

degree of market power exercised by private groups also may affect the sensitivity of markets to current and prospective demands. If monopoly power were widespread, it could have an influence on the effectiveness of both monetary and fiscal policies in pursuing their goals.

NATURE OF COST-PUSH AND DEMAND-SHIFT EXPLANATIONS

Controversy over causes of postwar inflation has focused mainly on developments since 1954. On the causes and nature of the episodes of inflation in the earlier postwar years, there appears to be widespread agreement. World War II left a legacy of accumulated demands for goods of all kinds, and methods employed in financing the war resulted in highly liquid financial positions. When wartime price controls were removed, effective demands at current prices were considerably in excess of supplies in virtually every market.

When the Korean War began in mid-1950, memories of war-induced shortages and price increases provoked protective buying by consumers and businesses, here and abroad. In both periods of inflation, costs as well as prices rose and there were large shifts in the composition of demands, but the influence of strong demands in originating and sustaining price advances was by far the predominant one.

In the 1954-57 inflation, demands were not strong in all markets simultaneously, and the advance in prices was moderate in comparison with the war-related experiences. In view of these circumstances, several interpretations of the period since 1954 have emphasized the independent nature of costs. Another interpretation has stressed rapid changes in the composition of demands. What is common to these interpretations is that they have attributed primary importance to rigidities or to autonomous elements in markets for goods and services and have given little or no weight to the role of aggregate demands. From these theses, further interpretation is drawn that use of general instruments of restraint on aggregate demands in order to check such price increases would be ineffective or would incur unacceptable social costs in terms of unemployment of human and material resources.

The "cost-push" approach to the explanation of price inflation seems fundamentally to assume that costs are more or less independently determined by market power and, therefore, little can be done about them. Prices are set by administrative decisions to cover all costs, including a satisfactory margin of profit, without regard to current or prospective demand conditions. Production is scheduled to conform to sales at these prices.

In such circumstances, it is said, Government policies—monetary and/or fiscal—must operate to provide demand sufficient to assure maximum output and full employment at the wages that are the result of labor-management agreements and at the prices businessmen—and, sometimes, public agencies—deem necessary. Otherwise, output and employment will be held or reduced below attainable levels, but there will be no appreciable restraint on advances in price levels and labor or other costs.

In practice, however, the extent to which the price of a product can be raised is limited by actual or potential competition from other products or from imports; these checks are strengthened by Government policies that operate to restrain demands and prevent ebullient expectations from developing. Competitive constraints on prices strengthen resistance to increases in costs and at times may exert downward pressures as businessmen attempt to maintain or increase profit margins. The influence on costs may take such forms as programs to raise productivity, various efforts to economize on the use of materials, control of administrative and other types of salaried employment, or resistance to increases in wage rates and fringe benefits.

The "demand-shift" explanation of the type of inflation experienced in the 1954-57 business expansion rests on a combination of factors. Inflation, it is said, originates in the general excess demands which temporarily emerge as the economy passes from recession to full employment, and from the excess demands in specific sectors that often remain after the aggregate excess has been eliminated. Inflation is perpetuated and spread throughout the economy, the argument proceeds, by the influence of costs in wage and price determination and by the relative insensitivity of prices and costs to decreases in demands.

In this view, particularly as it relates to the 1954-57 business expansion, demands increase and full employment is reached without generating upward price and cost pressures. Then, a rapid shift in the composition of demands is reflected in excess demands in some sectors and insufficient demands in others.