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cent of the civilian labor force was unemployed at the time of the outbreak of hostilities in Korea; by early 1951 the ratio had dropped to 3 per cent—a low figure by peacetime standards—and remained at that level through 1951, as employment was virtually unchanged (Chart 3).

These facts are sufficient to explain why a much larger increase in real gross national product was possible in 1940–1941 than in 1950–1951. But why were inflationary pressures strong in 1941, despite large-scale unemployment, and weak in 1951, when the economy was operating at a high employment level? Part of this question has already been answered: it was the relaxation of consumer demand that permitted the transfer of resources to the government sector without serious inflationary consequences in 1951. Conversely, supply forces were in part responsible for the inflation of 1941, as will be shown presently. Serious shortages of resources existed in the latter part of 1941, notwithstanding the fact that a large fraction of the labor force was still unemployed.

Forward Buying in World War II

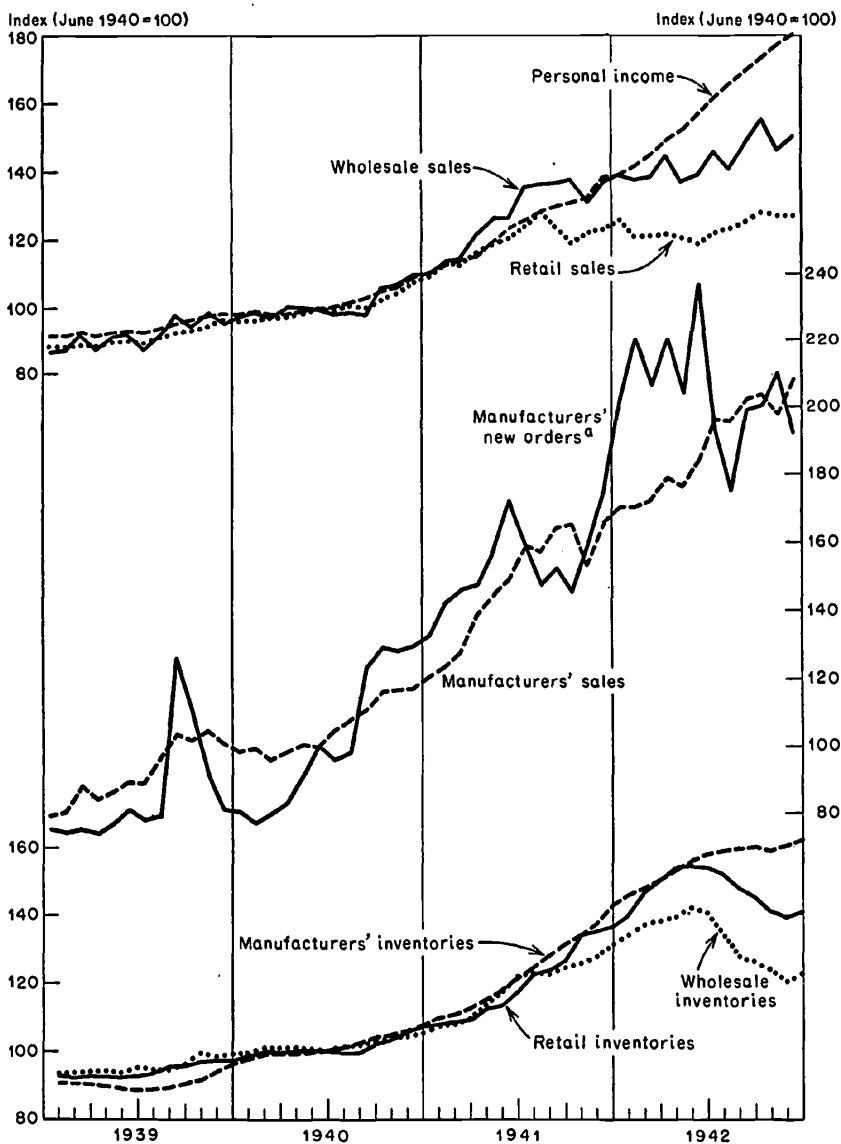
The buying waves of late 1939 had a historical precedent. Both production and prices increased after the invasion of Poland on September 3, 1939. The rise of industrial production and prices was rapid but short-lived (Charts 13 and 15). Note that wholesale prices advanced sharply in September and remained steady through the remainder of the year. Industrial production, on the other hand, continued to increase throughout the last quarter of 1939, before declining through the first four months of 1940.

