Implications for Policy: A Symposium

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WE OWE a considerable debt of gratitude to Sidney Weintraub, Henry Wallich, Laurence Seidman, and Arthur Okun for developing the concept of the tax-based incomes policy (TIP), and for keeping it alive in the face of public and professional disinterest. I believe that the papers and discussion of this conference have greatly advanced our understanding of the implications of the proposal, even if they have not answered all questions nor, I am sure, produced general agreement even in this room.

Among economists, just as among other groups, there is and will be opposition to TIP by those who oppose in principle any incomes policy. I am regarded—correctly, I suppose—as one who is skeptical about TIPs.[1] But it surely is not because I am opposed to incomes policies in principle. I first publicly called for such a policy in the 1958 Joint Economic Committee study on the relationship of prices to economic stability and growth.[2] I have supported the use of an incomes policy ever since, and have repeatedly urged that such a policy be established during every subsequent period in which it was not in use. I suppose my participation in administering and defending the guidepost policy of the 1960s equaled or exceeded both in duration and intensity that of any other person; and it reflected an enthusiastic personal commitment. I accept the analysis in George Perry's paper for this conference as fully consistent with a general

1. Gardner Ackley, "Okun's New Tax-Based Incomes-Policy Proposal," *Economic Outlook, USA*, vol. 5 (Winter 1978), pp. 8–9.

2. Gardner Ackley, "A Third Approach to the Analysis and Control of Inflation," in *The Relationship of Prices to Economic Stability and Growth*, Compendium of Papers Submitted by Panelists Appearing before the Joint Economic Committee, March 31, 1958, 85:2 (Government Printing Office, 1958), pp. 619–36.

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view of the inflationary process that I have held and promoted for twenty years or more, and I regard the paper as providing a fully adequate theoretical and empirical basis for an economist to support an incomes policy.

Thus, in my view, the question is not whether to use an incomes policy but only what kind to use. There are numerous models, of which I may perhaps usefully delineate three. I eliminate a fourth (compulsory controls) as far too costly in economic, administrative, political, and moral terms.

The first model is that of an incomes policy enforced by "jawboning" and related forms of education, pressure, and persuasion, which centered in the White House during the period 1962–68. From what I know or can assume about the plans of the Carter administration, its present intention regarding an incomes policy conforms essentially to that model. To be sure, the basic standard—"deceleration"—is considerably more vague than the Kennedy-Johnson guideposts; and it is not clear that the policy commands even as much genuine administration commitment as it did in the 1960s. On the other hand, the Council on Wage and Price Stability should supply considerably more and better staff support than we ever had.

I have previously outlined what I regard as the principal weaknesses of the jawboning model.[3] They include (1) the absence of any significant "legitimacy" for the policy in the eyes of those most affected, either through the actual involvement of leaders from the business and labor communities in advisory or policymaking roles, or through any legislative basis for the program;[4] (2) the personal identification of the program with the President, which has disadvantages both to the program and to the presidency that I regard as greatly outweighing the advantages to either; (3) the inevitable highly adversary character of the procedure; (4) the rather hit-or-miss application, primarily to cases that happen to draw government or public attention; and (5) the adherence of a firm or a union to such a policy that rests on the acceptance of a social or political responsibility contrary to economic interest. To be sure, if participation were general, the actual cost to each might be negligible. Even so, the paradox is that the greater the general participation, the greater the individual economic advantage in nonparticipation. I do not consider this as a necessarily fatal defect; but it must be recognized as a weakness.

3. For example, in Gardner Ackley, "An Incomes Policy for the 1970's," *Review of Economics and Statistics*, vol. 54 (August 1972), pp. 218–23.

4. The Council on Wage and Price Stability now at least has a legislative basis.

The TIP model avoids many of these disadvantages. Its necessary congressional mandate gives it political legitimacy; labor and business leaders have the opportunity to become involved at least during the legislative stage; the presidency is not demeaned by brawling confrontation with firms and unions. Rather, each private group makes its own decisions, taking account of costs and benefits, and there is no arbitrary or accidental selection of cases (except through legislative action to exempt areas of the economy from coverage or to provide special treatment).

