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Volume Title: The Korean War and United States Economic Activity, 1950-1952

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Volume Publisher: NBER

Volume ISBN: 0-87014-363-8

Volume URL: <http://www.nber.org/books/hick55-1>

Publication Date: 1955

Chapter Title: The Korean Expansion: 1950-1952

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Chapter URL: <http://www.nber.org/chapters/c2909>

Chapter pages in book: (p. 5 - 10)

assets and easy access to consumer credit can markedly influence the course of economic activity if, as a group, they develop expectations that lead them to make advance purchases on a large scale. The hypothesis that consumer expenditures are primarily a function of real income has been widely accepted, but the instability of consumer spending during 1950–1951 shows that, under some circumstances, psychological variables may for a time assume positions of equal or greater importance as determinants of consumer expenditures. However, it is important to remember that this instability was the result of generalized changes in expectations that were induced by dramatic military developments, and in no way demonstrates that peacetime cycles are regularly influenced by shifts in consumer expectations. Whether that is the case is a question that can only be answered by further investigation.

### **The Korean Expansion: 1950–1952**

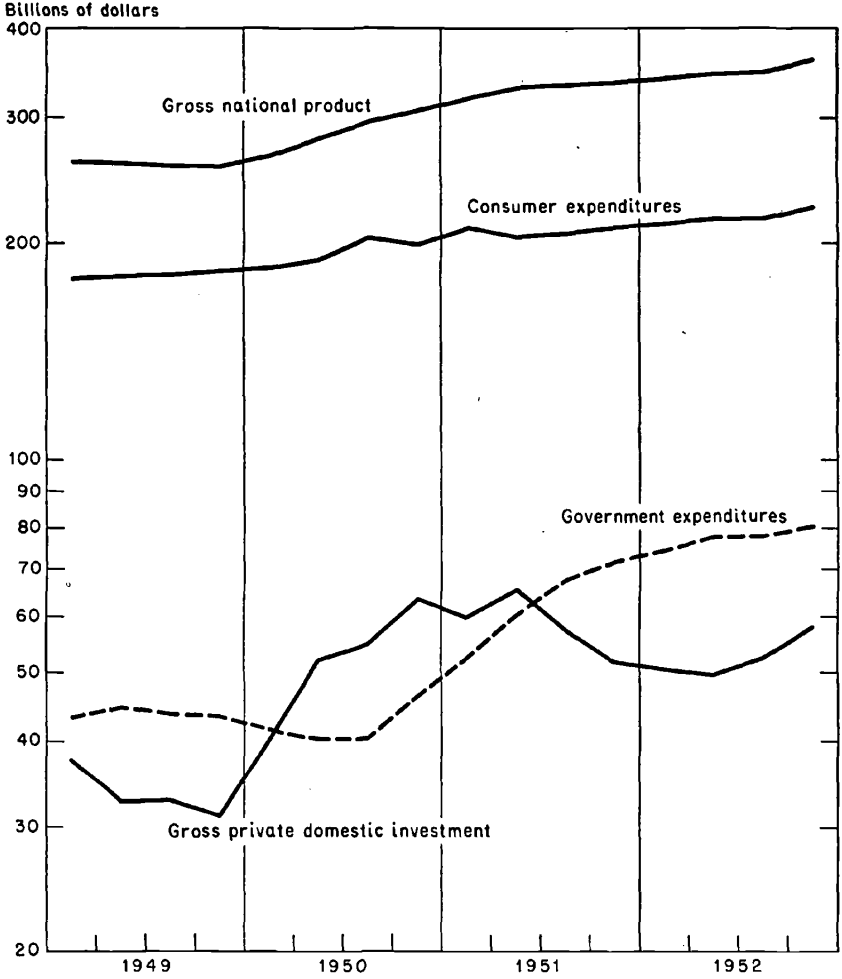
The Korean War and the associated defense mobilization strongly influenced the trend of economic activity in the United States during 1950–1952. The specific nature of these influences will be analyzed presently, but a brief survey of the position of the economy at the outbreak of hostilities, and of the magnitude of the mobilization program, will provide a useful background to the subsequent discussion.

#### *Economic Activity Prior to the Korean War*

The level of economic activity was high and rising prior to the outbreak of hostilities in Korea in June 1950. A vigorous recovery from the mild recession of 1948–1949 had been under way since late in 1949. Gross private domestic investment and gross national product increased more rapidly in percentage terms between the last quarter of 1949 and the second quarter of 1950 than in any subsequent interval during the period with which we are concerned (Chart 1). Consumer expenditures also increased, but at a more modest pace, while government expenditures and net foreign investment declined (Charts 1 and 6). Industrial production,

