affected by the latter program.[31] The prices of farm products and of related foods and textiles recorded the largest gains of the year, under the combined influence of the increase in aggregate demand and of the special conditions created by war, including the government's farm-price policy.

In 1940–1941, then, the rise in spending for defense purposes promoted an expansion in total spending which was largely uncontrolled until late in 1941. Prices did not begin to rise sharply until the simultaneous expansion of government and private spending had taken up the slack in unutilized capacity that existed at the beginning of the expansion, but inflationary pressures were unabated thereafter. In these respects the expansion progressed as theory and the observation of peacetime expansions would suggest. The surprising developments of the Korean period appear all the more unusual when viewed against this background.

Postscript: War and Peace Cycles

Broadly conceived, war is simply one of a number of external forces that may impinge on an economy and thereby modify the direction and pace of economic activity. The peculiar feature that distinguishes war from other external forces is the magnitude of the claim exerted by the state on the nation's resources. Once committed to mobilization, whether for defense or active warfare, the ordinary restraints on government spending must be brushed aside. An important new demand force is created, a force not constrained by income limitations or the need to estimate the potential profitability of economic decisions. This is the basic fact that gives war cycles their family resemblance and sets them apart from peace cycles. However, war cycles bear only a family resemblance —significant differences are observable in the economic developments associated with World War I, World War II, and the Korean War. The implications of those differences must be taken into account in any comparison of war and peace cycles.

[31] Among the commodities affected were hogs, evaporated milk, cheese, chickens and eggs, a number of vegetables, wheat, corn, cotton, tobacco, and rice. Cf. *Survey of Current Business*, February 1942, pp. 29–30.

This is not the place to attempt a detailed comparison of war and peace cycles,[32] but two important topics are directly relevant to the subject of this paper and deserve further comment. They are (1) the magnitude of the mobilization effort and (2) the influence of war on consumer spending.

The basic characteristic of war mobilization may be simply stated: Resources must be diverted from the private to the government sector, from peacetime to wartime uses. The greater the scale of the diversion required, the more severe are the economic problems created. It may be possible for the economy to support a moderate mobilization without serious inflationary consequences, whereas a full-scale mobilization almost inevitably enlarges the aggregate demand for goods and services to such an extent that direct administrative controls or other devices are adopted to supplement or supplant the price mechanism as the basic device for resource allocation and income distribution. It is an obvious corollary that the magnitude of the mobilization effort will influence the character of the economic developments during the mobilization period. Furthermore, postwar (or post-mobilization) developments are likely to be very different if a mobilization assumes proportions requiring huge government deficits and direct controls than if it does not. These points may be illustrated by a brief comparison of World War II and the Korean War.

During the long period of United States participation in World War II, the physical supply of consumer durable goods was severely contracted, and the supply of nondurable goods increased only moderately. Disposable income increased much more rapidly than the supply of consumer goods, but price controls and rationing prevented consumers from bidding freely for scarce goods, and a positive incentive to save was provided by the war-bond campaign, among other things. As a result, the percentage of income saved in the years 1942–1944 was four to five times as large as the rates typical of peacetime high employment years (Table 3), and huge volumes of liquid savings were accumulated. Consumers emerged

32 For an instructive comparison of economic changes in the two world wars and in peacetime business expansions see Wesley C. Mitchell, *Wartime 'Prosperity' and the Future*, National Bureau of Economic Research, Occasional Paper 9, 1943.

from the war anxious to buy the goods denied them during the war effort and supplied with accumulated savings to help make their desires effective in the market place. They lost no time. Consumer expenditures began climbing in the last half of 1945 in the face of falling disposable income.[33] The saving ratio decreased nearly 25 per cent between 1944 and 1945, and was halved between 1945 and 1946.

