The Heritage Foundation Backgrounder

No. 65 | The Heritage Foundation 214 Massachusetts Avenue N.E. Washington, D.C. 20002 (202) 546-4400

September 25, 1978

TAX-BASED INCOME POLICY: LATEST APPROACH TO WAGE AND PRICE CONTROLS

INTRODUCTION

The program of wage and price controls enacted by Richard Nixon ended in early 1974, but inflation has started to rise again in the United States and recent opinion polls show it to be the public's number one concern. At present, Administration policy is restricted to "jawboning," as it is termed (i.e., exhorting unions and management to hold down wage rises), and working with them behind the scenes. The Administration has an "inflation czar," as The Washington Post has termed him, in Robert Strauss who is claiming major successes in particular industries; but still inflation continues rising and the public sees current efforts as only a public relations exercise. George Meany, President of the AFL-CIO, has applied the term "wishboning" to the Administration's policy; and Arthur Okun, former Johnson Administration Council of Economic Advisers Chairman, has said that President Carter is doing everything possible to maximize the possibility of a miracle.

The Council on Wage and Price Stability under Barry Bosworth has had major disputes with labor. So against this background, it is little surprise to have talks of wage and price controls resurfacing.

Within the Congress, the Joint Economic Committee recently advocated "limited" controls and suggested a tax-based income policy (TIP) be given "serious consideration." The staff of the Senate Committee on Banking, Housing, and Urban Affairs is known to be drafting TIP legislation for introduction by Senator William Proxmire (D-Wis.) late in 1978 or early in 1979, and eight members of the House of Representatives (Representatives Lundine and

Note: Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.

Pattison of New York, Mikva and Simon of Illinois, Moorhead of Pennsylvania, Fisher of Virginia, Maguire of New Jersey, and Mikulski of Maryland) have joined in the introduction of H.R. 13865, the "Comprehensive Anti-Inflation Act of 1978," which also embodies a TIP scheme. This legislation was referred to the House Committee on Government Operations and the House Committee on Education and Labor, before which it is currently pending.

TIP also has strong support within the Carter Administration, as indicated by reports that staff employees of the U.S. Treasury Department and Internal Revenue Service were instructed to cancel their summer vacations so that they might work to determine what sort of TIP legislation should be promoted by the Administration. Lyle Gramley of the President's Council of Economic Advisers has been quoted as saying that "TIP is becoming more attractive simply because the other alternatives aren't much better or they're not working." The Federal Reserve Board of New York, formerly a strong advocate of monetary discipline and free enterprise, recently surprised several observers in its 1977 annual report, released on February 28, 1978, by suggesting that an income policy might be necessary to beat inflationary expectations and citing Britain as evidence. The AFL-CIO predictably announced its opposition to controls as rumors spread, and business is almost universally against them. TIP also enjoys the support of such leading figures as Henry Wallich of the Federal Reserve Board and Arthur Okun of the Brookings Institution (Brookings received a $75,000 grant from the Ford Foundation early in 1978 toward conduct of a seminar in Washington, D.C., designed to focus on TIP). It may also be highly significant that, as reported in the September 20, 1978, edition of The Washington Post, "White House anti-inflation czar Robert S. Strauss" had stated that "President Carter should adopt 'the toughest possible' wage-price program he can, and not listen to those who contend it would hurt him politically." This datum assumes added significance when it is noted that, speaking on September 20 before the annual convention of the United Steelworkers of America, President Carter announced that he would soon disclose details of a "tough" anti-inflation program. It is expected that this program will be centered around a set of "voluntary" wage-price guidelines backed by a system of limited sanctions.

TAX-BASED INCOME POLICIES

The Initial Proposal - Wallich and Weintraub

Although some economists had thought that there was some merit in taxing either firms or employees in the event that they needed or achieved large wage incomes during the 1960's, the first exposition of a comprehensive scheme along those lines to fight inflation was made in 1971 by Henry Wallich (currently a governor of the

Federal Reserve Bank) and Sidney Weintraub (now Professor of Economics at the University of Pennsylvania).[1]

The Background

The exposition of a tax-based income policy could not be meaningful without a prior understanding of the economic context in which the proposal was made.

