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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-

tion and prices attendant on increased expenditures will be considered at the appropriate time.

One certain result of a large-scale mobilization program will be an increase in government expenditures. Total expenditures will rise if the increase in government spending is not offset by a decrease elsewhere in the economic system. The *direct* inflationary impact of increased government expenditures will therefore be reduced if the added expenditures are financed entirely from added tax receipts.[18] Deficit-financed expenditures will be inflationary: since tax receipts are not increased initially, there may be no initial offsetting reduction in private spending, and, furthermore, the increased income resulting from the government expenditures may induce additional consumer expenditures and perhaps additional investment expenditures.[19] If the increased government expenditures are more than offset by increased tax receipts—that is, if the government surplus grows or the deficit is reduced—the direct result of the government fiscal operations will be less inflationary than if added receipts equaled added expenditures, and may even be deflationary.

It was not the growth of defense expenditures that was responsible for the price inflation of the first nine months of the Korean War, but the abrupt rise in private expenditures. The seasonally adjusted volume of government expenditures in the third quarter of 1950 remained at the second-quarter level (Chart 1), and the

[18] Some increase in total expenditures may occur even if added government expenditures are financed by added tax receipts (see Trygve Haavelmo, "Multiplier Effects of a Balanced Budget," *Econometrica,* October 1945, pp. 311–318; Gottfried Haberler, "Multiplier Effects of a Balanced Budget, Some Monetary Implications of Mr. Haavelmo's Paper," *Econometrica,* April 1946, pp. 148–151; and Franz Gehrels, "Inflationary Effects of a Balanced Budget under Full Employment," *American Economic Review,* December 1949, pp. 1276–1278). However, the multiplier effect will be smaller than if the added expenditures were deficit-financed. If unemployed resources exist, the theoretical value of the multiplier with a balanced budget is unity (total expenditures rise only by the amount of increased government expenditures), if it is assumed that the function relating consumption to disposable income remains unchanged and that investment expenditures are not affected by the increase in government expenditures.

[19] Thus the multiplier will be greater than unity. These statements assume, of course, that private investment is not reduced in reaction to the deficit financing, or at least not reduced enough to offset the increase in government expenditures.

government surplus increased sharply (Table 2).[20] Government expenditures began to increase in the fourth quarter, and there was a reduction in the surplus. These developments may have exerted some upward pressure on prices. It is certainly true that the entire fourth-quarter increase in gross national product was accounted for by government expenditures and inventory investment (Charts 1 and 6). However, it should be noted that wholesale prices rose only slightly in October and November (Chart 4). It was not until the second consumer buying spree got under way in December that wholesale prices rose sharply once again; they reached their peak in the first quarter of 1951.[21] The increased government expenditures of that quarter were much more than offset by added receipts. The enlarged surplus reduced the rate of growth of disposable personal income (Chart 10), but this favorable development was offset by the renewed surge of consumer spending.

Thus it was not government spending but the forward buying of businessmen and consumers that boomed production and prices through the first quarter of 1951. The rate of increase of prices was alarming, of course, especially in view of the fact that the inflation began long before defense production was well under way. Furthermore, the economy was operating at a high level of employment from the outset of the expansion; only 5 per cent of the civilian labor force was unemployed in the second quarter of 1950, and the ratio had dropped to 3 per cent by the first quarter of 1951. Under the circumstances, it seemed necessary to institute controls at the earliest feasible date.

The initial step in limiting credit for housing construction was taken July 19, 1950, when mortgage terms on government-

[20] The quarterly figures show the combined effect of federal, state, and local fiscal operations. Annual figures reveal the following breakdown (in billions of dollars):

	1949	*1950*	*1951*	*1952*
Government deficit (+) or surplus (−)	+3.05	−8.27	−7.07	+2.42
Federal	+2.03	−9.58	−7.45	+2.36
State and local	+1.02	+1.31	+0.39	+0.06

Source: *Survey of Current Business,* July 1953, Table 5.

[21] The sharp advance in wholesale prices during December and January may have resulted in part from an effort by sellers to raise prices before a price freeze could be announced.

TABLE 2

GROSS NATIONAL PRODUCT, GOVERNMENT RECEIPTS AND EXPENDITURES, AND GOVERNMENT SURPLUS OR DEFICIT, IN CURRENT PRICES, QUARTERLY, 1949–1952

(billions of dollars)

Year and Quarter (1)		*Government Expenditures* (2)	*Government Receipts* (3)	*Government Deficit (+) or Surplus (−)* (2 − 3) (4)	*Gross National Product* (5)	*Ratio of Deficit (+) or Surplus (−) to GNP (per cent)* (4 ÷ 5) (6)
1949	I	14.3	16.9	−2.6	63.1	−4.1
	II	15.6	12.7	+2.9	62.8	+4.6
	III	14.7	14.1	+0.6	64.6	+0.9
	IV	15.1	13.2	+1.9	67.7	+2.8
1950	I	16.6	17.6	−1.0	64.7	−1.5
	II	15.3	15.7	−0.4	67.6	−0.6
	III	13.8	18.2	−4.4	74.2	−5.9
	IV	15.7	18.4	−2.7	80.3	−3.4
1951	I	16.8	25.8	−9.0	79.1	−11.4
	II	19.6	20.3	−0.7	80.3	−0.9
	III	20.9	20.5	+0.4	82.2	+0.5
	IV	22.2	20.2	+2.0	88.3	+2.3
1952	I	22.0	26.7	−4.7	83.4	−5.6
	II	24.0	21.5	+2.5	84.4	+3.0
	III	23.7	22.4	+1.3	85.4	+1.5
	IV	24.7	21.5	+3.2	94.7	+3.4

Note: The annual totals of the quarterly figures in column 4 differ from the values in footnote 20 because of the rounding of the quarterly components of columns 2 and 3.