Private capital formation was also severely repressed during the war years. Inventories were depleted, replacement and maintenance of capital facilities were postponed, the construction of new facilities for the production of civilian goods was curtailed, and peacetime industrial facilities were converted to the production of munitions on an extensive scale. These wartime developments created a strong potential postwar investment demand, which was reinforced by the high liquidity of the business community and the easy-money policy of the monetary authorities. To make this potential demand fully effective, it was necessary to weather the transition to a peacetime economy, in order that a cumulative decline in income and expenditures should not develop from the reduction in government spending before consumers and investors could make their pent-up demands effective on the market. It is a matter of history that the transition was successfully completed, and that by mid-1946 the nation was faced with the problem of excess demand and inflation rather than deficient demand and unemployment. It is quite clear that the backlogs of demand created during the war were factors of great importance in the rapid postwar recovery of private expenditures.

Although the differential trends in the production of civilian and military goods typical of war economy appeared once again during the Korean mobilization, they were by no means comparable to the shifts in the composition of gross national product that occurred in World War II, and they cannot be traced to the same set of causes. In a very real sense the relative decline of consump-

[33] Disposable income fell from $153 billion in the second quarter of 1945 to $148 billion in the fourth quarter (seasonally adjusted quarterly totals at annual rates). Nonetheless, in every quarter but one, disposable income was higher than in 1944, so that it rose $4 billion between 1944 and 1945 on an annual basis (Table 3).

tion and investment related to consumption during 1951–1952 was voluntary. Furthermore, the balanced expansion of 1952 continued into 1953 with increased consumer expenditures accounting for more than two-thirds of the increase in real gross national product (Table 7). Finally, the "high" rate of personal saving in

TABLE 7

GROSS NATIONAL PRODUCT, IN CONSTANT DOLLARS, 1949–1953

(billions of 1939 dollars)

	1949	*1950*	*1951*	*1952*	*1953*
Gross national product	144.0	156.2	167.0	172.0	178.6
Personal consumption expenditures	103.2	108.9	108.5	111.4	115.9
Durable goods	12.9	15.5	13.4	12.9	14.4
Nondurable goods	50.7	51.7	52.4	54.5	55.8
Services	39.6	41.7	42.6	44.0	45.6
Gross private domestic investment	18.0	26.8	27.6	24.3	24.9
New construction	7.9	9.7	9.2	9.0	9.4
Producers' durable equipment	11.4	13.3	13.4	13.6	14.2
Change in business inventories	−1.3	3.8	5.0	1.7	1.3
Net foreign investment	0.6	−0.1	2.0	1.4	0.4
Government purchases of goods and services	22.2	20.7	28.9	34.8	37.4
Federal	12.9	10.8	18.9	24.5	26.6
State and local	9.3	9.8	9.9	10.3	10.8

Source: *Survey of Current Business,* February 1954, Table 1.

the past few years does not begin to compare with the rates attained during World War II (Table 3).

It is apparent that no "wartime" base was laid during the Korean mobilization to ease the problem of adjustment to the decline of defense expenditures now facing the economy. The mobilization did not create the kind of conditions that were responsible for the abnormal booms of consumption and investment demand that followed World War II. It should be added that the problem itself is not as severe as that posed by the ending of World War II. The same basic fact that minimized the accumulation of backlogs of demand—the smaller scale of the military program—

will also minimize the problem of adjustment itself, in the sense that only a relatively small increase in private expenditures would be needed to compensate for the maximum probable decline in defense expenditures and to absorb additional productive capacity resulting from growth in the labor force and in productivity. The moot question is whether even such a relatively modest increase in private expenditures can be attained after eight years of high-level activity.

Since the end of World War II we have witnessed two dramatic instances of independent variations in consumer spending—that is, changes in consumer expenditures that were not induced by concurrent changes in real income. The first was the upsurge of consumer demand that followed World War II, to which we have just referred, and the second was the series of rapid shifts in consumer spending during the early months of the Korean expansion. It is clear that in both periods the course of economic activity was strongly influenced by pronounced shifts of the consumption function.

The hypothesis that consumer expenditures are primarily a function of real income has been widely accepted by economists. Partly as a result, the origin of business cycles has been sought in factors that might be expected to cause fluctuations in investment. The instability of consumer spending in recent years suggests that this may be an oversimplification. However, it is important to observe that this recent instability has been the result of disturbances created by war and in no way demonstrates that peacetime cycles are regularly affected by independent fluctuations in consumer spending. Whether that is the case remains an open question, which can be answered only by further empirical investigation.