Forward buying by businessmen was responsible for this surge of activity. Manufacturers' new orders and the sales of manufacturers and wholesalers increased sharply in September as buyers reacted to the coming of the war (Chart 16). Much of this increase in the value of sales must be attributed to the abrupt rise of wholesale prices during the month. The sales of manufacturers and wholesalers then dipped slightly in October and rose once again in November, as prices remained stable.

An increase in personal income accompanied the increase in

CHART 16

INDEXES OF PERSONAL INCOME, RETAIL, WHOLESALE, AND MANUFACTURERS' SALES AND INVENTORIES, AND MANUFACTURERS' NEW ORDERS, SEASONALLY ADJUSTED, MONTHLY, 1939-1942



^a Unadjusted for seasonal variations.

Source: Personal income, *National Income Supplement, 1951, Survey of Current Business*. Manufacturers' new orders, *Survey of Current Business, Annual Supplement, 1942*. All other series by release from the Department of Commerce, Office of Business Economics. Conversion to June 1940 base by the author.

production, and the growth of income induced a growth of retail sales (Chart 16). However, there was no advance buying on the part of consumers; the personal saving ratio rose sharply in the fourth quarter of 1939 (Chart 20). Under the circumstances, retailers were proceeding cautiously. Although retail inventories increased moderately in the last three months of the year, the inventory-retail sales ratio fell steadily (Chart 17). Wholesalers also acted to prevent an accumulation of stocks relative to sales.

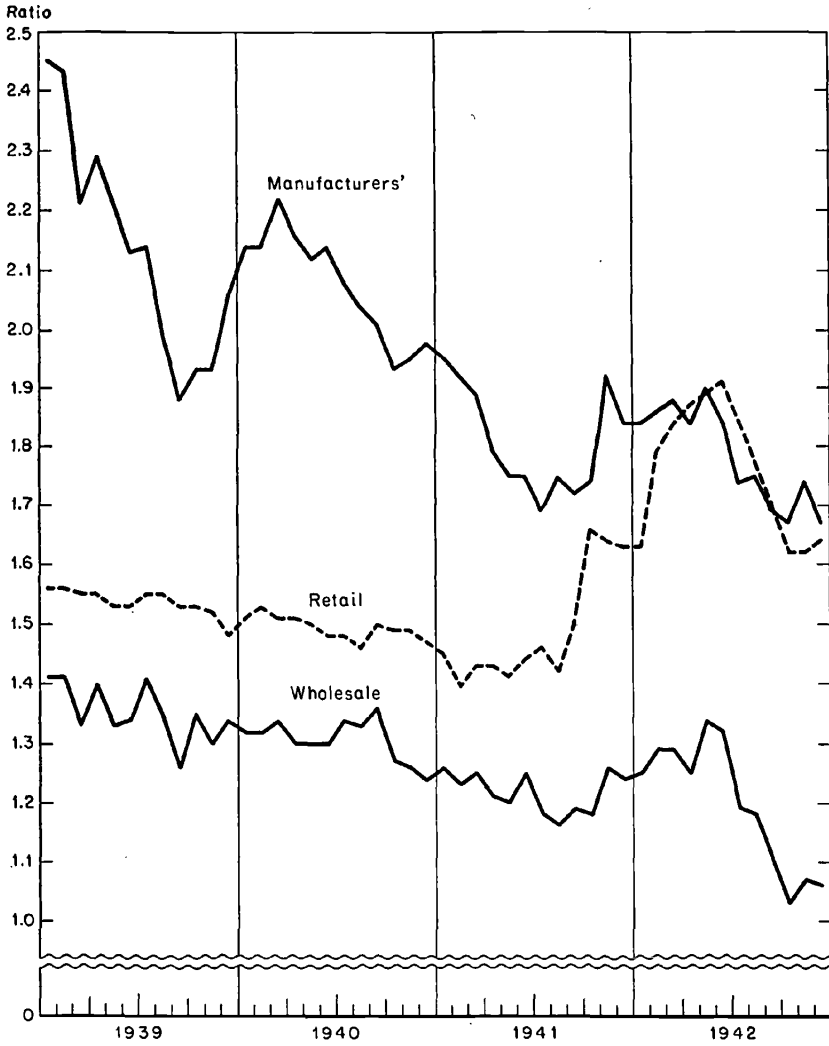
Thus it soon became obvious that no wartime shortages were yet in sight. The period of the "Phony War" began with the fall of Poland at the end of September, and there was no acceleration in the growth of consumption, fixed investment, or government expenditures during the fourth quarter of 1939 (Charts 12 and 18). Since the demand for final products did not justify the sharp increase in industrial production, manufacturers accumulated stocks quite rapidly, and the ratio of inventories to sales rose abruptly in December. Manufacturers reacted by decreasing production in January, and production and prices then settled for several months, although not to the levels that had preceded the boomlet.

