

303

ARMY INDUSTRIAL COLLEGE
Washington, D.C.

CONTROL OF RAW MATERIALS

Lecture

By

Mr. Benj. B. Wallace,
U. S. Tariff Commission.

March 30th, 1927.

304

INTRODUCTORY REMARKS - COL. IRVING J. CARR, S. C., D. O. L.

Gentlemen:

This morning we are going to take up matters of raw materials, particularly those that are critical and strategic. This subject works in very nicely with the studies which we now have on critical raw materials, their source of supply and flow, and also with our study of the War Trade Board activities during the War. One of the essential elements of war planning has to be the assurance of raw materials to the manufacturer; that is a foundation upon which we have to base our planning. We can place orders direct with the manufacturer and he can assure the production of a certain flow of finished articles but unless we can assure him he is going to get the necessary raw materials, with the proper amount of priority, our plans are not complete.

We are researching along that line and Mr. Wallace of the United States Tariff Commission, who has been studying foreign raw material sources, has come down here this morning to give us a talk on his viewpoint on that subject. He has also consented to answer any questions that may occur to the Class to ask him.

I take great pleasure in introducing Mr. Wallace:

11-1-33

CONTROL OF RAW MATERIALS

Gentlemen:

In opening one of the congresses of the Universal Postal Union, Bismarck said, "The world stands under the sign of communication." Today I might say, "The world stands under the sign of integration", - which is largely a result of that ease of communications which we have had in the last generation or two.

Coming to the point a little obliquely, let me call your attention to the growth in the number of cooperative associations. Two years ago the Department of Agriculture showed that between 1915 and 1924 the number of cooperative associations in this country increased from ten to fifteen thousand, their membership from about two-thirds of a million to two millions, and their business, increasing yet more rapidly, totaled over two billion dollars a year. After making a total of 285,000 cooperative associations with some forty million members. The Department of Commerce has tabulated some twelve hundred national or interstate commercial and industrial organizations.

The movement for the integration of business is attracting great attention in Europe today. Cartels are being organized daily and already dominate the interior markets of a number of countries, particularly Germany. "Cartel" is a German word which means substantially "monopoly" or "trust". The Germans, however, distinguish between cartels and trusts or combines. The typical cartel retains intact the subsidiary organizations which continue to produce inde-

pendently, but there is an allocation of output, agreements on markets and prices, sharing of profits or other devices for eliminating competition in marketing. The cartels have not infrequently paid to the individual firms composing them bonuses or bounties for sales in foreign markets.

There are three features in regard to cartels which I wish to bring to your attention.

First, cartels are rapidly increasing in number and becoming international in character.

Second, there is a progressive tendency to closer and closer organization. The international steel cartel, for instance, started out by apportioning quantities of production to different countries. Inside of a few months dissatisfaction was expressed and it was decided to agree on prices also. When the Franco-German potash cartel was formed, the framers allocated production and markets and established prices for their commodity, now they have decided they must also have a joint sales organization. The tendency is for cartels to develop a greater and greater concentration of control. The contrast which the Germans make between cartels and combines seems to be breaking down - at least the consumer has less and less interest in the subtleties of the distinction.

The third point I have in mind in regard to cartels is the propaganda going on in Europe at the present time, and in this country to some extent, to convince people that international cartels ("international industrial ententes" or understandings) will produce in

51

the long run a cure for most of the world's evils. They, it is alleged, will bring international peace, they will make tariffs unnecessary, they will introduce economy and efficiency - thereby making the consumer and the peaceful citizen forever happy.

The governmental control of raw materials, as I have been studying it, has been said by some to represent just a passing phase. They dismiss it as a matter of no importance. But as I see it, governmental control over raw materials is simply one expression of this movement toward the closer organization both of the buyers and sellers in practically every line of business throughout the world. It is bound to increase rather than to diminish. If governmental control over raw materials does not increase, it will be because adequate combinations of private producers will be built up; but even in mining and plantation industries, where the number of producers is comparatively limited, effective control is not likely to be attained and maintained without governmental encouragement and aid.

There are a considerable number of raw materials which are subject to monopoly by a single country and which have been monopolized more or less closely. The governmental controls which we discuss today are, in part, simply producers' monopolies organized with more or less governmental participation.