On the other hand, as the papers and discussions indicate, TIP has its own problems. I am convinced that a price-TIP would be an administrative nightmare. Yet the politics of "wage control without price control" may require that we accept some control on prices if we want to have TIP at all, as Albert Rees and others have pointed out. Moreover, the overwhelming econometric evidence that prices follow wages is demonstrated only at the macro level, not for firms and industries. The public may not understand the benefit of wage restraint, or wish to tolerate it, if the restraint in particular cases is or appears to be appropriated by particular employers. This I believe to be the key to union opposition to incomes policies. I am impressed with several of Rees' points about the difficulties of TIP when an employer deals with several unions or when a union deals with an industry. Indeed, I raised some of these same questions.

I am troubled by the necessary choice between the greater effectiveness of a continuous, penalty-TIP on wages (which Seidman's paper demonstrates) and the far greater administrative costs, public and private, which such a program entails (shown in the paper by Larry Dildine and Emil Sunley and in comments by Richard Slitor). On the basis of previous experience with wage and price legislation, I think we must be prepared to assume that each special interest—and this policy will touch them all—will press for special provisions to protect that interest, either in the initial legislation or in subsequent amendments. Such legislative provisions can destroy the effectiveness of the policy or create an administrative monstrosity, or both, as has happened in the past with price and wage controls. (This is also a well-established characteristic of tax legislation.)

In my view, the chief administrative problem is not tax evasion or even cheating, but rather that, say, one-half of the 1 percent of the firms covered will claim some aspect of the general rules to be unworkable or unfair.[5] Perhaps 10 percent of these complaints cannot be dismissed out of hand. If coverage is substantial—certainly close to universal—this one-twentieth of 1 percent of firms means the administering agency and the Congress must spend millions of man-hours to develop some remedies. And if either the agency or the Congress modifies the regulation or the legislation to handle a case, that almost certainly creates new problems or opportunities for others.

My judgment is that if the TIP model could at least be confined to wages, which may not be politically feasible, it is clearly preferable to the jawboning model of incomes policy. This is with the understanding, as James Duesenberry argued, that TIP is regarded only as a part of a continuing effort to build a consensus in support of mutual restraint.

There is, however, a third possible model, based primarily on voluntarism and persuasion, which might be preferable to TIP. I have described it elsewhere,[6] and will not repeat it here, except to indicate that it includes (1) a *highly selective* coverage of both wages and prices; (2) a legislatively established administrative agency with certain limited powers to require reporting and to delay increases that are above the standard; (3) essential independence from the White House; and (4) fairly elaborate formal arrangements for the advisory involvement of representatives of labor, business, and the public. The administrative (as opposed to the legislative) character of this model more easily permits ad hoc adjustments to avoid the various kinds of efficiency losses our discussion has noted. And it accommodates Rees' observation about the desirability (on occasion) of having incomes policy administrators "help in the settlement of actual or potential disputes in collective bargaining or in the improvement of collective bargaining structures."

My proposal describing this third model has been in the public domain for a considerable period and has attracted little interest, which probably indicates that it is fatally flawed. I refer to it only to point out that the choice is not between jawboning and TIP, or nothing. Social invention has been badly needed in this area and, while TIP is an outstanding candidate, there may be still other possibilities or variants of an incomes policy that would be either economically and administratively more efficient or politically more attractive.

5. By "unfair" I mean that there is an alternative, plausible way to apply the general principle involved that would be more favorable to the complaining firm.

6. See "An Incomes Policy for the 1970's," pp. 222–23.

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I HAVE NEVER been persuaded that incomes policies, if that term can be generalized, can work for any protracted period of time or leave any permanent effect on the wage and price structure. Nonetheless, it is clear that the TIP proposals try to confront some of the basic problems of most incomes policies.

Because there is a great deal of incentive—whether carrot or stick—involved in the TIP proposals, they are assumed to simulate market processes in many respects. Thus, if TIP were not employed as a substitute for conventional fiscal and monetary policies, some anti-inflation impact might be achieved. Certainly in the abstract, as the model developed by Laurence Seidman illustrates, it is not difficult to construct fairly general conditions in which TIP would appear to have some marginal advantage.

