Coping With Inflation

Muriel Converse, Richard T. Curtin, and Maureen Kallick
Survey Research Center
The University of Michigan

In the first half of 1979 businesses and households in the United States were confronted with a rate of inflation substantially higher than that experienced during the previous 5-10 years, a period itself characterized by price increases significantly higher than the norm during the 1950s and most of the 1960s. Reactions to this accelerated inflation were varied as consumers and business firms attempted to cope. In order to assess coping mechanisms, parallel studies based on representative samples of consumers and business firms in the manufacturing, wholesale, and retail sectors of the economy were conducted by the Economic Behavior Program of SRC during the summer of 1979.

Inflation is one economic fact of life of which consumers and business managers are well aware. In recent nationwide surveys, consumers have named inflation as the number one problem facing the nation, as well as the most important problem facing their families. Although rapid price increases have aroused public outcry since the late 1960s, until recently double-digit inflation was viewed as a temporary aberration, not as a long-term prospect. The persistent inflationary environment has had a pervasive impact on consumers. Inflation has now become a primary factor in shaping consumer spending and saving decisions, and these decisions affect business conditions and expectations. Below we discuss business firms' reactions to inflation first, followed by consumers' reactions.

BUSINESSES

Although many economic agents believed themselves hurt by inflation, more than half of U.S. business establishments in the manufacturing, wholesaling and retailing sectors of the economy said they were not. In fact, seven percent felt they had gotten ahead of inflation.

Inflation did not affect all sectors evenly, and a considerably larger proportion of retailers (almost 60 percent) than of wholesalers or manufacturers (somewhat over 40 percent each) reported they were *not* hurt. This implies that either the negative aspects of inflation relative to the positive aspects did not impinge as heavily on the retail sector as on other sectors during this period, or that retailers as a group were more effective in coping with it.

Behavior designed to cope with inflation may involve actions (such as anticipatory pricing) that exacerbate the problem, so that the degree to which establishments cope may be indicative of future changes in the inflation rate. Four broad categories of coping behavior were studied: inventory stockpiling, pricing, borrowing, and personnel changes. The percent of establishments of different industrial types and sizes that attempted to cope in any of these ways is shown in Table 1. The most commonly used mechanism for coping with inflation was adjusting employment (70 percent) followed by credit modifications and price increases (both at 60 percent) and inventory stockpiling (20 percent).

Employment Modifications

Adjusting the level and composition of an establishment's work forces was the most frequently used coping mechanism. Coping techniques tended to differ among sectors. Wholesalers, unlike either manufacturers of retailers, were more likely to increase part-time employment than to reduce it. Manufacturers (and large establishments of all types) were much more likely to modify their full-time employment rolls than were wholesalers or retailers; retailers and manufacturers were more likely than wholesalers to reduce overtime. With regard to overtime it is interesting to note the marked preference for reduction by all three sectors.

Logic would argue that one way inflation influences the desired level of employment is through actual and anticipated changes in the level of business activity. Indeed, the attempt to increase employment is more prevalent among establishments that have experienced rising sales volume due to inflation than among those which have not. Correspondingly, the attempt to decrease employment is concentrated among establishments that have not been helped by increasing sales volume.

Another aspect of inflation's influence on the desired level of employment is by way of changes in profit per unit of output or sales. Planned employment increases are twice as likely in establishments whose prices have increased relative to costs than they are in establishments whose prices have not increased relative to costs. And planned employment decreases are half again as likely in establishments that have not had price increases relative to costs.

It may be somewhat surprising that 44 percent of establishments planning to increase employment experienced neither increased sales volume nor increased profit per unit of sales in the six months prior to the survey, and only 20 percent of them experienced both. But this is fully in keeping with the generally-accepted idea that firms do not hire and fire with short-run fluctuations in activity, but, rather, base their employment decisions on longer-run considerations. The employment-profit-sales data may simply indicate that firms' expectations for the future differ markedly from their experiences of the recent past.