This review of the speculative boomlet of late 1939 and the reaction of early 1940 provides an important clue to the interpretation of the developments of late 1940. Industrial production revived in May 1940, the month of the invasion of France, and began a continuous expansion which was not to culminate until November 1943. The index of wholesale prices reached its low in August 1940, and by the end of that year was slightly above the level of late 1939. However, it was not until the second quarter of 1941 that prices began to advance at a rate comparable to that of the inflationary phase of the Korean expansion (Chart 15).

It has been shown that the rapid inflation of late 1950 was promoted by large-scale forward buying. Why did not a similar wave of anticipatory buying accompany the defense program in 1940 and early 1941? The answer seems to be that the abortive buying wave of late 1939 was still alive in the memories of businessmen, and that they were waiting for signs of real shortages to appear

CHART 17

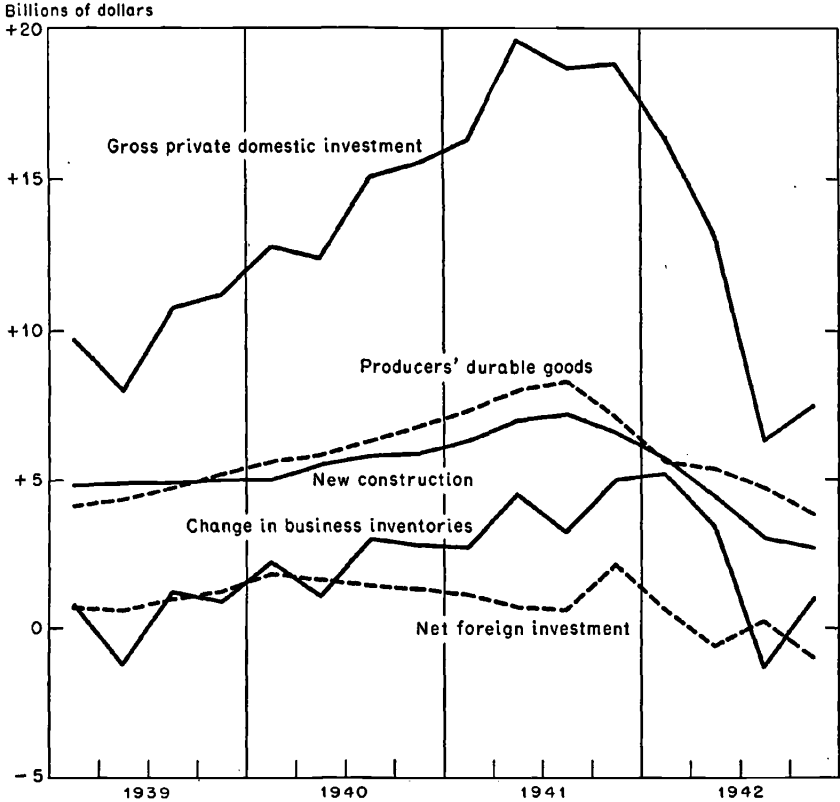
RATIO OF INVENTORIES TO SALES: MANUFACTURERS', RETAIL, AND WHOLESALE, MONTHLY, 1939-1942



Source: By release from Dept. of Commerce, Office of Business Economics. Ratios computed by author

CHART 18

GROSS PRIVATE DOMESTIC INVESTMENT AND ITS COMPONENTS, AND NET FOREIGN INVESTMENT, SEASONALLY ADJUSTED QUARTERLY TOTALS AT ANNUAL RATES, 1939-1942