CHART I

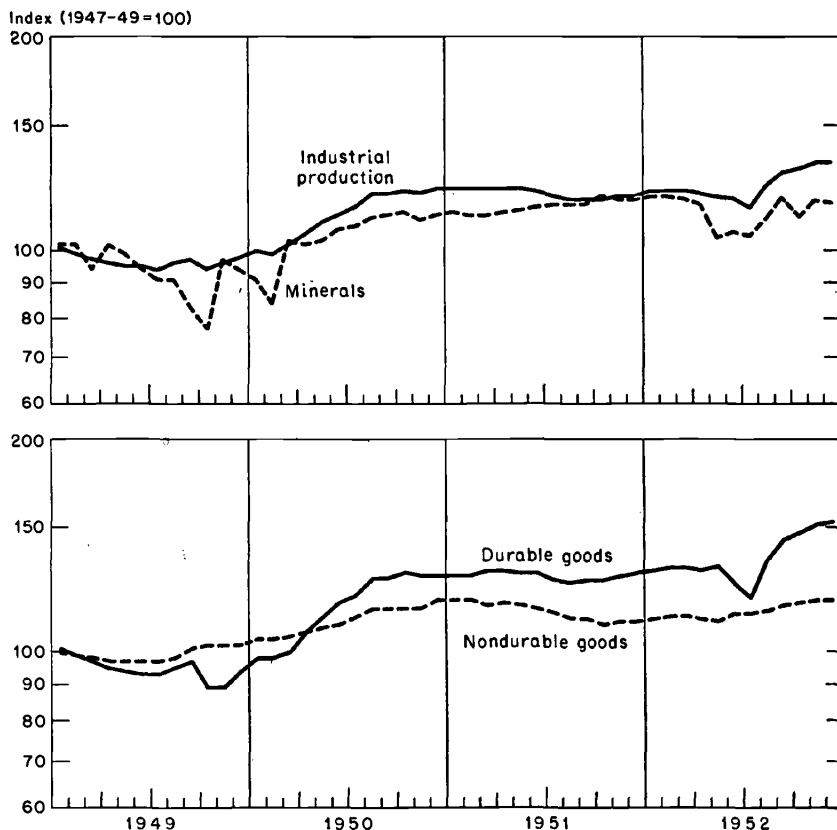
GROSS NATIONAL PRODUCT AND ITS MAJOR COMPONENTS,  
SEASONALLY ADJUSTED QUARTERLY TOTALS AT ANNUAL RATES,  
1949-1952



Source: *Survey of Current Business*, July 1953.

CHART 2

INDEXES OF INDUSTRIAL PRODUCTION: TOTAL, DURABLE AND  
 NONDURABLE MANUFACTURES, AND MINERALS,  
 SEASONALLY ADJUSTED, MONTHLY, 1949-1952



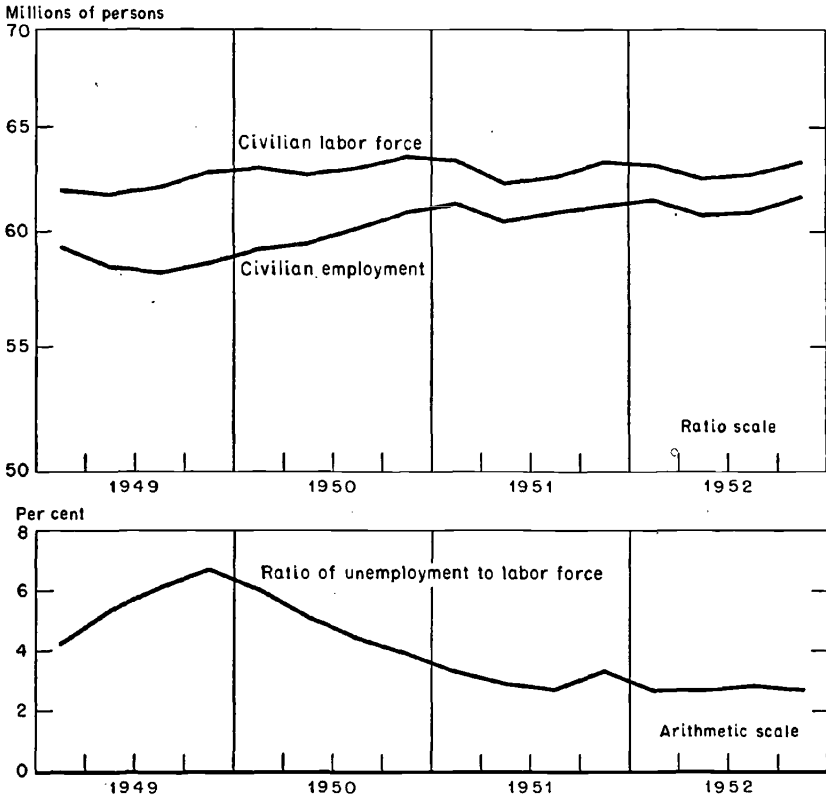
Source: *Federal Reserve Bulletin*, December 1953.

Ratio scales

civilian employment, and prices rose along with expenditures (Charts 2, 3, and 4), and by the second quarter of 1950 only 5 per cent of the civilian labor force was unemployed (Chart 3). Thus the economic forces set in motion by the Korean conflict impinged on an economy that was already operating at a high and expanding level of activity. The pool of unemployed labor that could be drawn upon to increase the national output was small.