The difficulty I have had and still have, especially after these meetings, is that, while we can construct a simplified model in which a tax-based incomes policy could work, the abstraction can never fully capture the complexity of a TIP in application. On this point I find myself in agreement with Joseph Pechman. No one questions that we are dealing with a problem in which administration is difficult. But is that difficulty merely something that could be overcome with operational experience, or are we confronted with an issue in which the complexity of administration is its fatal flaw?

I suspect there is no solution to the administrative problem. Larry Dildine and Emil Sunley did an excellent job on their paper. However, it strikes me that they barely scratched the surface of the problems we would confront with a TIP in full-scale operation. Those problems would not be significantly different from the administrative nightmare of our wage-price control experience that occurred after August 1971. What struck me about that period was the inconceivable complexity of what the controllers were attempting to do, firm by firm, product by product, wage by wage, and how the entire process held together, largely because the controllers never really attempted to confront market forces head-on.

There was an accusation at the time that the administrators who ran the control program did not have their heart in it and, therefore, the program could not be successful. In fact, every time they attempted to make the control system work—in the sense of trying to prevent companies and unions from doing what they would ordinarily do—the program ran into extraordinary problems, and the controllers backed away.

One important aspect of Phases II and III of the control program to remember is that although price and cost data were submitted in detail, they were never appropriately audited. There was no effort to actively administer the program. It was de facto a voluntary program characterized by a huge paper flow, frenetic committee meetings, and vague pronouncements. It was fundamentally wheel-spinning. But if TIP were implemented, legislation would require auditing and verification of the elements of the system to the same degree that our tax system is audited. This would create an insurmountable administrative problem. Litigation would quickly swamp the courts and make TIP politically infeasible almost immediately. That does not mean it may not be tried. There is a growing sense of desperation that could easily trigger risk-laden policy initiatives. If the cost of a failure of this type of program were zero, or there were only inconveniences associated with it, there would be no reason not to try. At worst, we would end up with an administrative mess but with no permanent damage. However, there *are* significant costs to every policy failure; and in constructing policy initiatives, it is essential to be aware of what happens if the policy initiative goes wrong. That is certainly true of fiscal and monetary policies.

If a TIP were tried, judging from what has happened during past control programs, the participants would rapidly learn how to beat the system. Because it would be almost physically impossible to maintain an appropriate audit of wages and prices, the extent of avoidance, if not evasion, would become far greater than anything even remotely contemplated in the income tax system. This could be quite disruptive to economic policy.

In the case of TIP, even if it failed, we would still have in place a control-oriented bureaucracy, and I fear the political pressures that would emerge to employ it. When government in effect considers certain price or wage relationships appropriate and a quasi-voluntary program fails to induce them, there is strong political pressure to mandate them.

Obviously, to the extent that a TIP program is narrowed and limited, the problems I outlined above are also narrowed. Thus, a TIP based on a limited form of the stick approach that was restricted to wages and to large companies would only sharply reduce administrative and auditing requirements. Those requirements would still be voluminous and fraught with problems—many of them unforeseeable—but it is unlikely that the system would be swamped by them. However, to the extent that TIP is narrowed, whatever positive benefits are expected in theory would be lost. It is difficult to make an effective judgment a priori on the trade-off between administrative simplicity and anti-inflation benefits. My suspicion is, however, that the impact on wages from a limited program is likely to be much too small to be worth implementing. For even a limited TIP is a large program that would entail administrative burdens. Unless there is a reasonable expectation of a significant anti-inflation payoff, it is difficult to make a case for going ahead with even a limited TIP.

That is not to say I see a simple solution to the current type of chronic inflation. I am not persuaded a 6 or 7 percent inflation rate cannot be changed and that the unwinding that began in 1975 and lasted through late 1976 is necessarily over. If it is, I would be gravely concerned that some form of unsuspected capacity restraint is being created. At this stage, it would seem that it is still possible to continue unwinding the inflationary pressures, provided that reasonable macropolicies are maintained. I think it is much too soon to throw in the sponge on macropolicy, especially if TIP is being considered as the alternative.

This conference has made a great contribution toward airing a number of the problems confronting TIP. But it may be even more complex than those of us who have been involved in similar undertakings suspect and, hence, more analysis is needed. I am most concerned that the administrative problems will be dismissed too easily. If that occurs, some very serious policy difficulties may be the consequence.

