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nessmen merely reacted passively to the actions of consumers or actively shared the expectations of consumers, the end result was the same: a sharp increase in demand on all market levels during the buying waves and inventory accumulation by businessmen as well as consumers.

Thus forward buying shaped the character of the inflationary phase of the Korean expansion. Two associated expectations doubtless influenced consumers and businessmen: the fear that shortages would develop as a consequence of formal or informal rationing and the belief that prices would increase. Such expectations may develop from time to time in the market for a particular product as a result of special conditions which affect that market alone. When many groups hold such expectations at the same time, affecting many markets, the short-period potential for inflation is great. That was the situation in the last half of 1950. The volume of demand generated by the forward buying was itself sufficient to create *temporary* shortages at existing prices, and as a result prices advanced rapidly. As it turned out, serious shortages of consumer goods did not develop in 1951. However, this might have happened if consumers and businessmen had not accumulated stocks in 1950 and early 1951, since the government substantially increased its claim on the nation's resources in 1951.

The Deflationary Phase: 1951

A remarkable transformation of the character of the expansion occurred during 1951. The rise in gross national product had been vigorous during the inflationary phase; in 1951 it was moderate. Rising prices accompanied rising production up to the first quarter of 1951; falling wholesale prices and stable industrial production were the dominant trends through the remainder of the year. Increasing activity characterized most sectors of the economy until the early months of 1951, after which activity diminished in many sectors.

This last point deserves amplification. In general, industries related to defense experienced an expansion of activity, while other industries experienced a contraction. These tendencies may be demonstrated in a variety of ways. A large volume of defense orders is placed with durable goods industries—and the production of durable manufactures fluctuated within narrow limits in 1951 (Chart 2). The bulk of the products of the nondurable goods industries move into consumption—and the decline in the production of nondurable manufactures in the last half of 1951 carried the index below the level of the third quarter of 1950. Real expenditures on consumer durables declined 14 per cent between 1950 and 1951.[7] Total consumer expenditures, uncorrected for price changes, declined sharply in the second quarter of 1951, and remained below the first-quarter rate through the rest of the year (Chart 5).

The decline in consumer spending had important consequences that quickly affected aggregate economic activity. As 1951 opened, the production of consumer goods was geared to high and rising sales of final products, as a result of the forward buying induced by the developments in Korea. As retail sales began to decline in February, retail stocks increased; by May they were 11 per cent above the January level, whereas sales had fallen 7 per cent in the same interval (Chart 7). After May, retail sales leveled off and retailers restricted their purchases, so that stocks were drastically reduced by the end of the year. The same pattern of accumulation of stocks in the first half and liquidation in the second half of the year prevailed in the wholesale sector. In contrast, manufacturers' stocks grew throughout the year, despite the fact that sales fell off in the last six months. The increase in manufacturers' stocks was the result of increasing activity in defense industries, which more than offset the reduced activity in consumer goods industries.[8] The net result of these various trends was an increase in inventory investment in the second quarter of 1951, followed by a decline in the third and fourth quarters (Chart 6).

The decrease in inventory investment in the last half of 1951 was

[7] *Survey of Current Business*, July 1953, Table A.

[8] Ninety per cent of the increase in manufacturers' stocks between June and December took place in the durable goods industries. Such consumer goods industries as furniture and fixtures, food and kindred products, beverages, textile mill products, and leather products reduced their inventories in the second half of the year.

not offset by a rise in fixed investment. Fixed investment expenditures were closely controlled by government policy during 1951. Private construction expenditures declined after the first quarter, but expenditures on producer durable goods remained virtually unchanged throughout the year. The decline in private construction was confined entirely to residential building; other private construction increased. Public defense construction increased very substantially.[9] Expenditures on new plant and equipment by every major industry group expanded between 1950 and 1951, but after mid-1951 only the defense industries were increasing their capital outlays.[10] The capital-expansion programs of the consumer goods industries were discouraged by materials allocations and by the softening of consumer demand. Fixed investment in the defense industries was encouraged directly by federal aid and indirectly by the continued high level of activity that characterized those industries throughout the year.