There has been a rapid development in the control of raw materials since the War. This is partly the natural outcome of the tendency toward integration and cooperation, partly due to the empha-

307

sis which the war placed upon raw materials; and, thirdly, to a considerable extent, it is the immediate result of the business depression in 1920 and 1921. These controls of raw materials are no exception to the general rule that monopolies do not arise in prosperous times from the greed and ambition of great organizers but are organized for the purpose of finding some means of escape from a bad industrial situation. As far back as the organization of the first potash cartel in 1877, overproduction was already present, though only four mines were in operation.

I classify any operation in which the Government has a hand as being under governmental control. These controls over raw materials may be divided into three classes according to the object sought.

(1) Where the Government takes a hand simply for its own revenue. Thus the Spanish Government exploits its ownership of mines which dominate the world's production of quicksilver, the Japanese Government controls the production and sale of camphor in Formosa and Japan, and the Chilean Government, in addition to its participation in the Nitrate Producers' Association, restricts sales by the imposition of an export duty now equal to more than one-third of the value of the nitrate at the port of exportation.

(2) Controls for the purpose of stimulating domestic manufacture, such as the restrictions on the exporting of pulp wood from Canada.

(3) Controls which are organized for the purpose of aiding the producers and creating domestic prosperity. In this class those

which have excited the most attention are rubber, potash, coffee, and sisal. The controls over these articles are exercised in different ways, but in every case the control was the result of overproduction and of a depression in the industry, and in every case governmental interference tends to become more and more effective.

Take the history of the potash cartel as a typical example. Agreements and understandings began in 1877. In 1888 the first "syndicate" was organized. After several reorganizations, in 1910 a German Federal statute brought about a closer industrial organization and in 1919 there was a revision and amendment of the law, compelling all producers to join the syndicate, and putting the industry almost as much under the control of the government as a government department. The sources of supply, the labor policy, the domestic and export policies are all more or less under the government control. But while domestic prices are under its very close control, the syndicate is left free to get as much as it can from the foreign consumers.

We must proceed to a short discussion of the question how far these controls ensure adequate provision of supplies.

To begin with, the controls are instituted almost always at times and in respect to commodities in which there is an overproduction of material. There may never have been an oversupply of quicksilver, and other exceptions might possibly be found, but ordinarily abundance of supply characterizes the products controlled or monopolized. Sufficient control over price to insure profits, together

50

With insufficient control over production, may lead to chronic over-supply. That has been the history of the potash industry. To begin with, it was organized as a monopoly due to overproduction; the further down you get in its history, roughly speaking, the greater you find excess productive capacity until just recently over one-half of the potash mines were closed down. That is the latest development. The Germans are claiming a great deal of credit for that, as progress in the direction of efficiency and economy. The mines closed down will receive compensation, so there is a heavy fixed charge to be subtracted from the economies otherwise attained.

Secondly, the immediate object of control is to lessen the supply rather than to increase it. Whether the Government's object is revenue, domestic manufacture, or the prosperity of the producers, that aim is sought by restricting the supply available to foreign countries. Either the supply is reduced directly - by limiting the exportable quota of rubber, by limiting the acreage of long-staple cotton, by buying up coffee and withholding it from the market - or by fixing a higher price or imposing an export duty, the foreign demand is curtailed.

Usually, the limitation of supply has no other object than the raising of the price. There are certain cases, however, in which a national policy of conservation of exhaustible resources has been alleged as a reason for restricting exports. This argument is used very widely in defense of the Canadian restriction on pulp wood. The argument is used in connection with the Japanese camphor monop-

211

oly, and in regard to other forest and mineral products where there seems to be a possibility that the supplies will run out. There is, however, no necessary connection between the policy of conservation and monopoly. The Japanese camphor monopoly has pursued a policy of reforestation; it has replanted a great many camphor trees. But the Japanese Government might have pursued a policy of reforestation without monopolizing the supply of camphor. Conservation of timber of this country is not understood as requiring that the Government should engage in the lumber business.

Thirdly - and here we come to the crux of recent controversies - it is alleged that the restriction of certain supplies and the raising of prices is essential in order to ensure adequate future supplies of the controlled raw materials. This has been argued most forcefully in such cases as rubber, coffee, sisal, that is, in regard to crops which require a number of years to mature. In mineral materials such as potash, nitrates, etc., there is usually an abundant supply; if not, as in tin or quicksilver, a higher price does not necessarily ensure more abundant supplies in the future. In the case of annual crops, production responds rapidly to higher prices. There may be large fluctuations of yield, but the supplies can be increased within a short period of time; if the price goes high, it stimulates the plantings of the next year. But for those crops which require several years for maturity, if a real shortage develops, the price may remain high over a considerable period of time. Coffee was immensely profitable for several decades, then

rather low for about two decades; in the last few years it has again become profitable.