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IT IS SOMEWHAT embarrassing to follow two speakers who have had a lot to do with setting up price controls, managing them, and seeing them from the inside. My only claim to being here is that in testimony before Congress in 1971, following an appeal by Kenneth Galbraith for price controls, I strongly urged Congress to avoid price controls and suggested that if it were really serious about controlling inflation it should consider an approach that accomplishes the same objectives but is much simpler.

The approach recommended was basically a variant of the Weintraub-Wallich plan. It relied on the general principle that the law decides which expenses are deductible in the computation of taxes. Wage increases in excess of some established guideposts would not be a deductible expense for the purpose of calculating profits. In effect, wage increases granted over and above the guideposts would come entirely out of the net after-tax profits, instead of 48 percent being paid by the Treasury.

One could also think of a more sophisticated taxation scheme in which an excess profits tax is imposed on the increase of profit margins per dollar of sale above some base period, but without allowing the deduction of wages in excess of the agreed amount in computing the profit margin.

Let me begin by stating that it seems to me that TIP, no matter what form it takes, should be considered only for the purpose of breaking momentum inflation, a theory that Perry has described so well in his paper. He has shown that the source of current inflation is largely momentum. If that momentum could be broken, most people would be better off, and no one would be worse off.

Inflation can be very costly or only moderately costly. But certainly it is costly in practice. At the same time, there is no question in my mind that TIP has distortive effects. The best possible TIP, including that of Lerner, still has some disruptive effects. Accordingly, a transitional TIP might be best.

I agree with Alan Greenspan that inflation is probably still declining in response to high unemployment. Inflation may fluctuate, but it is probably on the expected declining course. Because the effects of unemployment are slow and systematic, the inflation rate could bounce up after a year or two in which unemployment declined fairly fast. But nonetheless, the process via unemployment is extremely costly and painful. If there is another disruption from any source, more restrictive fiscal policies will follow. These issues ought to be faced.

Almost everyone participating in the discussion seems to agree that TIP, although perhaps not the ideal answer, is better than controls. The bleak picture that Alan Greenspan has described in managing price controls is something I have seen on many occasions when I lived through many price-control experiences in Italy. My doctoral dissertation was about Italian price controls in 1935. They were a nightmare.

What we really have to control is wages. But politically it is very difficult to do that without also controlling prices. In fact, it probably cannot be done. That is why I think TIP is really promising—because it can be applied fundamentally to wages, possibly with some reinforcement from an excess profits tax. There are, as we have seen, two basic kinds of TIPs, the carrot TIP and the stick TIP. From the point of view of its appeal, the carrot TIP is far superior. Arthur Okun should be given a great deal of credit for developing a concept that in principle is highly attractive for many reasons. Like the stick, the carrot is easier to apply to wages than to prices. But I have doubts about feasibility because, as most seem to agree, reward must be universal. The government cannot treat a large firm and a small firm differently and provide one with the incentive and not the other. It has to be universal, and if it is going to be universal, it runs into the problems that Joseph Pechman has described quite well.

In my view, the enforcement problems, which may be severe even for large firms, are worse for small firms. Thus, if the employee of a small firm is promoted and receives a higher wage, the firm exceeds the target. Every small firm will have a similar problem. Employees would be changing positions, and there would be no way of forming a base. Think of the new employee at a firm that has already granted large wage increases. He does not receive the benefit of the tax rebate, even though he himself did not have an increase in wages. I think that the horror stories are almost unlimited. The problem of administration would seem nearly impossible.

Then there is the stick TIP. This approach could work through higher corporate tax rates, which is the original Wallich-Weintraub form, or through the nondeductibility of wages, which is the proposal I have made. But I have to modify that claim. After I made that proposal, Senator Proxmire asked me to investigate whether anything like that had ever existed. I then turned to Cary Brown, who pointed out that during World War II there was a provision that allowed the Treasury to disallow deductibility of wages in excess of wage control. So there is a historical precedent, and that is one great advantage.[1]

Of course, there are problems of enforcement with my proposal, too. I would support Okun's suggestion to let firms decide at the beginning of the period how they will classify workers. Let them decide whether they want to report by per capita, by standardized classes, or by any similar system. We do not need to strive for perfection if we rely on TIP as a temporary program, by which we aim to lower inflation by, say, 1 percent a year for three consecutive years, and then call a halt to the program, cutting our losses. And let us be sure that at the time we dismantle the program, we have not reached an unemployment rate that is too low. Otherwise, we immediately re-create a problem. Thus, the enforcement problems do not strike me as totally insoluble, although I agree with Alan Greenspan that once we have settled on one of these methods, we should explore it further.