CHART 3

CIVILIAN LABOR FORCE, CIVILIAN EMPLOYMENT, AND  
RATIO OF CIVILIAN UNEMPLOYMENT TO CIVILIAN LABOR FORCE,  
SEASONALLY ADJUSTED QUARTERLY AVERAGES, 1949-1952



Source: 1949-1951, Clarence D. Long, *The Labor Force in War and Transition: Four Countries*, National Bureau of Economic Research, Occasional Paper 36, 1952, Table A-1. 1952, by letter from Long. Ratio of unemployment to labor force computed by author.

*The Magnitude of the Mobilization*

- The ratio of national security expenditures to gross national product provides a useful index of the magnitude of a mobilization effort. National security expenditures absorbed the following percentages of gross national product (measured in current dollars) during World War II and the Korean War:

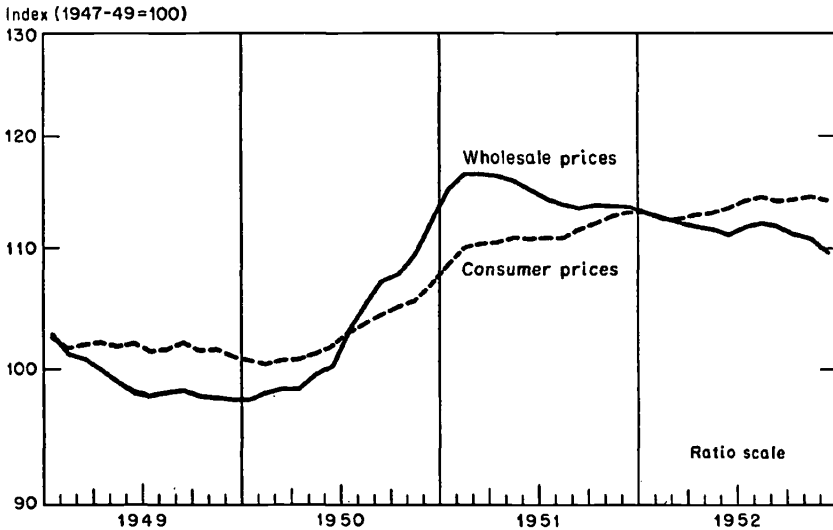
1940	2.2	1950	6.4
1941	10.9	1951	11.3
1942	30.7	1952	14.1
1943	41.4	1953	14.1
1944	41.5		
1945	35.3		

Source: Computed from data in *Survey of Current Business*, Department of Commerce, July 1953, Table 2; February 1954, Table 4.

It is readily apparent that even by 1952 the United States had not reached a stage of transformation into war economy comparable to that of 1942–1945. The shares of gross national product devoted to security expenditures were approximately equal in 1941 and 1951. In terms of the magnitude of the mobilization effort, the parallel to the Korean period is to be found in the years 1940–1941, when the United States was still a neutral in World War II. Nevertheless, there is a profound difference between the two

CHART 4

INDEXES OF WHOLESALE AND CONSUMER PRICES,  
MONTHLY, 1949–1952



Source: Wholesale prices, *Survey of Current Business*, March 1952 and March 1953. Consumer prices, *Survey of Current Business*, March and April 1953. Indexes constructed by Dept. of Labor.

periods: In 1940–1941 American troops were not fighting overseas and the characteristics of a wartime economy were not fresh in the minds of Americans. During the Korean period the United States was actively engaged in the hostilities and there was a grave possibility that the conflict would acquire global proportions. The sense of the imminence of wartime economy at the outbreak of the hostilities in Korea, combined with memories of the shortages of consumer goods during World War II, created a climate of expectations that had no counterpart in 1940–1941. The economic effects of the mobilization that began in 1950 would have been very different were it not for the fact that it was accompanied by the hostilities in Korea and the attendant threat of global conflict.

It is apparent that a defense mobilization will provide a stimulus to economic expansion if government expenditures increase the aggregate demand for goods and services. However, the expansion need not await the actual growth of government expenditures. In the first place, some government expenditures for defense will lag behind the placement of orders. For a time, the increased production consequent on the orders will be reflected in private inventory investment rather than in government expenditures. Second, private fixed investment may be encouraged in industries related to defense not only by the general stimulus of orders for goods but also by such devices as accelerated tax amortization, direct loans, and loan guarantees. Such private investment expenditures, while resulting directly from the defense program, are not included in government expenditures. Finally, the outbreak of hostilities or the announcement of a mobilization program may stimulate expansion by affecting the expectations of various groups in the economy. This last was a highly important influence in the nine months following the invasion of South Korea in June 1950.

### **The First Nine Months: Expansion and Inflation**

One immediate aftermath of the outbreak of hostilities in Korea was a sharp increase in consumer expenditures. In the third quarter of 1950 the spurt in expenditures for consumer durable goods was especially pronounced, but there was also a noticeable rise