

prices of currently produced goods and on wage rates and other elements of production costs. Since a contraction of this severity has not occurred since World War II, attention may be confined to the milder recessions experienced since then.

In recession, prices of sensitive industrial materials generally decline. Contraction in domestic demands and decreases in prices may reduce domestic supply by altering international commodity flows and/or by making marginal operations unprofitable. For the nonsensitive materials, analysis is complicated by the tendency of producers to change prices by varying concessions and discounts from unchanged list prices. While it is known that net or actual prices fluctuate more widely than list prices, little information is available to show the degree of change in actual prices.

List prices tend to be maintained in the early stages of contraction and if the recession proves to be brief, recovery in activity begins before many list-price cuts have been made. When it becomes clear that demands are reviving, the list price for a product on occasion is lowered to conform to actual transactions prices—because the operation of new facilities or some other development causes demand-cost relationships to be fundamentally different from those on which producers had been basing their decisions.

In describing the behavior of nonsensitive materials during business expansion, it was emphasized that producers' price decisions are based largely on calculations of costs at various possible levels of output as well as on judgments about demand. When demands contract and production is reduced, many elements of costs do not decline. Wage rates, for example, are maintained—or may actually increase in some lines owing to the terms of long-run labor agreements. The tendency of wage rates to be maintained was characteristic also of the mild recessions of prewar years.

Even in an administered price market, individual producers, faced with declining demands, have an incentive to reduce prices in order to increase sales, if they think competing producers will not also reduce prices. This goes far to explain the preference of producers for unpublicized price cuts—for price cuts brought about through concessions rather than through reductions in list prices. In certain situations, however, there may be incentives to publicize price reductions by cutting list prices: a cyclical contraction in demand for a particular material may be accompanied by competition from a new and lower cost source of supply or a new substitute material, or it may be accompanied by a change in the methods of production that appreciably reduces costs.

The recession behavior of manufacturers' prices of most finished industrial products is similar to that of the nonsensitive materials. To the extent that prices of materials decline, however, downward pressures on prices of finished goods are intensified. Prices of services tend to resist forces of decline in recession. In many cases, they rise further because of the increases authorized by regulatory agencies on the basis of earlier increases in costs, but the rate of rise in average prices of services slows down.

To summarize, prices of many sensitive materials typically decline in recession. These commodities have little weight in broad price indexes, however, and their influence currently is much less than in the indexes available for prewar years. Declines in prices of some other commodities are likely to be concealed in concessions from stable list prices. Still other prices, however, may resist any downward adjustment to declines in aggregate demand in moderate recessions.

If the previous expansion was accompanied by inflationary developments and appreciable increases in levels of prices, the increases are not likely to be fully erased during mild business recessions, giving rise to what has been called the "ratchet effect." If, however, price increases in the previous expansion were small, they may be subsequently offset as the competitive pressures that develop during recession, domestic and foreign, strengthen incentives to cut costs and to reflect these reductions in the form of lower prices. This emphasizes the importance of containing growth in credit and in demands for goods and services during periods of economic expansion and of preventing a climate of expectations conducive to large and widespread advances in prices and costs.

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The interpretations of the functioning of the market system which have led to skepticism about the efficacy of general measures of public policy have been supported almost exclusively by analyses of the 1954-57 business expansion. A