Wallich and Weintraub were essentially pessimistic about the efficacy of wage and price controls to have any "real" effect on underlying rates of inflation in the U.S. economy. They acknowledged that the cause of inflation is expansionably monetary and fiscal policy and that price and wage controls can certainly prevent inflation if they simply dictate the level of price increases and the government has official clout to enforce this, but as soon as controls are released prices rise faster than before the controls, resulting in a situation where the price level is not appreciably lower[2] and may even be higher[3] than it would have been in the absence of controls.

They also considered the serious effects of controls on resource allocation via reductions of production, and the inability of price changes to signal changes in consumer preferences. Nevertheless, they considered that the institutional structure of the U.S. economy[4] is such that monetary and fiscal policy could only lower inflation at an economic cost in terms of lost output

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1. Henry C. Wallich and S. Weintraub, "A Tax-Based Income Policy," Journal of Economic Issues, June 1971.

2. See, for example, Michael Parkin in Lloyds Bank Review, July 1975, and Edgar L. Feigu and Douglas K. Pearce, "The Wage-Price Controls Experiment - Did It Work?", Challenge, Vol. 16, No. 3 (July/August 1973), for analysis of the U.K. and U.S. situations respectively.

3. See Timothy W. McGuire, "On Estimating the Effects of Controls" in The Economics of Wages and Price Controls, Vol. 2 of Carnegie-Rochester Conference Series on Public Policy, edited by K. Brunner and Allan H. Meltzer (Amsterdam: North-Holland Publishing Company, 1976), pp. 115-156, and Charles H. Whiteman, "A New Investigation of the Impact of Wage and Price Controls," Federal Reserve Bank of Minneapolis Quarterly Review, Spring 1978.

4. And Britain as well it would seem. Weintraub made one of the original explanations of the proposal in the Lloyds Bank Review (January 1970) perhaps with the anticipation that any form of wage and price policy was more likely under the (then) socialist government in Britain than President Nixon in the U.S. In any event, the Labor Party lost power in 1970 and a Conservative Government was elected under Mr. Heath. When the government imposed controls in 1972, they reverted to the classic rigid controls typical of the 1966 freeze.

and employment. This was because, on the one hand, industry continued a large degree of concentration in the marketing and service sector and thus had considerable ability to "administer" prices and, on the other, labor had a powerful union structure over a large part of the economy including many remuneration agreements with scope wider than just individual firms. Hence, restrictive monetary policy would be accompanied not by rapid reductions in the rate of increasing prices and wages, but by a continuing high level of price and wage hikes based more on historical circumstances and the actions of competitors than on anticipation of future aggregate demand. This would mean that firms would find themselves faced with concurrent falling demand for their output and rising costs for their labor output. Hence, a recession would develop. In the 1930's wage and price controls fell because of a different institutional structure to the present day, but now the cost in terms of lost output was a major item to be borne in mind when considering macroeconomic solutions to inflation. To give the reader an idea of the kind of costs which proponents of TIP envisage, George Perry of the Brookings Institution has estimated that one percent increase in unemployment will lower the inflation rate by 0.3 percentage points in the first year and 0.7 percentage points if maintained for three years. Furthermore, one percent unemployment is equivalent to $60 million of lost output.

It is against this model of the economy that TIP has been accepted by its main proponents, and it is in an attempt to anticipate the side effects of monetary restraint that it seems to have funneled support amongst many people close to the policy process.[5] TIP has been proposed at a propitious time for its proponents, for inflation shows no signs of abating and politicans are reluctant to tighten monetary policy to make it. It is perhaps because of this poverty of alternatives that the Joint Economic Committee recently held two days of hearings on TIP and said:

> We have long been on record as opposed to comprehensive wage-price controls and we do not recommend them now. However, we are deeply concerned that pressures will mount for such policies if we do not get inflation under control. We should therefore implement an incomes policy now so that we will not be driven into more drastic measures later....One idea that deserves serious consideration is a tax-based incomes policy (TIP).[6]

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5. See, for example, U.S. Congress, Congressional Budget Office, Recovery With Inflation, July 1977, p. 40; U.S. Congress, Joint Economic Committee, The 1977 Midyear Review of the Economy, 95th Congress, 1st Session, September 26, 1977, p. 76.