Source: *Survey of Current Business*, July 1953. Government Expenditures is the sum of Government Purchases of Goods and Services (Table 42) and Government Transfer Payments, Net Interest Paid by Government, and Subsidies less Current Surplus of Government Enterprises (Table 46). Government Receipts is the sum of Personal Tax and Nontax Payments (Table 44), Corporate Profits Tax Liability (Table 40), and Indirect Business Tax and Nontax Liability and Contributions for Social Insurance (Table 46).

guaranteed loans were tightened. The restrictions were extended to nongovernment-aided private credit in October. Reconstruction Finance Corporation loans for nondefense purposes were sharply reduced. Consumer credit controls were established in

September and strengthened in October. The Federal Reserve authorities raised rediscount rates in August and discouraged the sale of short-term government securities to the Federal Reserve during the last half of the year.

Despite these credit restrictions, the loans of all commercial banks increased $7.5 billion and the privately held money supply $7.0 billion during the last half of 1950, and prices surged upward once again during the second buying wave. Accordingly, the Federal Reserve raised margin requirements in January 1951 and raised reserve requirements of member banks in January and early February. The restrictions on real estate credit were extended to a number of categories of commercial construction in February. Reduced Federal Reserve open-market purchases of government securities limited the expansion of bank reserves following an accord with the Treasury, announced in March.[22] Administrative allocation of materials restrained private fixed investment in nondefense industries after mid-1951. These restrictions probably slowed the growth of private investment during 1951, thus reducing the rate of growth of income and, indirectly, the rate of growth of consumer expenditures.

Increased rates of taxation also restrained the growth of disposable personal income in 1951. A huge surplus was accumulated on government account, but primarily in the first quarter of the year (Table 2). The surplus was greatly reduced in the second quarter, and deficits were run in the third and fourth quarters.[23] Thus gov-

[22] "The Treasury and the Federal Reserve System have reached full accord with respect to debt-management and monetary policies to be pursued in furthering their common purpose to assure the successful financing of the Government's requirements and, at the same time, to minimize monetization of the public debt" (Joint Announcement by the Secretary of the Treasury and the Chairman of the Board of Governors, and of the Federal Open Market Committee, of the Federal Reserve System, March 4, 1951, reprinted in the *Federal Reserve Bulletin,* March 1951, p. 267).

[23] The surplus of the first quarter reflected a sharp increase in corporate and individual income tax receipts, a normal seasonal development which was accentuated by increased rates of taxation. During the first half of the year, about $3 billion of the cash surplus was retained in the Treasury's cash balance, $1.6 billion was used to retire bank-held debt, and another $2 billion was returned to the public through the retirement of government securities held by nonbank investors (*Federal Reserve Bulletin,* July 1951, pp. 740–741). The deficits of the last half of the year were met by drawing down the cash balance accumulated in the first six months and by the

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ernment fiscal operations were inflationary after the first quarter —but less inflationary than if higher rates of taxation had not been imposed. In fact, the major contribution of the government to economic stability in 1951 was to slow the rate of growth of income and thus help provide the setting in which the rise of consumer saving had such important anti-inflationary consequences.[24]

If consumers can claim the major share of the credit for promoting economic stability in 1951, they must in fairness admit that they had considerable help from the government and from businessmen, and they must also accept a large share of the responsibility for the instability of late 1950 and early 1951. Had government fiscal operations been more inflationary during 1951, and had private fixed investment been uncontrolled, consumers might not have been able to resist the lure of increased consumption made easy by rising income. Had consumers not bought heavily during the inflationary phase, they would not have saved as much later. Had businessmen not ordered and produced so heavily in 1950 and early 1951, the decline in inventory investment in the second half of 1951 might not have occurred to moderate the growth of income. The neat balance of inflationary and deflationary forces in 1951 was in no small part the consequence of developments growing out of the inflation of 1950.

Balanced Expansion during 1952

The balance between defense and civilian needs that was struck in mid-1951 was maintained through 1952. The share of gross national product (in current dollars) devoted to national security expenditures was increased from 11.3 per cent in 1951 to 14.1 per

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sale of new securities (*Federal Reserve Bulletin,* February 1952, pp. 118–119). Hence the impact of the surplus was somewhat reduced during the first part of the year by the return of a portion of the surplus to nonbank holders of government securities and, conversely, the impact of the deficit may have been softened in the last six months as the Treasury drew down its cash balance, since the sale of additional securities probably would have increased the private money supply.

[24] Consumers saved larger percentages of their incomes in 1941 than in 1951, but disposable income was rising so rapidly in 1941 that consumer expenditures mounted along with personal saving (see below, pp. 46–51).