

Because prices are more sensitive to increases than to contractions in demands, a general rise results as prices advance in those sectors where demands are increasing rapidly and decline by smaller amounts or not at all in those sectors where demands are decreasing. General monetary and fiscal policies appropriate to combat an inflation arising out of excess aggregate demand are not suitable, it is contended, to combat an inflation arising out of excess demands in particular sectors of the economy.

The composition of demands relative to the composition of available resources has an important bearing on developments in business expansions. The problems of inflationary pressures, however, are likely to arise well before demands and output reach the limits of capacity, partly because the use of marginal production facilities raises costs. Problems of inflation certainly arise before output reaches capacity in all major sectors because resources are not highly mobile. In 1955 and 1956, for example, output was well below capacity in the basic textile industries but very close to capacity in the basic metals industries. As E. A. Goldenweiser wrote in 1941:

"It should be mentioned * * * that there is no clear-cut line at which an increasing number of bottleneck advances in prices passes over into a general inflation. The development of a number of bottlenecks in many leading commodities may be the introductory phase of a general inflation. It can occur long before the entire country is operating at full capacity, because neither plant capacity nor labor supply is completely mobile. The existence of unused capacity in some industries may not prevent great shortages of capacity in others, and the presence of large numbers of unskilled workers without jobs may not prevent grave shortages in many skilled lines. So long as these instances of shortages are scattered and relatively few the situation is not properly described as inflation and can be handled by nonmonetary remedies. But it may become general long before full capacity is achieved. It should be kept in mind that it is the available supply of goods and not the theoretically possible supply that must meet a growing demand in order to prevent inflation."¹

The demand-shift approach treats the milder, peacetime inflations of the sort experienced in 1954-57 as something different in kind from the type often associated with wars, whereas the difference appears rather to be one of degree. The immobility of resources is more obvious in the former cases, but it is not confined to them. In the more severe inflations, immobility of resources also limits shifts to areas of strongest demands, but its existence and influence are concealed by the general excess of demands.

In an economy with high and rising standards of living and many other features fostering change, demands are not likely to expand in such a way that their composition is always in balance with the location and types of existing plant and other resources. In business expansions, imbalances are likely to exist, and they are not likely to be precisely the same from one expansion to the next. Such imbalances operate to attract the newly available resources (and savings) into the sectors of strongest demand pressures.

PATTERNS OF PRICE AND COST CHANGES IN BUSINESS FLUCTUATIONS

Prices are determined by the interaction of a number of factors functioning continuously in many different types of markets, and there is an unending process of market adaptation to changes in the various factors. While business fluctuations differ from one another in important respects, they all have features in common with regard to the interactions of demands, output, costs, prices, and profits. Reviewing the process of change during postwar business expansions and contractions in this country, certain relationships and patterns of behavior are discernible.

Periods of expansion

Early in expansions of business activity, prices usually are rising in markets for "sensitive" industrial materials—that is, the materials whose prices are most responsive to short-run changes in demand. For rubber, hides, and some other sensitive materials, world production cannot be increased much (if at all) in the short run in response to rising demands. As a result, increases in demands are rather promptly reflected in price advances and may alter the international flows of commodities.

¹ E. A. Goldenweiser, "Inflation," *Federal Reserve Bulletin*, April 1941, p. 292.