We may consider rubber more at length. It has been argued, and is still argued, that the control of this raw material was necessary in order to prevent a great shortage which is supposed to develop about 1930 and continue for some years thereafter. So far as I can see, the basis of that prophecy was and is very speculative. The production can be predicted with some fair degree of accuracy. The consumption is less certain but predictors assume a normal development of the market and project the curve of demand into the future. But, and it is a large BUT, the predictors did not predict the developments in the technique of using rubber. They did not foresee the cord tire and balloon tire; they left out of account altogether the increase in the use of reclaimed rubber. You will find that the shortage they predicted was rather a narrow one, only five to ten per cent of the total supply, and secondly, that if you allow for anything like the consumption of reclaimed rubber which has become the practice in the last two years, you have not a shortage at all but a very considerable oversupply in 1930 and the years following. The majority of the owners of rubber estates, by their actions, - by their failure to plant more trees and by their selling on long-term contracts at quite moderate prices, - admit that they have no deep conviction of the certainty of this rubber shortage in the future. The supplies for the future - in so far as they depend on greater production rather than upon economy in use of rubber - are

RECEIVED
MAY 10 1923

in little if any better shape than they would have been if there had not been a restriction plan. In the slump of 1920, 1921 and 1922, there was practically no planting; in 1923 and 1924 the restriction scheme increased prices, though they continued rather low and little was planted. In 1925 and 1926, high prices made the industry boom, but without great effect upon plantings which continued relatively small, below normal in fact; and it has been argued that the enforcement of the restriction plan seems to deter plantings just as much as would a low price. So far as I can see, the American and other consumers have paid additional prices (which may be figured in various ways, - perhaps one-half billion dollars for four years) without having really secured any assurance of more adequate supplies in the future than if they had not paid the enhanced prices.

A more extreme claim has been put forward that some rubber control, for instance the so-called Stevenson Plan of restricting output, was necessary to save the industry, which would otherwise have more or less disappeared. It was thought that the industry was in a bad way but up to November, 1922, the industry was not in nearly so bad a way as a great many others were. The prices which were obtained, even at the lowest mark, were sufficient to pay the running cost and in many cases a small profit for about two-thirds of the companies.

It is held by a good many students of prices that a competitive price for any article is only sufficient to cover about

314

eighty-five per cent of the production. It seems to be true that the normal long-run price of an article is not the full cost of production, not the cost per unit plus a reasonable profit, but is something under the cost of producing and putting on the market. The normal state of industry is for one company to be going out, another company coming in, making a constant changing of price - so that marginal producers are usually losing money. Detailed tabulations of actual costs support these generalizations. Accordingly, if one says that two-thirds of the rubber producers were holding their own, it does not indicate a very serious depression as depressions go in competitive industries.

The argument was advanced that the rubber business was in such a bad way that many companies would fail, the plantations would revert to jungle, and that when the prosperity of the world increased, there would be a great demand for rubber with none to satisfy this demand. If you accept this picture as a true one, there might be some justification for the rubber-restriction plan since the rubber control in the long run might be said to be for the interest of the consumer as well as the producer.

It is sometimes argued that after all neither these governmental controls nor private monopolies can effectively control prices in the long run. As I see it, what is likely to happen in the case of rubber is that whenever a surplus may develop in the future, there will be restriction of output. I think that in the general run of events when a restriction is again called

26

for, the Dutch will join the British and there will be a hard and fast monopoly. In the future, consumers not only of rubber but of other commodities are likely to be faced with this situation. In one decade prices will be fairly satisfactory to the producers and there will be no governmental control; in the next decade, as prices begin to turn in favor of the consumers, the government will step in to restrict output and raise prices. When demand again exceeds supply, governmental control will cease. In other words, it will be "heads, the producer wins, tails, the consumer loses". In this succession of events, however, the supply will presumably be adequate at all times for those who can pay a fairly stiff price. The supply, however, may fail if the control is no more skillful than the British rubber control in 1925.

It is a general belief that in the long run some forms of price controls will be more moderate than some others. If, for instance, the control is not entirely centralized or if the control is in the hands of a government bureau, there may be a tendency toward more stable prices than would be found otherwise. The nitrate association has been in the habit of fixing prices for one year in advance; 80 per cent of the directors may change the price during the year, but the machinery is a little hard to operate, and mid-year changes are not common.