One problem that would arise is obtaining the cooperation of labor. What we heard from Albert Rees is discouraging; however, his comments focused on the Wallich and Weintraub approach. For the purpose of catching the public's attention, Wallich referred to his approach as backboning rather than jawboning. But that is the wrong way to present the case to the public and to labor—as a plan that would force employers to stand up against labor.

Another way to say it is: here is a program to reduce inflation that uses the guidelines that have been established, and everyone has an interest in sticking to it. We want to put some public disapproval on those who do not stick to it by attaching certain penalties. That places all the emphasis on cooperation, and none at all on backboning. We must minimize the extent of violations. But we could agree that if people want to violate the principle, they may have good reasons, and they may pay the penalty.

Nonetheless, it should be made clear that the intent and purpose is not

1. U.S. Bureau of Internal Revenue, Regulations 111, Subpart B, sec. 29.23(a)-16, published in U.S. Treasury Department, *Regulations 111 Relating to the Income Tax* (Government Printing Office, 1943).

at all to impose the burden of slowing inflation on labor through lower *real* wages. The goal is to benefit everybody. Since the response of prices to wages should be fast, inflation will slow down. There may be a little lag. When wages are rising at only 6 percent, prices may be rising more than 4 percent, but the two variables ought to be declining close together. I think that is the sort of thing that has to be emphasized.

However, there are still other problems. One is that the proposal sounds like an antilabor approach. Second, it is applied only to wages and not to prices. And there is a third aspect: there might be a tendency for the penalty on increases in wages to be transferred into higher prices. Because the excessive wage settlement costs the firm much more, TIP might have this effect. From this point of view, there is much to be said for combining the nondeductibility of excess wage increases with an excess profits tax on the profit margin above some level. In that case, it is highly unlikely that the firm will find it to its advantage to pass on the higher cost in higher prices. That would be a guarantee for labor that they are protected against an expansion of profit margins.

This system should be applied fundamentally to a small number of firms, say, 2,000 as an arbitrary number. That it can be applied to a small number of firms is a helpful point of departure. There is, to be sure, the risk that as we approach full employment, the greatest push may come from the low-wage workers in small firms. That is a problem, and we should not press too hard for full employment. There may be a way to combine coverage of firms employing more than X people with that of unions representing more than Y people. Such unions may deal with many firms, and penalties would be applied at the level of the firm.

Let me conclude by stating some of the main problems of a TIP. One area of concern is the administration problems that we have heard about from the experts, particularly the legal and management aspects. It seems to me another serious problem is starting out. In the beginning, some people will have had a recent increase in wages, and others will not have had one for three years; that raises the issue of equity.

That is a tough problem, and I have learned a great deal about this from Gardner Ackley on a recent occasion when he talked about the efforts to maintain equity in a program of this kind. The problem would probably be alleviated if the average wage of the three years preceding the program were used as a base from which to compute allowable wage increases. Limited duration of the program would also help.

I have already mentioned the distortive effects. I believe that any TIP will have such effects beside the desired effect of slowing inflation. It is important to be aware of this, and try to dismantle any such program as fast as possible.

I am inclined to disagree with Alan Greenspan's pessimism about the possible effect of failure of this policy. I do not understand why there should be pressure on the political system. The experience we had at the end of Phase IV was that everybody was fed up with it, even those who had been in favor of it. Only four years later those failures seem to be forgotten!

I am not impressed with the argument that TIP would create evasion pressure. Evasion pressure assumes that firms are eager to pay higher wages. It seems to me that pressure to evade is questionable, because it provides a basis on which the firm can stand. It supplies an "objective" figure for the firm, at which it can say, "That is the point at which we stop."

In the end, I think a TIP design based on a stick approach with a limited number of firms—possibly my proposal or something similar—deserves further consideration. Certainly this conference has persuaded me that all forms of TIP, including my own version, are not as alluring as they once seemed. But reliance on unemployment still appears to me to be even less alluring.

