

common markets, and between domestic goods and goods produced abroad. In these circumstances, increases in prices and costs are likely to be confined to a relatively few markets and are unlikely to be very large.

On the other hand, if demands have been expanding rapidly and assessments of prospects are highly optimistic, increases in wage rates and fringe benefits are likely to be large and price advances extensive. Increases in wages will be propagated throughout industry and may directly cause further expansion in demands for goods and services. Price advances may indirectly contribute to expanding demands by generating expectations of additional advances.

Increases in the price indexes will further contribute to cost increases through escalator provisions of labor, rent, and other contracts. Some State and local taxes and fees may be raised to cover the rising costs of current services and higher costs of school, highway and other construction. These taxes are also reflected in the consumer price index used for escalation purposes. And thus an interacting inflationary process of demands, prices, and costs can get in full operation.

Implicit in this description of price behavior for industrial commodities is the fact that relatively few markets conform to an ideal competitive model. In the competitive model, prices are determined by the interaction of buyers' bids and sellers' asking prices in the market; the individual seller has no significant influence on total supply and therefore has no discretion except with regard to his acceptance or rejection of the going price or how much he will supply at that price. This type of market behavior is approached most closely in markets for livestock, some other agricultural commodities, and the industrial materials earlier described as sensitive.

Markets for industrial commodities, on the contrary, are generally characterized by "imperfect" or "monopolistic" competition. Prices in these markets often are described as "administered." In such industries, a producer must make decisions regarding the pricing of the product—including all the price-related decisions associated with quality, design, and selling techniques. These pricing decisions are based on judgments of what sales would be at different levels of prices, on calculations of what costs per unit would be at various levels of production, and on the behavior of competing producers and products. Thus pricing decisions take into account, in addition to demand, the range of forces affecting production and costs, just as sales, production, and costs are influenced by pricing decisions. Producers must attempt to find a price that is in harmony with all the relevant short- and long-term demand and cost considerations, but without knowing precisely what will most effectively accomplish this aim.

The fact that prices are set by the decisions of producers implies a degree of market power—stemming from the nature of the product and the nature of the production process—but it does not connote full monopoly power. On the contrary, market forces—including competition within the industry and from other domestic or foreign products or alternative sources of satisfaction—are constantly working to alter past price decisions.

Rates for utilities, freight, public transportation, insurance, and postage are also administered prices, as are rates for many other business and consumer services. Both the cost and demand conditions encountered in the service industries vary widely. Some services are produced under conditions affording opportunities for basic technological improvement and productivity advance while for others such opportunities are limited. Some are primarily labor while others have a higher commodity content. Prices of some services are very responsive to local labor market and related economic conditions while others are subject more to nationwide forces. Some are regulated by public commissions and still others are stipulated fees for public services. In particular instances, service prices follow trends in wage rates fairly closely.

The result of most of these influences is that inflationary pressures in the economy are transmitted to services via increases in costs. For the regulated prices, advances may lag considerably behind the initiating causes and may occur in many instances even after business expansion has given way to recession.

Periods of recession

During contractions in demands and activity, changes in prices and costs and in relationship between them are determined mainly by the duration of the contraction and by developments in the preceding expansion. In a prolonged and severe depression, accompanied by distress sales and substantial decreases in prices of existing assets, strong downward pressures develop on