6. U.S. Congress, Joint Economic Committee, 1978 Report.

SHORT RUN OR LONG RUN?

However, Wallich and Weintraub did not propose TIP solely as an ameliorative measure during the process of price stabilization adjustments. True, they say

> It would be an error, however, to regard an incomes policy such as we propose as a substitute for monetary and fiscal policy. Instead, the proposal is conceived as a supplement to the familiar monetary fiscal policies so that the economy might operate closer to full employment without the inflationary changes of excess demand and "overheating."[7]

But the important word here is "operate" for they also state:

> ...TIP deserves consideration as a long run solution. One of the clearly demonstrated characteristics of other forms of incomes policy is that, given that they are attractive initially, they tend to break apart in the course of time. The effectiveness of TIP should improve over time as administrative techniques are perfected and the market learns to respond to it.[8] (Emphasis added.)

In other words TIP is a long-term policy to, in the proponents' belief, run the economy at a higher rate of employment without inflation. Thus, politicians are latching onto TIP for one reason whilst its authors envisioned it for another. It is also not clear what kind of monetary policy various TIP proponents consider as appropriate. Weintraub, for example, says:

> Given a suitable incomes policy to align wages (and salaries) to productivity, monetary policy would be released to make its contribution to full employment ....Full employment requires ample money supplies for its sustenance.[9]

And Robert J. Gordon, at a recent Brookings conference, certainly saw an exposition by Lawrence S. Seidman as implying an "accommodative" monetary policy.[10] It seems that "appropriate monetary and fiscal policy" is, in fact, a euphemism for the suspension of marketing restraints and the original authors' acknowledgement of

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7. Wallich and Weintraub, op. cit., p. 1.

8. Wallich and Weintraub, op. cit., p. 18.

9. S. Weintraub, "Incomes Policy: Completing the Stabilization Triangle," Journal of Economic Issues, December 1972, pp. 105-22.

10. See Brookings Papers on Economic Activity, Issue 2, 1978, p. 349, Brookings Institution, Washington, D.C.

monetary and fiscal policy as the cause of inflation as well! However, Arthur Okun of the Brookings Institution has explained the policy more in terms of an ameliorative measure for the price of returning to price stability.[11]

A DETAILED EXPLANATION OF WALLICH AND WEINTRAUB'S ORIGINAL PROPOSAL

In essence, Wallich and Weintraub advocated that the government should announce a "guidepost" for wage increases; for example, 5 percent. Any firm settling for a wage increase greater than the guidepost would be penalized by a higher rate of tax on its profits. For example, if profits tax were 40 percent and the firm settled a wage increase of 6 percent (i.e., one percent above the guidepost) then the excess tax may be 2 percent and the firm would pay 42 percent profits tax rather than 40 percent. They also envisage that the profits tax would be progressive so that the higher the wage settlement above the guidepost, the greater would be the excess tax on the firm's profits. Wallich and Weintraub also foresee the government changing the rate of excess profits tax as time passes until, they say, a point was reached where the policy was truly effective.

Most interestingly, perhaps, the proposal does not tax wages directly, but the profits of the firms, because the intention, in the minds of the authors, is to "strengthen the employer's backbone." Implicit in this is the notion that wage bargaining is, at least in the manufacturing sector of the U.S. economy, similar to pollution. In normal circumstances the union and the employer bargain and diverge and, even though the process may involve some industrial disruption, in the final analysis a wage bargain is arrived at which the employer can pass on to the consumer. Thus, unions and employers may "externalize" the costs of wage increases (ensure they are borne by sources other than the participants to the bargaining process). As evidence of this, Wallich and Weintraub cite the historical relationship exhibiting approximate constancy in labor's and capital's share of the national product. The cost of wage increases has also been in excess of the long-run increase in productivity but has not resulted in unemployment and a squeeze on profits because the government has pursued expansionably fiscal and monetary policies that have maintained employment at high and approximately stable levels.