Comments and Discussion

Henry C. Wallich: Of course, nobody likes TIP per se. It is really a question of the alternatives. We are running out of good options and have to look at choices among unattractive ones. The discussion of this conference has brought up a number of important points, some of which have caused me to change my mind about various issues.

For instance, I am no longer persuaded that the income tax is necessarily the best tax through which to levy a penalty. Perhaps disallowance of excess wage increases, despite the possible adverse shifting effects, is a more meaningful and manageable procedure. There is a precedent for it in the tax code.

In addition, I am no longer convinced that TIP must be widespread in its coverage. Perhaps the top 2,000 firms would be the appropriate universe with which to deal in order to simplify the administrative problems.

I have also acquired some doubts as to the fixity of the link between prices and wages. If a plan is to be at all acceptable to labor, that relationship needs to be demonstrated more firmly both at the empirical and the theoretical level. But there are ways of overcoming the doubts and reassuring labor against the danger of runaway profits. If those profits should tend to go above some benchmark level, one could impose a surcharge on the corporate profits tax that would stabilize the share of profits in the GNP. Such a surcharge would not be an excess profits tax on any single company but one on the entire corporate sector, including high earners and low earners.

At one time I thought TIP should be terminated as quickly as possible. But the possibility of reducing the natural rate of unemployment strikes me as an important point in favor of a TIP of longer duration. I feel that Laurence Seidman's argument on this matter is fairly clear and persuasive.

If TIP could lower inflation, that benefit could be used to lower inflation at the existing natural rate of unemployment, hold inflation constant at a lower natural rate, or something in between, as long as TIP remained in force and its guideline were lowered year by year.

Finally, I am gratified that the discussion here has been largely between those who would favor some form of TIP and those who are generally skeptical about it. It is important that the various proponents of the different schemes have not argued against each other, but rather have tried to develop the implications of the alternative approaches to see how something viable could be best constructed. Nothing is ever enacted the way it is first proposed. The need at this point is to keep the discussion going. If I could push a button to make a proposed TIP go into effect now, I would not push that button; but I would urge strongly that we continue to examine this type of proposal.

Arthur M. Okun: I see an urgent need to develop new strategies against inflation because the outlook on the present scenario is extremely bleak. I believe that inflation has already accelerated a little above the 6 percent plateau of recent years. That movement stems, not from excess demand, but from an inevitable catch-up in nonunion wage rates, a gradual adaptation of private decisionmaking to the higher secular inflation rate, and an addictive attachment by the government to cost-raising measures—just the opposite of the constructive course that Robert Crandall outlined in his paper. I wish I could share Franco Modigliani's and Alan Greenspan's brighter view of the economic outlook. In my judgment, inflation will next decelerate only when unemployment rises and, in light of the current stance of monetary policy, probably during a recession. Of course, as George Perry highlighted in his paper, recession will slow inflation, but only at the absurd cost in production of roughly $200 billion per point.

Faced by costs of that magnitude from recession, our society is challenged to find some mechanism for a mutual deescalation of wages and prices in prosperity. When our common interests so clearly outweigh the conflicting interests of various groups, the ability of the nation to lick stagflation is a serious test of our democratic political process, and not merely a question of our ability to find the right unemployment rate. TIP and the cost-reducing strategy, focusing on reductions of payroll and excise taxes, are a route to mutual deescalation without recession.

I have no deep substantive convictions about the relative merits of a reward TIP and a penalty TIP. I first tried to promote interest in the Wallich-Weintraub plan in 1973; many people who were sympathetic to its objectives regarded it as inequitable and hence politically unacceptable. Because of that reaction, I sought to convert the stick to a carrot. To be fair to workers *in fact,* a penalty TIP on wages needs some indemnification for the first year, when, according to the empirical evidence, the slowdown in prices would be likely to lag behind a slowdown of wages. To be fair to workers *in image,* however, a penalty TIP needs further modifications; I believe that some of the suggestions made at this conference may point the way.

