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Farm and Food

Dr. Butler Explains Formulas for Parity

By DR. KARL D. BUTLER

An official reports just out indicates that the national farm parity ratio has dropped to the lowest level since November 1940. On Oct. 15, 1955, the parity ratio was set at 82 per cent.

With all of the current discussion regarding the farm problem, which really is a combination of many problems, it might be well for us to attempt a better understanding of this question of parity. Just what is parity?

Dr. Karl D. Butler

Parity was designed to be a measuring stick. Parity prices are theoretical prices computed according to a legal formula which is supposed to indicate the prices farm products should bring to be in a "fair exchange relationship" with the things farmers buy.

Under the old parity formula, parity prices were figured by taking the average price of a commodity in a base period, 1910-14, and multiplying it by the current index of prices farmers paid for wages, interest, and taxes.

For example, in 1910-14 the price of beef cattle was $5.42 per hundredweight, while the January 1955 index of prices farmers paid was 284 per cent so the old parity price for beef cattle was $5.42 tomes 2.84, or $15.40 per hundredweight in January, 1955.

Under the modernized parity formula, parity prices of individual commodities are adjusted each year to reflect the relationships that existed among the market prices of the various farm commodities in the most recent 10 years.

How to Compute It

The steps in computing a modernized parity price for a commodity are as follows: (1) Find the average price of the commodity for the most recent 10 years; (2) Divide this 10-year average price by the index of all farm prices (1910-14 equals 100) for the same period to obtain an "adjusted base price"; and (3) Multiply the "adjusted base price" by the current index of prices farmers pay, interest, taxes, and farm wage rates to obtain the modernized parity price.

For example, the average price of beef cattle in the 10 years, 1945-54, was $19.70 per hundredweight. During this same 10-year period, all farm prices averaged 261 per cent of their 1910-14 average. This means that the adjusted base price for the computation of parity prices for beef cattle in 1955 is $19.70 divided by 2.61 or $7.55. The index of prices farmers pay, interest, and taxes, and wages paid hired labor was 283 (1910-15 equals 100) in January, 1955, so that the modernized parity price for beef cattle wa $21.40 per hundredweight.

The modernized parity formul became effective on Jan. 1, 195 for all commodities except whea peanuts, cotton, and corn, sul ject to the provision that r parity price may be reduced mo than 5 per cent in any one yea by reason of the application of th new formula. Parity prices con puted under this provision ar called "transitional parity prices

Change on Jan. 1

Wheat, peanuts, cotton an corn have continued to use th old parity formula under a du parity provision of the law whic provides that parity for the basi commodities shall be the highe of the prices computed under th old and modernized formulas un til Dec. 31, 1955. The moderniz formula is scheduled to becom effective for the four basic com modities now excluded on Jan. 1956, with a transitional provisio limiting reductions to 5 per cen per year.

Although the use of the parit ratio is generally accepted as useful measuring stick, not a economists or farm leaders agre as to its validity. In fact, som economists openly challenge it.

In the Oct. 24, 1955, Newsweek Henry Hazlitt wrote:

"The whole notion of a pric 'parity' that ought to be per petually maintained betwee farm and non-farm prices is ab surd. So is the whole idea tha any group of producers is per petually entitled to some fixe 'fair share' of the national in come.

"If there were any merit i such a notion, it ought to b universally applied. If farm prices are to bear the same re lationship to non-farm prices tha they bore in the extremely fa vorable period from 1910 to 1914 (now more than 40 years past) then the price of everything ought to bear that 1910-14 relationship to the price of everything else, and the public treasury ought to be used to maintain this relationship.

Held 'Preposterous'

"Nobody has so far been brazen enough to propose anything so preposterous. Everyone knows that the supply and demand and conditions of cost of production for every commodity change every year. The market, as well as 'fairness,' must reflect such changes."

Mr. Hazlitt and others agree that, with programs now in effect, the age-old law of supply and demand is not free to operate properly, and huge surpluses are built up which in turn exercise a depressing effect on market prices.

Possibly a national leader will emerge some day who will challenge the whole price support idea and perhaps the parity concept itself; but, until that day, a sensible approach seems to be that advocated by those who are sincerely working toward bringing about a better balance in agriculture through the employment of flexible price supports.