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11. Arthur M. Okun, "The Great Stagflation Swamp," Challenge, November/December 1977.

The second interesting feature of the policy is that it is aimed at correcting the asymmetry in the bargaining process between the relative strengths of capital and labor. To the extent that the burden of restraining union power is passed from politicians to employers, TIP will find great favor with Congress and the White House. Experience in America has been that "jawboning" by the President's aides and even, at times, by the President himself has simply made the President look powerless, but TIP passes this buck to business and could thereby be termed "a 'hired-gun' incomes policy.

The economic logic for TIP is that set out above, and Wallich and Weintraub point out that the idea of firms simply fixing prices as a markup over costs is shared in many econometric models of the U.S. economy. The inflation restraints function works, say the authors, because the firm would settle lower increases, and thus the markup would result in proportionably lower price rises, causing inflation to steadily decline. There would be no need to place any restraints on prices because of the "historical relation" of the constant ratio of prices above cost. Competitive pressure would probably ensure that this could not rise. Furthermore, implicit within the foregoing statement is the assumption that firms could not pass on in price increases any of the excess tax on profits were they to be forced to settle above the guidepost. Wallich and Weintraub do not, however, hinge everything on the "historical relation" and suggest that if labor objects to profiteering, then an excess profits tax could be introduced to supplement TIP.

WHY TAX PROFITS TO RESTRAIN WAGES?

It may have struck the reader that Wallich's and Weintraub's proposal is very "indirect." In order to lower wage increases, they propose the taxation of profits, so why not go straight to wages and tax increases above the guidepost by making them not deductible for income tax purposes or by levying a dollar-for-dollar payroll tax? Wallich and Weintraub point out that such a tax would be shiftable. Labor would simply add an amount onto its wage claim to compensate for the tax, and management would pass it onto the consumer. Such a system of direct tax would also be more complex to administer. It should be stressed that it is not the intention of TIP to raise revenue for the government, so any revenue gained would be offset by tax reductions elsewhere--perhaps on the profits tax of firms who <u>do</u> settle within the guidepost; they could receive credits proportional to the difference between the guidepost and their settlement.

SETTING THE GUIDEPOSTS

As for the criteria for setting the guideposts, there are some economic features to bear in mind, although the choice is ultimately a political one. The economic fact that the government must take

into account is that there is a long-run productivity growth rate in the economy which, in the case of the U.S., is approximately 3 percent. Thus, if the inflation rate is 10 percent at the time of implementation, the government could choose any figure between and including 3 percent to 13 percent for the guideposts, depending on how far and how fast it wished to slow inflation. The figure is clearly related to the average growth of productivity and does not allow for higher wage rises for higher productivity gains in particular firms or industries except at the cost of a fine in the form of the excess tax. It is because, at the firm level, wages can be raised for this reason or simply to accede to a powerful union that Wallich and Weintraub call TIP something of a "free market" solution to inflation and attempt to get support from market economists for it. As will be argued below, the fact that relative prices can still adjust, albeit at a cost, is a rather selective use of the notion of a free market.

ADMINISTRATIVE QUESTIONS

Several points of administrative interest still need to be clarified. TIP would have to apply to total remuneration, not just wages and salaries (e.g., fringe benefits, bonuses, etc.), and it would have to be adjusted on a per employee basis if it were to actually succeed in restraining total money expenditure. It would also have to rely on data that are already available if it were not to induce the growth of a new bureaucracy. Furthermore, TIP would induce a change in the "skill mix" if employers could release higher skilled workers and employ lower skilled ones, as lower skilled workers typically would have lower wages and hence could be given larger raises before the firm's wage bill rose to the level where it was when the higher skilled workers were employed. There would also need to be the now-understood regulation associated with any policy of controls to prevent "regradings" and shop dismissals followed by reappointments at higher wages. For these reasons Wallich and Weintraub propose that the classification should be

> Total wage and related payments in each job classification and grade, divided by the number of man-hours worked in the respective categories, and combined into a weighted index of wage incomes. This would give a fairly watertight specification of a wage increase. The data should be available on the records....[12]

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12. Henry C. Wallich and S. Weintraub, *op. cit.*, p. 14.