This idea is corroborated when we consider desired employment changes in relation to managers' responses to queries about their expected ability to cope in the next few years given continued inflation. Approximately 50 percent of business establishments felt they would be less able to cope with continuing inflation over the next few years, and

Table 1. BUSINESS REACTIONS TO INFLATION, 1979

Ways in Which Business Establishments Coped with Inflation	All Establishments	Manufacturers	Wholesalers	Retailers	Small Establishments	Medium Establishments	Large Establishments
Inventory Stockpiling	**21%**	**27%**	**26%**	**18%**	**20%**	**24%**	**13%**
Accumulation of:							
Raw Materials	11	20	10	8	9	15	9
Finished Goods	16	12	23	15	16	17	9
Pricing	**60**	**72**	**58**	**58**	**57**	**71**	**53**
Increasing prices in anticipation of cost increases	30	44	22	30	30	32	29
Passing on cost increases more rapidly	50	59	52	47	46	61	53
Borrowing	**61**	**61**	**45**	**66**	**57**	**72**	**61**
Reducing:							
Short-Term	46	49	43	47	44	54	50
Long-Term	54	47	45	58	56	50	42
Increasing:							
Short-Term	8	6	4	9	5	15	6
Long-Term	9	12	7	9	7	13	21
Employment Modifications	**70**	**84**	**64**	**69**	**66**	**81**	**92**
Reducing:							
Full-Time	20	30	13	19	17	25	44
Part-Time	27	29	13	31	29	23	31
Overtime	50	54	40	52	45	63	70
Increasing:							
Full-Time	20	29	14	19	19	22	20
Part-Time	19	17	22	18	19	18	25
Overtime	4	14	5	1	3	6	5

Note: Tabulations are based on 928 cases.

this expected loss of ability was particularly pronounced for small establishments. But of the 8 percent of establishments whose managers thought they would be better able to cope, 50 percent planned to increase employment. This is more than twice as large a percentage as that of establishments expecting to be equally able to cope and almost three times as large as that of establishments expecting to be less able to cope. Conversely, over one-third of establishments expecting to be less able to cope with inflation planned to decrease employment, while only one-tenth of those expecting to be better able to cope planned to decrease employment.

BUSINESS FIRMS' RELATIVE ABILITY TO COPE IF INFLATION CONTINUES FOR NEXT FEW YEARS

Type of Establishment	Less Able	Equally Able	Better Able
Manufacturers	41%	48%	10%
Wholesalers	63	28	8
Retailers	47	44	8
Small Estab.	52	40	8
Medium Estab.	40	46	12
Large Estab.	46	46	7
All Estab.	49	42	8

Note: Table does not show the small proportion replying "don't know."

Borrowing

More than half of all establishments were attempting to reduce borrowing whereas less than one-tenth were attempting to increase it. This is not surprising since over 60 percent of establishments thought that interest rates were high, even considering inflation.

Sixty percent of all establishments attempted to cope with inflation by changing their borrowing patterns. Wholesalers were much less likely than retailers or manufacturers to attempt to modify their credit in any way. Retailers differed from other sectors in one respect: many more of them atttempted to reduce long-term borrowing. Large establishments also differed with respect to credit manipulations: many more of them attempted to increase long-term borrowing and many fewer attempted to reduce it.

Pricing

Almost one-third of all establishments reported engaging in anticipatory pricing, which may help explain the rapid acceleration of inflation that has occured since the data were collected. Indeed, during the first half of 1979 anticipatory pricing was most prevalent among manufacturers, the first link in the production-distribution chain. This behavior may well have become more prevalent in the distribution sectors since then. Half of all establishments reported passing on cost increases more rapidly, with this behavior most noticeable among manufacturers and medium-size establishments. Although more rapid cost pass-throughs do not augur as poorly for future inflation as anticipatory pricing, their affects can be significant.

Inventory Stockpiling

Fully one-fifth of manufacturing and sales establishments attempted to accumulate inventories in anticipation of rising costs. One would expect that this is lower than it would have been had credit been easier. The fact that *real* interest rates at this time may have actually been low is irrelevant in light of these respondents' perceptions that interest rates were high.

Differences between sectors of the economy relative to inventory stockpiling were large, with over a quarter of manufactureres and wholesalers having engaged in this kind of coping behavior as compared to only 18 percent of retailers. There was less of a tendency for large companies to cope in this manner.

CONSUMERS

Consumers can react to inflation-pinched budgets by increasing household income, through increased labor force participation for example, or by changing how they spend their income, including how much they save or take on debt. Although the rise of dual-earner households has been an important coping response to inflation, this short report focuses only on consumer reactions to inflation which center on spending and saving decisions, not on how households have attempted to increase their income.

How successful have consumers been in coping with inflation? In the summer of 1979, the majority (60 percent) of respondents reported that their families had managed to stay even or had gotten ahead of inflation. Despite the frequent and often bitter complaints about inflation by the majority, only a minority, although substantial, actually felt that they were financially hurt by inflation. The majority were apparently able to cope with inflation with some success.