It is easy to understand the expansion of activity in the defense industries during 1951. The requirements of the defense program dictated reductions in the output of consumer durable goods and in the volume of residential construction, and these reductions were implemented by various controls. But what factor or combination of factors was responsible for the decline in consumer spending after the first month or two of the year—the decline which in turn reacted on inventory investment and fixed investment in the consumer goods sector? It was that development which, by reducing the demand for resources in the private sector, permitted the transfer of resources to the government sector without exerting a strong upward pressure on prices.

Supply of Consumer Goods in 1951

In contrast with 1942–1945, the decline in consumer expenditures after the first quarter of 1951 was not forced by a shortage of consumer goods. True, price controls were in effect, and restrictions on materials did require reductions in the output of important classes of consumer durable goods. However, at the very time that

[9] *Survey of Current Business*, July 1953, Table 31.
[10] *Ibid.*, June 1952, Table 2.

these restrictions began to limit the output of consumer durables —that is, in the second quarter of 1951—the demand for such goods eased off, following the buying waves of the inflationary phase. Sales of retail stores as a percentage of disposable personal income were shown by quarters for 1950–1951 in Table 1. The sharp rise in the retail sales of durable goods relative to income during the second buying wave was followed by a continuous decline through the remainder of 1951. Especially noteworthy is the demand trend in the dominant automotive group.

The demand for nondurable goods also eased early in 1951. Expenditures for nondurables were relatively stable in 1951 (Chart 5), but this over-all stability was the net result of opposing movements of several of the major classes of nondurable goods. Apparel and general merchandise stores experienced the greatest decline in sales relative to income, while the sales of food stores and eating and drinking places were well maintained. More generally, sales of semidurable goods declined as expenditures for perishables—primarily food—increased. The decline in the sales of semidurables cannot be explained in terms of a physical shortage of resources for the production of such goods.

The most convincing evidence that the decline in consumer spending was voluntary is provided by the ratio of stocks to sales in retail stores (Chart 9). The over-all ratio for all retail stores was far above the pre-Korea level at the time when sales began to decline in early 1951. Even at the end of 1951, after the drastic reduction in retail stocks which took place during the last half of the year, the stock-sales ratio was considerably higher than it had been at the end of 1949 or before the outbreak of hostilities in June 1950.[11] Thus goods were available in 1951; the reasons for the decline in consumer spending must be sought elsewhere.

Household Stocks, Liquid Asset Holdings, and Changed Expectations

A forward buying movement is intrinsically a short-period phenomenon. The consumer who purchases a car, refrigerator, or new

[11] The over-all ratio does not conceal a shortage of durable goods—the statements in the text also apply to the ratio for durable goods stores alone.

suit a few months earlier than he intended is not likely to purchase another for some time to come, and the housewife who accumulates a stock of sugar or coffee is not apt to lay in more than a six-month supply. Furthermore, the purchase of expensive commodities either reduces liquid-asset holdings or requires the assumption of new debt. According to estimates prepared by the Securities and Exchange Commission,[12] liquid saving by individuals decreased from $2.9 billion in 1949 to $1.5 billion in 1950 (virtually all of it saved during the fourth-quarter buying lull) as disposable income increased $19 billion.[13] This low rate of aggregate liquid saving must reflect dissaving by many individuals and smaller than customary saving on the part of others.[14] Other things being equal, both the increase in household stocks and the growing desire to replenish liquid-asset holdings or to retire debt would tend to reduce consumer expenditures relative to current income after a buying wave had been under way for a few months.[15] Perhaps these factors are sufficient to explain the downturn in retail sales after January. On the other hand, forward buying might well have persisted for a time had consumers continued to anticipate future shortages. There can be little doubt, however, that a new change of expectations removed the positive incentive to forward

12 *Statistical Series, Release No. 1077,* April 17, 1952. Liquid saving is defined there as "saving in the form of currency and bank deposits, equity in savings and loan associations, private and government insurance, securities, and repayment of mortgage debt and other consumer debt." Liquid saving is therefore net of any increase in consumer debt, which rose by $2.3 billion in 1949, $3.2 billion in 1950, and $0.4 billion in 1951.