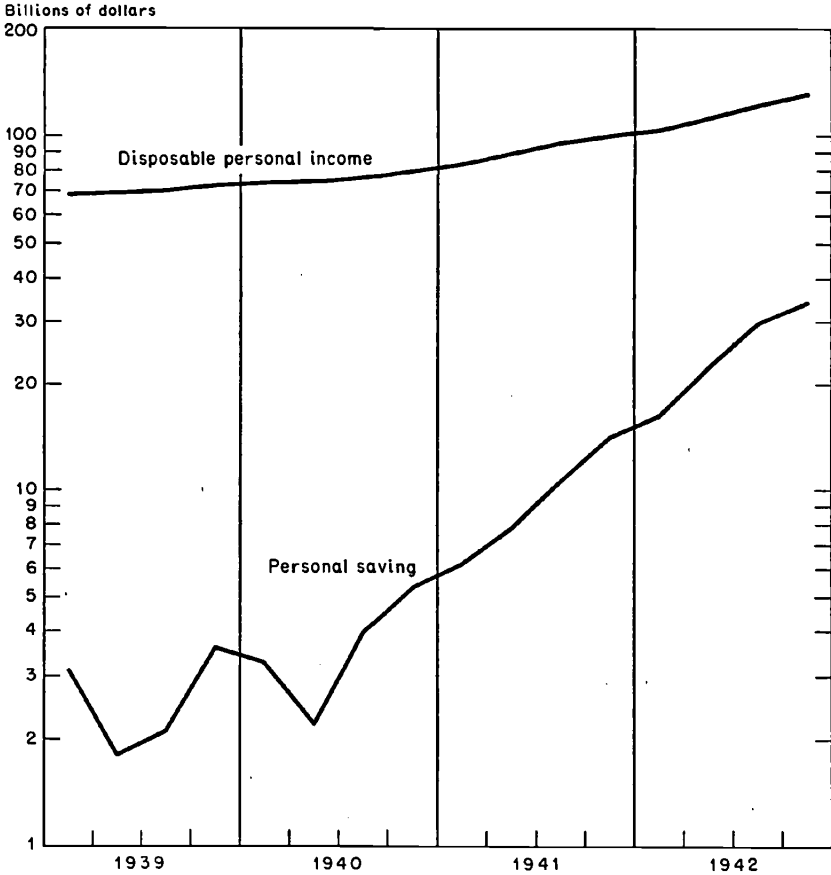
Source: *National Income Supplement, 1951, Survey of Current Business.*

before undertaking extensive new forward commitments. A Priorities Board was established in September 1940, and manufacturers' new orders increased substantially during that month (Chart 16). However, the flood of orders in no wise compares with that of the preceding September and was not sufficient to exert a powerful upward pressure on prices (Chart 15), given the productive slack in the economy.

The inflationary pressure would have been stronger had consumers acted as they did in 1950. However, they did not.

CHART 19

DISPOSABLE PERSONAL INCOME AND PERSONAL SAVING,
SEASONALLY ADJUSTED QUARTERLY TOTALS AT
ANNUAL RATES, 1939-1942



Source: *National Income Supplement, 1951, Survey of Current Business.*

Ratio scale

Consumption increased along with disposable income, but so did personal saving, and the ratio of saving to income rose (Charts 19 and 20). It was their experience of shortages during World War II that led consumers to expect them in 1950. Such foresight was not developed in 1940.

Thus the divergent price developments of 1940 and 1950 were

in part the result of a difference in expectations. Government expenditures and expenditures for producer durables and construction all increased more rapidly in percentage terms between the second quarter of 1940 and the first quarter of 1941 than in the corresponding period of 1950–1951, even before correction for price changes. It is of course true that a large volume of unutilized resources existed in 1940, so that defense and related expenditures could be increased without pressing seriously on the volume of resources available for the production of consumer goods. On the other hand, the boomlet of 1939 proves that underemployment is no guarantee against short-period inflation promoted by active inventory speculation. In fact, had consumers acted in 1939 as they did in 1950, the boomlet would probably have carried higher and lasted longer, despite the fact that no defense mobilization was undertaken at that time. Furthermore, the preceding discussion has made it clear that resources *were* available for the production of civilian goods in 1950. The violent rise in prices in 1950 must be attributed to the inventory speculation of consumers and businessmen rather than to government competition for resources.

The Role of Consumer Saving in 1941 and 1951

The lull in consumer spending which followed the second buying wave of the Korean period was reflected in a sharp rise in the ratio of personal saving to disposable income (Chart 20). During the inflationary phase of the expansion the saving ratio had fluctuated violently with each change of expectations, and it stood at a low level in early 1951 as a result of the heavy buying of January and February. The ratio then increased sharply in the second quarter and remained at a high level through the rest of the year, averaging 8.8 per cent in the last three quarters, as compared with 3.6 per cent in the first quarter.

In view of the important stabilizing role of personal saving in 1951, it is interesting to observe that the saving ratio was considerably higher in 1941 (Chart 20). The ratio rose steadily from the third quarter of 1940 to the fourth quarter of 1941. The successive