Two-thirds of upper income families reported that they had stayed even or ahead of inflation, compared with about half of lower income families. As shown in Table 2, respondents under age 25 were more likely to report staying even or getting ahead of inflation, with no significant differences among those 25 or older. Interestingly, college-educated respondents were less likely to report staying even or ahead of inflation (53 percent) as compared with those with less than a high school education (63 percent). Although income and education are closely associated, these variables demonstrated opposite relationships to perceptions of being hurt by inflation, and indicate greater perceived hardship among those with relatively high education and those with low incomes.

Saving and Debt

Spending decisions have also been affected by attitudes toward saving and debt. The appeal of savings and the

Table 2. CONSUMER REACTIONS TO INFLATION, 1979

		Increase in Prices Has Caused...			In Times of Rapid Inflation...		
Demographic Characteristics	**Family Stayed Even or Ahead of Inflation**	**Change in Shopping Behavior**	**More Shopping for Lower Prices**	**Reduced Purchase of Items With Large Price Increases**	**Favor Advance Buying**	**Bad Idea to Save**	**Better to Borrow**
All Families	60%	71%	47%	69%	25%	24%	14%
Family Income							
Less than $10,000	53	79	49	76	23	18	9
$10,000-14,999	52	77	50	78	29	16	7
$15,000-19,999	55	72	42	74	27	23	11
$20,000-24,999	67	69	48	61	24	27	19
$25,000 or more	69	63	46	61	23	36	24
Age of Respondent							
Younger than 25	73	74	50	72	32	25	15
25-44	57	72	51	70	26	28	19
45-64	61	71	44	72	23	24	12
65 or older	61	69	41	62	21	11	7
Education of Respondent							
Grades 1-11	63	74	44	75	23	10	6
High School Graduate	59	79	51	75	26	19	9
Some college	65	69	45	67	24	28	16
College graduate	53	59	44	60	25	40	28

Note: Tabulations are based on 2131 cases distaste for debt have been significantly affected by the inflationary environment. Among all families, 24 percent felt it was a bad idea to save as much as possible during times of rapid inflation, and 14 percent of all families felt it was better to borrow as much as possible in times of inflation. Attitudes toward saving and debt varied significantly among demographic subgroups. The appeal of saving and the avoidance of debt was highest among elderly, low education, and low income families. In contrast, high income families and college educated respondents, subgroups responsible for a large share of aggregate saving and debt, were most likely to express the opinion that it was better to borrow and a bad idea to save in times of rapid inflation. Among families with incomes of $25,000 of more, one-third reported it was a bad idea to save as much as possible with rapid inflation, and one-fourth reported it was better to borrow as much as possible in times of inflation.

Price Comparisons

Rapid inflation has heightened comparative price shopping behavior on the part of consumers. More than two-in-three consumers reported inflation had changed the way they shop, and half reported that they now more frequently shop around for a low price. More frequent comparative price shopping was reported by a near majority throughout most major population subgroups (see Table 2).

Although comparative shopping enables consumers to make better spending decisions, this reaction alone cannot offset the impact of general and sustained price increases. The classic coping mechanism is for consumer spending decisions to change in response to relative price changes. Higher gasoline prices, for example, can be accomodated within a fixed income by decreased gasoline consumption or by decreased consumption of other goods and services. To the extent that consumers cut down or stop buying items which have had particularly large price increases, they can cope with inflation by shifts in spending patterns. As shown in Table 2, this shift represented a widespread and pervasive coping response, as more than two-thirds of all families reported that they had cut down or stopped buying items which have had particularly large price increases. High income families somewhat less frequently reported this coping response than low income families (61 vs. 76 percent), reflecting greater discretionary income and more frequent income increases. The elderly, those over age 65, were less likely to report changed spending habits, reflecting in part more limited discretion in their budgets. College educated respondents were the least likely to report coping with inflation by reduced purchases (60 percent), while those with less than a high school education were the most likely to report this response (75 percent).

Advance Buying

Consumers also reacted to inflation by increasing purchases in anticipation of future price increases, rather than by decreasing purchases. Advance buying as a means to cope with inflation was viewed with favor by 25 percent of all families in September 1979. This favorable view toward advance buying was widely shared among all income and education subgroups. Advance buying was viewed with more favor by the young, with nearly one-third of those under age 25 favoring advance buying, in comparison with one-fifth among those over age 65.