(iii) *Prices Unresponsive to Excess Capacity.*

We have now, in effect, moved on to the second of the alternative situations that we proposed to analyse. We have been assuming that, in the absence of a price agreement, active competition would cause prices to be flexible and to fall in response to excess capacity. Now we assume that the producers, chiefly because they are less numerous, succeed in maintaining stable prices in the face of a changing balance between demand and capacity. This of course is the situation in the generality of manufacturing industry. When the demand for cars suffers temporary decline, their prices do not fall to the level of variable costs; the total burden of adjustment is usually met by a fall in output. For adjustment to take this form, there is no need for manufacturers to make an agreement; each of them takes it for granted that price reductions would without delay be noted and matched by competitors with the result (given the prevailing elasticity of demand for cars) that all would stand to lose. The circumstances of the markets for heavy electrical equipment, however, are vastly different. The size of individual orders relative to a firm's turnover puts management under very strong pressure to cut prices in order to be sure of getting work. Where the largest and most advanced types of equipment are concerned, to miss an order does not only produce unemployment of men and machines; it may also cause firms to fall out of the race in technical development. In order to be able to tender for the most advanced type of equipment, firms require experience to draw upon and this experience cannot be acquired if they fail to get orders. The willingness of firms to cut prices at the risk of 'spoiling the market' would also be influenced by the fact that competitive prices, instead of being 'posted' as with cars, would be quoted in closed bids. Firms would not normally know what prices their rivals were quoting and might be tempted to reduce their quotations substantially in order to make sure that they were not undercut. It is of course open to firms to exchange information about prices at which contracts have actually been placed, so that it would be possible for them to know, after the event, whether rivals were in fact reducing their bids below some normal level. This arrangement might go some way in inhibiting firms, eager to increase their share of a fixed market, from starting a price war.

These considerations suggest that price stability, based on the wish not to spoil the market, is possible but by no means assured in the circumstances we are considering. Let us now ask whether it would be in the public interest.

If prices can be maintained, in the face of temporary falls in demand, then producers certainly enjoy a more stable prospect than they would have otherwise and will be more willing to create facilities large enough to meet their customer's peak requirements in the knowledge that the associated excess capacity, in normal times, will not bring them heavy losses. Only very grudging recognition, if any, is usually given, in this context, to the benefits that society as a whole can derive from a more predictable business environment. If the context is economic planning, and the need for a more stable rate of investment, then most people are prepared to see virtue in arrangements that enable firms better to insulate their expansion plans from short-run fluctuations in the balance between demand and capacity. But there is a strange reluctance to perceive