I have on my outline other points connected with prices, but as I understand the attitude of the War Department, it is not much interested in prices, feeling itself able to meet any price anyone else can meet, so we may drop prices and proceed to questions.

3/6

OPEN DISCUSSION - CLASS

Question.

You mentioned a steel cartel. To what extent is the United States involved in that?

Answer:

The United States is not involved at all. The cartel includes most of the producers on the Continent of Europe, negotiations being in progress now to take in Poland. There is a great deal of discussion about England. Judge Gary is reported to have said, immediately after the first announcement of the completed cartel, that he did not anticipate any trouble for the United States; that it would be relatively easy to come to some understanding with the foreign producers. The immediate object of this cartel was to raise prices. The agreement was forced by an unsatisfactory situation in which the productive capacity was very much greater than the demand, so that there was cut-throat competition, no company making much money. They organized, limited production and thereby forced the prices up.

The United States has not been doing any great amount of export business in steel. We export the finished products but not the bars, sheets, etc. The immediate effect of the cartel was to raise the prices in Europe, including the export prices, and therefore, rather to raise prices and to diminish competition in the United States.

The German, not the international, cartel was giving an indirect bounty on exports, and our Treasury Department has put into effect

anti-dumping duties on German pig iron.

Question:

Have not the courts in this country held that price-fixing by commercial enterprises is illegal?

Answer:

Yes, price-fixing by combinations of producers is illegal. But the law exempts agricultural enterprises from the penalties of the Sherman anti-Trust Law. The theory is that agricultural cooperative organizations control only the marketing and not production, and, therefore, can not in the long run control prices. I think that is generally true. That has been one of Brazil's difficulties; the Government has tried to regulate prices by buying up supplies without any effective control over production. But the point will bear watching in the future, there is a steady tendency for an organization to start out simply to provide for orderly marketing of a product, and then to strive to perfect its organization so as to be able to cut down production.

Question

We are interested in securing raw materials. Will these controls affect our supply of materials?

Answer:

In some cases it might affect the price you would have to pay but is not likely to affect the quantity of supplies you would receive. Toward the close of the World War the War Trade Board had

10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

to make an agreement with the sisal monopoly for raw material for binding twine. The sisal monopoly quoted, if I recall correctly, twenty-three cents (23¢) as their price and the Board offered twelve (12¢). After a while an agreement was reached at nineteen and one-half cents (19½¢). It was just a case of concentration of control of the supply. The producers had the stuff and they had sufficient financial backing to wait until we decided to pay their price; the harvest was coming on and we had to have binding twine and had to pay the price they asked, or most of it.

Question.

If the control of these raw materials is passed from the individual to a government agency, a government political control, is that not likely to interfere with our getting these materials prior to the outbreak of war?

Answer.

There might be danger of that. So far, most of the controls are not directly operated by governments, or the operation is effected by an export duty or general regulation of that sort. Even in the potash cartel, where the whole thing is organized by law and the government has an ultimate control over nearly everything, it does not exercise immediate control over export prices and contracts. If the German Government, however, should consider it unwise to export potash at a particular time, I do not believe there would be any exported. Governmental controls raise the possibility that they would be afraid they would be involved in unneutral acts. As

long as trade is wholly in private hands, traders sell to any who will buy, but as governmental controls over raw materials approach more closely to direct possession and sale, the danger increases that international lawyers would hold the sale to constitute an unneutral act, the same as the sale of munitions.

Question:

Can you give us a little side light on the tendency of the tariff policy on imports here in the United States, taking for instance the idea of stimulating production of manganese with the object of bringing out the production here in the United States? Has there been any set policy in the past few years on this?

Answer.

There is no policy. There is a general tendency, however, when any group of producers think they have resources capable of development, for them to appear before the Congress appealing for an import duty. There is also a general tendency for the Congress, either by reason of its wisdom or otherwise, to enact statutes granting them protection.

The answer to the question whether this is a good policy depends primarily upon the state of domestic supplies. If there is a large quantity of a grade of ore below that which could be profitably used without a tariff, it might be wise, from a military standpoint, to put on a duty and begin operating that property so that there would be a developed source of supply in this country in the event of War.

As I understand the manganese situation, we have no such reserves of ore and there is nothing to be gained by putting on an import duty, the high duty we now have has not brought out those abundant sources of supply which, it was alleged, the country possessed.

Question:

Do you know the attitude of the steel people on this?

Answer.

They are very much opposed to the duty; but manufacturers or consumers do not ordinarily have sufficient influence to defeat proposed legislation for protective duties.