noted, the word cost will refer to the combination of labor cost and indirect taxes and will *not* include gross business income. Using the word cost in this sense, we may say that prices are determined by the interaction of demand and cost, with gross business income being the residual.[9] Given demand and cost behavior, we will consider whether this balancing item, gross business income, has behaved as expected. More specifically, we will assume the goal of profit maximization, formulate hypotheses about the behavior of prices under various conditions of costs and demands, and examine the data to see if they are consistent with the behavior predicted by the hypothesis. In order to formulate specific hypothesis, capable of being tested by the data available, we will be forced to make certain simplifying assumptions, and in some cases to employ rough and ready techniques for evaluating the data where more precise measurements are impossible. Wherever possible, we will discuss, qualitatively at least, the implications of our departure from the theoretically desirable refinements and measurements.

Regarding costs, we assume initially, that in each industry the direction of relative changes in costs is given by the direction of relative changes in unit labor costs. This assumption will be relaxed at a later point insofar as indirect taxes are concerned.

Changes in demand as has been noted above, are assumed to be given. There is the problem, however, of measuring changes in demand. The term demand is employed here in the sense common to economic usage, i. e., the complete schedule of amounts that buyers are willing to purchase at all possible prices, and not merely the amount exchanged at the going market prices. Thus an increase in demand refers to a shift of the entire schedule, and means, in general, that buyers are willing to purchase more at all possible prices than they were before the shift. We have no precise measures of demand in this sense. Nevertheless, we can classify most industries on the basis of whether their demand rose by more or less than the average for all industries. If, for example, both the price and the output of a particular industry rose by more than average, there is good reason to believe (although there is no certainty) that demand rose by more than average. Similarly, a less than average rise in both price and output indicates a less than average rise in demand. Where less than average increases in output are accompanied by more than average increases in price, or vice versa, it is more difficult to classify the the increase in demand. In general, however, an inspection of the relative magnitudes involved will allow us to classify a demand change as greater or less than average.

There is an assumption in this procedure which should be made explicit. The price which is relevant for investigating changes in demand is the market price, whereas we are using the price of value added in each industry. The two prices will differ when there is a divergence between the movement of raw materials prices and that of value added prices. Since we are mainly interested in *relative* price and cost movements, our analysis is weakened to the extent that the relative movements of prices of raw materials among industries differs significantly from the relative movement of value added prices. A

[9] This should not be taken to deny that in the long run at least, some part of gross business income becomes a cost.