If a penalty TIP were incorporated into proposed legislation, I would support it enthusiastically. Nonetheless, I am convinced that a reward TIP belongs on our list of promising options. Unquestionably, rewards must be offered *universally* to employees of small firms as well as large ones. Undoubtedly, universal coverage adds to administrative burdens, but, I would insist, to only a limited degree. The same set of rules must be prepared on how to evaluate compensation whether the program applies to a handful or a myriad of firms. In this connection, as Richard Slitor suggested, the present rules developed for the income tax—on such issues as pension funding, stock options, and health insurance—are entirely adequate for a TIP, whether its coverage is narrow or universal. If they are good enough for a universal tax under which corporations pay 48 cents per dollar, they are good enough to handle a marginal increment or decrement in the tax rate. The only enforcement of any penalty or reward TIP would operate by auditing tax returns, rather than by monitoring behavior or requiring advance approval of action. If the low-probability threat of audit is a reasonably effective way to make all firms comply with the provisions for depreciation, the investment tax credit, expense allowances, and all the other complex features of our income tax, then it should be good enough for a reward TIP. Obviously, a universal program would raise more inquiries from taxpayers, necessitate more mailing, and hence require a larger staff at the Internal Revenue Service to provide those services. But surely that is a small set of added costs.

Nor is the record keeping required of firms in a reward TIP inherently any more onerous than that imposed by the employment tax credit or the deductibility rules for entertainment and travel expenses. But suppose that the Congress shared Joseph Pechman's view that it is an onerous burden on small firms. In that event, if Congress insisted that tiny businesses with, say, less than 20 workers could qualify their employees for the reward with a mere pledge of good faith to restrain wages, the program would lose little of its effectiveness.

The basic advantage of a reward TIP is that, when businessmen have the opportunity to qualify their employees for a tax cut, they have a strong incentive to translate that tax cut into a slowdown of wages. Because of the rational self-interest of employers, a reward TIP should have a significant marginal effect on the actual wages paid by firms. After hearing the criticisms made at this conference, I remain convinced that a reward TIP on wages is an entirely feasible and manageable program.

On the other hand, I am convinced by criticism, particularly from Gardner Ackley, that a price reward raises severe administrative problems. I was searching for symmetry in proposing that, but the measurement of prices is not symmetrical with that of wages. Because price measurement is so complex, a feature that was intended to assure workers of evenhandedness might turn out to bestow arbitrary and unmerited tax cuts on some business firms.

Any TIP must be built on the foundations of a social consensus in favor of mutual deescalation. It will take a lot of education and more bitter experience to convince a majority of citizens that TIP may be the option that is the least bad. The polls tell us that the American people—union members, as much as any group—detest inflation. Albert Rees has not told us how labor leaders will react when they realize that the realistic alternative to TIP is a series of recurrent recessions brought about through monetary restraint. The U.S. inflation rate will be lowered over the next decade; the serious question is whether that is going to be accomplished by inefficient and inhumane recessions, by stifling price-wage controls, or by some innovative, sensible method like TIP.

General Discussion

Charles Holt pointed to a new rich body of data that might be useful for simulating the administrative problems of a TIP. The information, constructed largely for research purposes by the unemployment compensation system, is based on quarterly reports from employers in thirty-seven states on the earnings and hours of individual workers and is being assembled into a longitudinal sample.

Joseph Pechman cautioned Franco Modigliani against coupling an excess profits tax with a penalty TIP on wages, noting the adverse experience with that tax during wartime periods and its deservedly bad reputation.

Alan Greenspan felt that the conference had produced something approaching a consensus that the penalty TIP on wages is the form most likely to have a reasonable chance of effectiveness and administrative feasibility. Yet it was clearly the scheme that was most difficult to sell politically. George Perry agreed that the administrative advantages of a penalty TIP had been emphasized by many at the conference; but he did not find the arguments convincing. He thought firms were much less likely to cheat in claiming rewards for their workers than in minimizing liabilities for penalties on themselves. Because of its universality, a reward TIP could afford more leakages and still have a larger total impact in slowing inflation. Finally, he was not convinced that random audits from the Internal Revenue Service were an ineffective technique of enforcement because they seemed to work reasonably for the income tax as a whole.

William Brainard thought that Modigliani's remarks about the distortions of a TIP raised many broader issues. To the extent that TIP alters relative prices, the consequences depend on whether (and if so, how) inflation itself distorts relative prices, as is frequently asserted. Brainard shared Laurence Seidman's view that TIP would work in part by changing expectations. The resulting deceleration of inflation need not have any adverse allocational costs.