Nevertheless, they do see a shift toward less-skilled labor as necessity, a negative by-product of TIP as it would tend to lead towards greater income equity.

SCOPE AND COVERAGE OF TIP

For administrative and economic reasons, Wallich and Weintraub would exclude small firms from coverage. To have its desired effect, they say, only firms with profits in excess of $1 million would need to be covered. Similarly new firms could be excluded as their size is likely to be insignificant.

More difficult, they feel, is the question of long-term contracts. Difficult legal and political questions would be raised if pre-existing contracts gave wage increases significantly higher than under TIP. Even if the problem were solved by excluding from excess profits tax those firms that had entered them, there would still be the problem that TIP would take three years to be fully effective.

For public utilities, where there is an established practice of regulating authorities, allowing them a "normal" and steady rate of return, there are clearly possibilities for profits tax shifting. Wallich and Weintraub would rather continue with this arrangement and exclude utilities from TIP than upset it.

AN EVALUATION OF TIP

The success or otherwise of TIP crucially depends on firms not being able to shift forward to consumers the excess tax on profits that the government levies. Nevertheless, their discussion of the subject is very unsatisfactory. It seems to leave the impression that all they have done is express a vague hope that the tax will not be passed on.[13] They say that the lack of greater profitability in concentrated industries relative to competitive industries is evidence of little tax shifting. They suggest that the effect of a profits tax hitting different firms unequally may be the reason for the fact that it is not passed on, unlike a payroll tax which does hit all firms equally. But absence of supernormal profits in a concentrated industry can be explained by other than profit

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13. Henry C. Wallich and S. Weintraub, _op. cit.,_ p. 5.

maximizing behavior on the part of firms and is not any kind of evidence of the inability to shift the corporate income tax. Other studies[14] conclude that the burden can be shifted, depending on the firm's behavior; and Musgrave and Musgrave[15] in a detailed analysis conclude that the empirical evidence (the "litmus test" of any theory) is inconclusive.

Isard's study and Miller's study are especially interesting. Isard compares two cases: in the first, the firm is a profit maximizer and in the second, it follows a markup rule. It sets prices at a certain percentage above what costs happen to be. The firm is assumed to face the same constant elasticity demand curve in both cases, but in Case 1 knows the curve and in Case 2 does not. His analysis concludes that in the first case (profit maximization) the firm will first of all make the output decision and then pay tax on the profits; thus, the tax will not be passed on. However, in the second case the whole of any increase in labor costs is shifted forward, and also a fraction or multiple of the increase in tax assessments. Although Isard sees Case 1 pricing behavior as more likely to reflect real-life business behavior, his Case 2 pricing behavior is a closer approximation to the real-life pricing behavior assumed by Wallich and Weintraub.

Miller, in his analysis, assumes that the revenue raised by TIP is redistributed to firms that increase unit labor costs by less than the TIP guidepost. It also assumes, in line with Wallich and Weintraub, that the firm has some "price administering power;" i.e., it faces a downward sloping demand curve. In this situation he notes that TIP becomes a tax on labor. If an employer wishes to hire one more worker, then he has to pay the market wage rate. Assuming a rising supply curve, this means that the hiring of an extra employee under TIP, with the tax included, is unprofitable, whereas it would have been profitable with no TIP. However, it is now very profitable to sack employees, for the employer is entitled to a subsidy for reducing unit labor costs by producing less with fewer employees. But because less is being produced, the price of each unit of output is higher, so TIP has raised the price level and reduced wages. It has also increased the profits of the firm. As the evidence is considered, it is difficult to say anything very definite about the ability of firms to pass on corporate taxes, and this constitutes a serious charge against TIP proponents.