13 In contrast, liquid saving increased to $13 billion in 1951 as disposable income again rose $19 billion. Virtually none of the saving occurred during the first-quarter buying wave.

14 According to the *1951 Survey of Consumer Finances,* there was a decline in large holdings ($2,000 or more) of liquid assets during 1950 and "a substantial increase from the previous year in the proportion of consumers that reported using large amounts [$500 or more] of liquid assets for purchases of durable goods." Furthermore, although the over-all frequency of dissaving declined in 1950, "consumers with incomes of $3000 or more dissaved more frequently in 1950 than in 1949." *1951 Survey of Consumer Finances,* Part I, "The Economic Outlook and Liquid Asset Position of Consumers," *Federal Reserve Bulletin,* June 1951, pp. 627–644.

15 If income were growing rapidly, the reduction in expenditures relative to income might be reflected in a retardation in the rate of growth of consumer expenditures rather than in an absolute decline. However, disposable income was growing slowly in 1951, and expenditures declined as saving increased (see below, pp. 31–32 and 46–51).

buying after the first few weeks of the year, although the precise nature of the factors responsible for the change is somewhat obscure.

The decline in retail sales began immediately after the general price freeze was announced on January 26, 1951. Insofar as the forward buying of consumers had been for the purpose of anticipating price advances, the establishment of price controls may have removed one incentive for additional buying. However, one of the facts most clearly established by the *1951 Survey of Consumer Finances* was that a substantial majority of consumers expected price increases during 1951, and that very few expected price declines. Furthermore, the survey, which was conducted in January and February, stated, "Imposition of price controls at the end of January 1951 had little immediate effect on consumer price expectations; opinions expressed in interviews taken before and after the date that controls went into effect showed no difference on this point." [16]

At about the same time that the price freeze was announced, it became apparent that retail stores were well stocked with goods. Since businessmen as well as consumers had purchased heavily in late 1950, and since the defense program had not interfered seriously with civilian production, an increased flow of goods matched the increase in final demand, and the anticipated shortages did not develop. This concrete evidence of a plentiful supply of goods was probably the most important reason for the shift in consumer expectations. However, it does not follow that changed price expectations played no part.

The major findings on the state of price expectations reported in the *1951 Survey of Consumer Finances* were summarized as follows: [17]

> Consumers were more generally agreed on the trend of prices in the coming year than at the time of any previous postwar survey. Approximately 7 of every 10 spending units thought that prices would rise. Very few believed that prices would fall. Despite the belief that prices would not fall, about one-half of all consumers said that this was a bad time to buy durable goods, principally

16 *Loc. cit.*
17 *Ibid.*, p. 628.

because prices were too high. About one-third of all consumers thought that this was a good time to buy, before prices went higher or shortages developed.

Why should consumers wish to defer purchases of durable goods because prices were "too high" if at the same time they expected prices to rise further? The last sentence in the quotation suggests an answer which is consistent with all the findings. Apparently only a minority of consumers expected shortages to develop, and it may therefore be inferred that only a minority expected *rapidly* advancing prices. Although consumers were asked to express an opinion about the probable trend of prices during 1951, they were not questioned on the magnitude of the change they expected. Even if people did not believe that price controls would stop the inflation, they surely believed that the controls would slow the rate of advance. But if this were the case, the penalty for postponed buying would not be severe, and there was no urgent reason to buy immediately—after all, goods *were* plentiful at current prices. Under the circumstances, some retrenchment from the abnormal rates of expenditure of recent months was desirable, and consumers acted accordingly.

Government Expenditures and Government Controls

In the most general terms, a mobilization program will promote an expansion in production, prices, or both if it results in an increase in spending on newly produced goods and services. How might that result come about? It is convenient to classify the possibilities under three headings:

1. The direct effects of increased defense expenditures. These include both government expenditures and the fraction of private investment that is intimately tied to defense production.
2. Increased expenditures induced by income growth.
3. Increased expenditures induced by changes in expectations that are independent of income growth.

A factor will be described as inflationary if it leads to an increase in total spending. The question of the relative changes in produc-