

in order to raise demands and output in those industries where capacity is not being intensively utilized would intensify demand pressures on those industries where output is already close enough to capacity to result in rising costs and higher prices. Consequently, while a higher level of aggregate demand might increase total output somewhat, it would also accentuate upward pressures of demand on prices.

An additional and important aspect of these developments and relationships is that an expansion of capital outlays is likely to be stimulated well in advance of full utilization of plant capacity. Business enterprises always have some capital replacement needs, and additional capital expenditures in most cases reduce costs or increase sales potentials. Incentives to undertake new commitments for expansion as well as for replacement are intensified if business managers expect higher levels of demand for their products from both secular growth and cyclical expansion. Since it ordinarily takes many months before new facilities can be acquired and efficiently integrated into the production process, business managers must plan expenditures to increase capacity well before output reaches the limits of their ability to produce.

Among the elements of cost, attention in recent years has been focused on changes in labor costs, partly because wage rates have risen persistently and labor costs are an important part of total variable costs. In major industries, where changes in wage rates tend to be industry-wide, such changes occur at a particular moment in time and they usually are widely publicized. On the other hand, changes in productivity, which operate in the direction of offsetting the effect of wage rate increases on labor costs per unit of output, occur over a period of time. Also, the advances are likely to vary considerably from plant to plant and from one producer to another.

For many industries, average measures of productivity show more cyclical variability than wage rates, rising in the early stages of expansion, leveling off as output approaches capacity, and declining in the early stages of recession. This pattern of change is probably accentuated by the short duration of the business fluctuations of postwar experience. Many new facilities are put in place late in expansion—or in the early months of recession—and there is some time lag between installation and their efficient operation. When there is such a lag, the resulting productivity gains may appear late in recession and early in expansion.

Partly for this reason, unit labor costs tend to decline in the early stages of expansion when productivity gains generally exceed increases in wages. As expansion develops, unit costs turn up because productivity advance slows and the rise in wages continues and possibly accelerates. In recession also, unit labor costs typically rise in certain industries as output per manhour declines.

Meanwhile, capital consumption and other relatively fixed costs—by definition—do not vary with the level of output. On a per unit of output basis, therefore, they show an inverse correlation with output, decreasing when output is rising and increasing when output is falling.

Cyclical variations in costs per unit of output, which result in considerable part from swings in production, are not accompanied by similar variations in prices. Consequently, profit margins fluctuate more widely than labor and other costs per unit of output, generally moving in the opposite direction. In the early stages of expansion, profit margins rise sharply; in later stages, they level off or decline; in recession, they decline decidedly.

The preceding review of price and cost influences indicates that in early stages of economic expansion, production and employment are likely to advance without generating widespread price and cost pressures. While wage rates and prices of certain materials increase, margins of profits over costs widen and are likely to approach their cyclical peaks. After expansion has progressed for a time, however, upward price and cost pressures build up, primarily because output in some industries has reached high levels in relation to capacity and unemployment has been reduced. As described earlier, less efficient plant facilities must be used and productivity advance slows or is reversed. At the same time, reduced unemployment and enlarged profit margins intensify pressures for increases in employee compensation.

With demands strong and output in some industries already at high levels in relation to capacity, the subsequent behavior of prices and costs is strongly influenced by the rate at which over-all activity has been expanding and by expectations. If the pace of expansion has been moderate, competitive conditions are maintained within most industries, between industries serving