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14. See John Hotson, "Advance Effects of Tax and Interest Hikes," Canadian Economic Journal, September 1971; Preston Miller, "TIP: The Wrong Way to Fight Inflation," Federal Reserve Bank of Minneapolis Quarterly Review, Spring 1978; P. Isard, "The Effectiveness of Using the Tax System to Cut Inflationary Collective Bargaining: An Analysis of the Wallich-Weintraub Plan," Journal of Political Economy, May-June 1973, pp. 729-740.

15. Richard A. Musgrave and Ryan B. Musgrave, Public Finance in Theory and Practice (New York: McGraw-Hill Book Company, 1973), Chapter 18, pp. 415-419.

THE EFFECT OF TIP ON WAGE SETTLEMENTS

Nevertheless, assuming that not all the tax can be passed on, the effect of TIP on wage settlements is the next major question. Wallich and Weintraub assume a model of collective bargaining in which management gradually increases its wage offer during the negotiating time (which may include industrial disruption such as strikes) and labor gradually reduces its claim. This arises due to increasing costs to both parties due to strikes, disruptions, etc. The effect of TIP, say Wallich and Weintraub, is to increase management's "backbone" and make it hold out longer.

For example, consider the following. The government announces a TIP guidepost. The effect is to move the management wage offer curve down and, if the union's wage demand curve remains at its original position, then the wage settlement is reduced. A lower settlement has been reached (as TIP proponents claim) but at a cost of more industrial disruption. Now consider what will happen if the unions grow disgruntled with TIP after some months and start to make higher wage claims but do not lower industrial disruption at a faster rate. This could be termed an "increase in militancy." In other words, over a period of time union response has rendered TIP both ineffective at restraining wage increases and more costly in terms of strikes. Supposing that the government responds by increasing the excess tax on profits, thus moving management's wage offer curve further down, then by this time strikes will have become so ubiquitous as to render all the virtues of TIP meaningless. Management and labor would be in a state of "industrial civil war" and screaming at the government to repeal the policy. The long-term implications of such an increase in industrial militancy are even more worrying, for if it increases during a TIP period, will it dissipate just as quickly? British experience suggests that the demonstration effect proves otherwise. Once labor grows big muscles, it starts to flex them.

Little is to be found in the writings of TIP proponents about the possibility of this; and that fact alone is surprising because what is essentially taking place, in the latter scenario, is a change in the institutional structure, and all the major writers on TIP are people who give the greatest attention to institutions in their analyses. It is odd that they should have given so little attention to an institutional change which is, of itself, a sufficient condition to render the credibility of TIP meaningless.

A possibility which would appear to enhance the chance of the phenomenon described above is that due to the tendency for prices to adjust to wages with a substantial lag, there would be an initial windfall increase in the product share of profits upon the implementation of TIP. This was certainly one concern expressed at a recent conference at the Brookings Institution.[16]

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16. Brookings <u>Papers on Economic Activity</u>, Issue 2, 1978, pp. 351-353, 257. Brookings Institution, Washington, D.C.

WOULD BUSINESS LIKE TIP?

Not only would labor oppose TIP, but so would business. It would be placed right in the firing line of the anti-inflation battle responsible for causing a disease which government had created. Traditionally a supporter of strong monetary and fiscal policy to curb inflation, business morale would plummet and investments slump as firms sought to keep assets liquid in case they should have to face a large wage demand and because the outlook under a long-term TIP would be very depressed.

WOULD TIP LET THE MARKET FUNCTION?

The great claim for TIP over strict controls on wages and prices is that it would let the market function. However, as mentioned earlier this relies on a very selective idea of what a functioning market is. Certainly prices would be free to rise and fall, but the ability of firms to react to changes in prices as signals of unexploited profit opportunities[17] would be severely hampered by the tax they would have to pay if they wished to hire labor or raise wages for existing employees. As a result, profit opportunities (i.e., consumer wants) would either go unsatisfied or be provided for by imports. More broadly, TIP takes no account of millions of changes in productivity that occur every year in a sophisticated economy like the U.S., but simply limits wage increases to the national long-run average. This is a fatal flaw, because the long-run national average growth of productivity is barely a real figure. Certainly, someone in America probably achieved it over the last few years, but it is essentially a statistical construct. It is the statistician's way of trying to make sense of a world where there have been thousands of new terms created and old ones destroyed, millions of new products introduced and changes in the whole structure of the economy and its technology; and, as such, to apply it to the determination of all wage settlements is to take macroeconomics beyond the extremes of its usefulness. John Dunlop of Harvard, an expert on labor economics, puts it more straightforwardly:

> Single, uniform standards for wages, as for prices, are simply not effective.[18]

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17. For one of the best discussions of the role of entrepreneurship, see Israel M. Kingner, Competition and Entrepreneurship, New York, 1971.

