, and the depression began.

The Depression Begins

When depression begins, it feeds on itself to breed more depression.

"The interrelated developments, once the depression began, can be more clearly traced, and their influence on agriculture more clearly visualized. It is generally agreed that since the decline in 1929 there have been three distinct phases in the depression: The first embraced the two years up to the spring of 1931; it brought on a series of monetary disturbances which characterized the second period, from the middle of 1931 to the spring of 1932; the third is the current period characterized by the measure adopted to stem the financial debacle.

"The downward course of the depression during 1930 and 1931 led to a financial crisis. Debtor countries found it difficult to maintain satisfactory trade balances to meet their foreign obligations and to secure new loans upon which they had been de-
pendent for several years. To protect their currencies in relation to gold, these countries were forced to adopt exchange regulations to restrict gold exports. Doubt then arose as to the financial soundness of creditor countries, followed by runs on money markets. Great Britain, in September, 1931, was forced to abandon the gold standard. In quick succession other countries, covering about half the globe, followed its example. Creditor countries, chiefly the United States and France, unwilling either to loan more money or to import goods, attracted large quantities of gold from the rest of the world bringing about a still greater ‘mal-distribution’ of the world’s gold supply.

"In the United States bank failures reached enormous proportions and led to hoarding by the frightened public. Investors also lost confidence in practically all forms of securities, the prices of which fell to unheard of levels, and the flotation of new securities practically ceased. Bank deposits were drawn down. Banks, fearing more runs, restricted credit, and commodity prices continued to fall. At the end of 1931, commodity prices at wholesale had returned to the pre-war level.

"The United States, in its efforts to stem the tide of depression, by the summer of 1932 had made fundamental changes in banking, had legislated into existence new credit institutions with vast financial resources, and through the Federal Reserve System had supplied open market credit in very large volume. In the international field, the leading countries of the world were endeavoring to find a basis for cooperation in political and economic affairs, that would help stabilize financial conditions and restore the flow of trade.

"The developments of the past three years have resulted in a drastic decline in the demand for the products of our farms, both in this country and in foreign countries, but production, in the aggregate, has not been materially reduced. In some lines production has continued to be heavier than the markets will absorb even at ruinously low prices, and burdensome supplies have accumulated. Although the continuance of production at the pre-depression level has contributed to the great depths to which agricultural prices have fallen, the forces primarily responsible for the agricultural depression are found outside of the agricultural industry.

"In summary, the principal causes of the depression as it affects American agriculture may be listed as: (a) Monetary and credit policies during and after the World War, including the increased demand for the world’s limited supply of gold as many nations strove to return the gold as the basis for their currency after 1924; (b) over-expansion of production and productive capacity in many industries, with an accompanying increase in
the volume of indebtedness; (c) the unparalleled orgy of speculation in securities; (d) the trend toward economic self-sufficiency, especially among European nations, which resulted in considerable degree from obligations to pay war debts and reparations, and from efforts to escape the effects of falling prices and which was manifested in trade barriers and import restrictions that retarded international trade and curtailed the foreign demand for our agricultural products."

PLANNING THE WAY OUT

There, briefly, is the story of how we got into our present trouble. How does it help us in planning the way out? First of all, it makes clear that this depression was not "inevitable;" it was not some occult phenomenon, beyond the power of man to forestall. It was man-made, the result of policies consciously chosen and deliberately carried out.

To begin with, the war was not a stroke of Fate, falling upon a hapless world. Policies could have been adopted which would have maintained peace; instead, policies were chosen, which, when followed to their conclusion, brought on the war.

During the war, the policy of inflation was not inescapable; it was chosen; other methods of financing the war could have been used. After the war, the victor nations chose to exact reparations with one hand, and with the other put up tariffs which made payment impossible except in gold. Not until the resulting drain of gold wrecked the financial structure of Europe has substantial progress been made toward a solution of this situation.

In the United States, tariff walls were raised in 1922 and again in 1930. Here again the choice was deliberately made; we put our tariffs up, despite the fact that a nation can be a large net exporter, or a leading world financier and creditor, but it cannot be both at once.

A world disaster which is the result of wrong policies can be rectified by right policies. Our economic machine is badly damaged, because we drove it into the ditch; but it can be repaired and put in the running again.

What part can we play in this general reconstruction? The first thing we can do is to put our own house in order. And while we are doing this, it will pay us to remember that ours is not the only house on the lot. It will do us no good to clean up and dump our rubbish in our neighbor's yard, if that leads him to dump as much or more of his rubbish in our yard in return.
This consideration need not hamper our actions. It means only that our plans should be laid with reference to the rest of the world as well as to our own country, not for reasons of altruism, but simply for our own good.

**Remedial Policies**

Our brief study has shown us that agriculture is suffering from extremely low prices and relatively high costs. It has shown further that the reasons for low agricultural prices are: (1) the decline in the general commodity price levels; (2) the lag in the costs of distribution from producer to consumer; and (3) continued high production of agricultural products, in the face of a reduced demand.

It seems evident, then, that in mapping out policies to meet the agricultural emergency we can develop several lines of attack.

One line takes us in the direction of "reflation," in an attempt to raise the general commodity price level toward pre-depression levels. This would raise agricultural prices to the point where the majority of farmers would be able to make ends meet. It would equalize prices and costs by raising prices.

Another line regards pre-depression price levels as past and gone beyond recall. Those who hold this point of view believe that costs of all kinds—freight rates, debt and interest charges, taxes, rents, wages, etc.—should be "deflated" in line with the deflation of the general commodity price level. This would tend toward the equalization of prices and costs by reducing costs.

A third line of attack takes a direction different from either of the first two. It does not attempt to raise the general price level, nor to "deflate" costs; it aims to raise agricultural prices only by limiting the amount of the product that can be sold on the domestic market. This is called the domestic allotment plan. One form of this plan would limit production as well as the amount sold domestically.

This plan will be brought up and discussed in the present session of Congress. It is already attracting a great deal of interest, and legislative action upon it may presently be forthcoming.

Accordingly, the next circular in this series of publications will deal with the domestic allotment plan.
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SOURCES OF DATA


3. The Agricultural Situation, November, 1932, p. 22.

4. Agricultural Economics Department, Iowa State College. Compilations based upon U. S. Department of Agriculture data.

5. From an average of 143.2 from 1925 to 1929 inclusive, to 95 in September, 1932. The Agricultural Situation, November, 1932, p. 21.

6. The Annalist, Friday, November 25, 1932, p. 713.


