9-11-1975

What is Parity?

Arthur B. Sogn
South Dakota State University

Follow this and additional works at: http://openprairie.sdstate.edu/econ_comm

Part of the Agricultural and Resource Economics Commons, and the Regional Economics Commons

Recommended Citation
http://openprairie.sdstate.edu/econ_comm/75

This Newsletter is brought to you for free and open access by the Economics at Open PRAIRIE: Open Public Research Access Institutional Repository and Information Exchange. It has been accepted for inclusion in Economics Commentator by an authorized administrator of Open PRAIRIE: Open Public Research Access Institutional Repository and Information Exchange. For more information, please contact michael.biondo@sdstate.edu.
WHAT IS PARITY?

From time to time we are asked to explain parity, what it is and how it is determined in relation to agriculture prices. While there is no single description of parity, we will attempt at least a brief description of the concept.

In the very simplest of terms, "parity is a price comparison". However, to understand parity, two related indexes must be understood:

*The index of Prices received by farmers is a measure of the changes in average prices that farmers receive for what they sell.

*The index of Prices paid by farmers is a measure of changes in average prices paid by farmers for goods and services used for production and family living. It is made up of 80 or 90 items including clothing, household supplies, food, furniture and furnishings, building materials, automobiles, trucks and tractors, feed, farm machinery, fertilizer, equipment, gas, oil, tires, seed, taxes, interest, and farm wage rates.

OLD PARITY FORMULA

Parity Ratio then is the relationship of the two above indexes. The parity ratio measures the purchasing power of products sold by farmers in terms of things they buy compared with their purchasing power in the base period of 1910-1914. Parity for a specific time is computed by dividing the prices received index by the prices paid index. If the result is above 100, prices of products sold by farmers have more per unit purchasing power than during the base period.

What tends to make parity a little confusing is that two different systems are used to figure the parity ratio. Often times people will then quote the ratio figure that is most advantageous to their cause. The formula that we have described is the Old Formula.

NEW FORMULA

There is, since 1950, another formula known as the New Formula, and since 1965 this is the formula that is quoted by governmental agencies. Again in the simplest of explanations, the New Formula is calculated exactly as is the old formula except the New Formula takes into consideration the prices for the last 10-year period as well as the 1910-14 base period. The New Formula is now by far the most commonly used and is considered by most to be most relative under modern conditions. It is important to note the New Formula does not discard the 1910-14 base period. It rather adjusts it by using the relationship of the past 10 years along with the old base.

Again let us state the above explanation of parity is simplified and the actual computation is more complicated than the above description. However, in attempting to answer some of the questions we receive, people do not want to know how to calculate parity in detail. They want to know in general terms how it is determined.

USES OF RATIO

Parity can be used to decide how farmers as an average are doing based
on what they sell as it relates to what they buy; or Parity can be applied to income so as to provide a farmer with the relationship of his level of living compared to other occupations; or Parity can be applied to a single agriculture commodity to see how it compares in its relationship with parity and with other commodities. This is why you see the parity ratio for corn, wheat, soybeans, cattle, hogs, or it may be for vegetables -- singly or as a group. The parity is also calculated for tobacco, fruits, nuts, seeds, poultry, honey and countless other commodities.

PERCENT OF PARITY

One additional step in the parity ratio consideration is the percent of parity calculation. The percent of parity is one of the more common quotations used by our Congressmen and farm leaders. This comparison is after the current parity relationship is determined, then an additional calculation is made to determine what percent of 100 percent of parity the commodity is. Thus, the quotation that a commodity is 85 percent of parity.

THE REAL SIGNIFICANCE

Farmers and agricultural leaders have long known that high or low farm prices are not in themselves of any great significance. Of more importance is what farm products will buy in things needed for living and farm production. Hopefully, this general explanation of parity will help in understanding the price relationship parity has to which the ratios relate.

Arthur B. Sogn, Extension and Research Economist