18. Quoted in Business Week, October 3, 1977.

And when would TIP be implemented? When is the market in equilibrium so that imposing a "single uniform standard" will not create perceived inequities? How is the problem of multiyear contracts to be resolved? Wallich and Weintraub do not have a satisfactory answer.

THE ADMINISTRATIVE PROBLEMS OF TIP

Furthermore, the administrative problems with TIP could be enormous. There are problems of scope and coverage, and proponents say that only companies with profits of $1 million or the Fortune top 1,000 would need to be covered; but inevitably distortions will arise that will get worse with time. In some industries, there are longstanding union agreements that apply to large and small firms alike where government mandated severance would be found to create friction. Rees[19] raises many questions of this kind, such as, what would happen if a union struck an industry-wide or pattern-setting agreement in excess of the guidepost with an unprofitable chain that would suffer under TIP? The implications would certainly rebound elsewhere, and the costs of wage settlements would still be externalized--one of the problems that Wallich and Weintraub assert they would solve. How would non-profit-making institutions be treated? Some of these are quite large and the government, as one of them, could find itself a prime target.

Another claim by its proponents is that TIP would not require any new bureaucracy, but this is a claim that has been made for all controls since World War II and has never proved to be the case. Gardner Ackley has commented:

> From my experience in designing and administering price controls during World War II, and again, in a policy role, during the Korean War, I retain keen, and sometimes bitter, memories of great ideas of about ways to restrain wage and price increases for which the fine print could never be written--or if it could be written, filled endless volumes of the Federal Register with constant revisions, exceptions, and adjustments necessary to cover special situations that could never have been dreamed of in advance by the most imaginative economists, accountants, and lawyers.[20]

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19. A. Rees, "New Policies to Fight Inflation: Sources of Skepticism," Brookings Papers on Economic Activity, Issue 2, 1978, pp. 453-477.

20. Gardner Ackley, "Okun's New Tax-Based Income Policy Proposal," Economic Outlook, USA, Winter 1978, p. 8.

It is difficult to see how the proposals could even be administered accurately at the firm level, even with the firm acting on good faith, because the definition of employee compensation put forward by Wallich and Weintraub (see above) asks for statistics which initially no large firms currently compute and certainly no small ones do.

CONCLUSION

The view that controls or incomes policy can contribute to a permanent reduction in the rate of inflation associated with any given level of unemployment (i.e., a reduction in the "natural rate" of unemployment) is fundamentally misguided. As an indication of the adjustment process to a stable price level, TIP is likely to make things worse, in terms of wage settlements and strike costs, rather than better. Above all, the distortions that such policies induce in the market reduce the economic welfare of everyone.

More insidious but no less important is the tendency of controls, even a novel one like the above, to detract from the real cause of inflation. The real cause is laxity in monetary and fiscal policy over a long period of years that has built up inflationary expectations to such a level that it will not be possible to eradicate them in a matter of months. Nevertheless, the adjustment, if it started now, could reduce inflation to tolerable levels by the end of 1980, but progress in this demands our attention to the task that is not engendered whilst short-cuts are mistakenly believed to exist.

The economists who believe that the economy can be interfered with to any degree by government have, essentially, an engineer's view of economics. An engineer is told a particular end to achieve, he has all the necessary information on the state of technology, and he has only a few variables to deal with.

The economist, by contrast, does not know the value hierarchies of consumers, nor does he know all the available means to achieve those unknown ends, and he is dealing with an infinite number of variables in those unknown means to achieve those unknown ends. Sometimes, economists forget this.

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