TIP FOR INFLATION: WHY AND HOW

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Our credibility as a nation has been jeopardized by inflation and aggravated by the accompanying unemployment. Every age faces setbacks to test its resolve for historical evolutionary survival. The 1930s grappled with unemployment, and the not unrelated march of dictators. The 1940s saw the war, peacetime conversion, and the Cold War. Subsequent traumatic episodes, as the Cuban missile crisis, Vietnam, and Watergate can be cited. Energy and inflation, or inflation and energy now appear paramount. Blot out the inflation blight and, barring nuclear war miscalculations, we should again be able to resume the free world leadership that our military might compels and our economic power commends.

My position remains that (except by happenstance) a stable price level and minimal unemployment will elude us on traditional monetary policies, or on the less efficient fiscal policy except in extraordinary circumstances such as the 1930s. At the moment, it would entail some digression to develop this. To those who see monetary policy as ample for the desired price and job stability, and in a relatively noninterventionist framework, I hope my own proposals will be assessed as at least a necessary supplement to monetary policy. I would even go further: on the assumption that an effective and largely nonbureaucratic tax-based incomes policy (TIP) is adopted, I would see no difficulty,

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for the most part, in subscribing to the steady money growth rule foreshadowed in the 100 per cent money of Irving Fisher, or the Simons-Hayek-Robertson discussions of the 1930s, or by modern exponents. The difference between us, as I see it, is whether steady money emissions per annum can perform the stable price feat or whether a TIP-type incomes policy is essential as a prior condition for the real output control mechanics implicit in steady money growth.

I dwell on this because it would be a curious misreading of my position to allege that I deny the potency of money supplies.[1] It has been the efficacy of money control as an inflation instrument that has drawn the criticism, never its potency. It has, too often, been simply too potent, chopping jobs and production rather than subduing the price level. Money retains its majesty in financing output and funding jobs.

Subsequent discussion will strike on literally three planes, with first some general views to establish a position; next, to deal with some slightly more technical issues; and finally, a statement of my own proposals for inflation policy followed by an evaluation of the evolving Carter price level package of October 24.

STAGFLATION: THE IMPOSSIBLE HAS HAPPENED

For perspective, the formidable importance of inflation is sketched so that discrepancies in assessing the issue can emerge sharply.

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[1] Cf. my Capitalism' Inflation and Unemployment Crisis (Addison-Wesley, 1978), and Keynes, Keynesians, and Monetarists (University of Pennsylvania, 1978) for further elaboration.

Inflation: The Number One Problem

Concurring with the various polls, inflation remains our number one economic problem. It is "the one in many" that mars our economic performance, suppressing actual accomplishments well short of our potential. It impedes full employment; it engenders income inequities and anguish, social unrest and political turbulence; it contributes powerfully to the international dollar decline and raises import prices; it occasions stock market jitters, bearish bond markets, historic high interest rates, and unstable financial markets; it visibly upsets government and private budgets; and it deflects allocational and expenditure decisions from patterns (presumably more rational) ensuing under a more stable price order. The stop-go of minor skirmishes and major failures in combating inflation has repercussions on the housing and construction industry, with multiplier ramifications through the economy.

Subdue inflation and our other national problems should fall into place. Continuing our past stumbles and fumbles leads to a cumulating agenda of unfulfilled objectives, whether envisioned as new ventures for government or as designs to eliminate areas of intervention and alter the scope of the private and public sector.

The Great Intellectual Distraction

Not least, the alarms over inflation and its acceleration constitute a great intellectual distraction. Constantly discussed, new issues are shoved into the background. In the competition for the limited attention span devoted to public issues, a Gresham's law is at work: the familiar diverts reflection from the more novel phenomena. An undue amount of professional skills, moreover, are preoccupied with the chronic economic ill. Yet despite the concerted focus of intellectual resources, the number of original ideas to arrest the inflation stalemate are conspicuously few.

The Stagflation Ordeal: The Impossible Has Happened

The last decade has witnessed the simultaneous distress of too much inflation and too much unemployment, with the odd couple constituting the stagflation ordeal. The debacle in the United Kingdom has at times been more severe, as output fell amid a chaotic price level surge, giving currency to the slumpflation term. The price of this enrichment of the language was a more total disorientation of the economy.

In the older boom-bust cycles, prices and output rose during the upswing and unemployment rates fell; the reverse pattern marked the recession fallback. Either inflation or higher unemployment rates prevailed. Now, the see-saw has yielded to the buzz-saw: we have simultaneous bad economic tidings. Instead of a single disorder one at a time, we suffer the double trauma. What used to happen in banana republics, or in bizarre comic operas where everything went wrong at once, creating havoc in all directions, has happened to us, and to other affluent, politically mature, and sophisticated economies endowed with all the prescribed sophisticated stabilization techniques.

The "impossible," or "inconceivable," has thus happened. Older economists would have been appalled at the juxtaposition of events. Manifestly, the double-trouble attests to some failure of ideas, and their reenforcement in policy. It is especially perplexing that in an age where economics has become mathematized, fascinated with econometrics and obsessed with the computer devouring piles of data, the main tangible result is a sequel that previous generations of economists averted, namely, the stagflation malaise. Buried under the enriched technical avalanche, progress in ideas for the smooth functioning of the economy has been impaired.

THE KEYNESIAN-MONETARIST DIALOGUE

Passing reference must be made to the prescriptive versions of the dominant Keynesian and monetarist dialogue filtered over from professional to popular consciousness.

Over the stagflation decade monetarists have generally alleged that central bank policy has been too lax, with the money spill culminating in inflation. They usually advocate annual money increases in the three to five per cent range. In more inadvertent renditions, a steady money pace seems to be the virtue, rather than the two-pronged rule of steadiness at a rate consonant with longer run production growth. The objective remains, to abort inflation on the premise that the steady percentage rule will restore a stable, full employment economy.

Keynesians, with minds riveted on past unemployment episodes and, until a late day, less mindful of the inflation burden and inequities, have usually targeted their money supply recipes on alleviating job distress. Their money supply advocacy has more frequently, over the dour decade, seized on annual money growth rates in the seven to ten per cent zone.

Dialogue has often been at cross-purposes, and misspent; much of the debate has been over whether the glass of water is half empty or half full. Nonetheless, each has called attention to part of the problem, the monetarists to the Keynesian inflation neglect and the Keynesians clinging to implant the dire past unemployment memories.

As a long-time critic of the fashionable brands of Keynesianism, even while not derogating the potency of monetary policy, it is possible to deprecate its efficacy against inflation. Monetary policy scores its hardest direct blows on jobs and production, being particularly destructive to the housing industry when it is severely restrictive. By creating enough unemployment -- as under good Phillips curve doctrine -- it can *indirectly* slow up the average wage and salary ascent and thus contain the price level. Effectually, by inflicting unemployment distress, it can mitigate the inflation disorder: it supplants the unwanted for the undesirable. For it to win against inflation, there is a precondition, namely, that labor must acquiesce in moderating its wage demands. When labor grows more adamant despite unemployment, insisting on higher pay despite jumping unemployment rates, the double-trouble of stagflation or slumpflation occurs.

The monetary cure against inflation thus partakes of the same dubious policy attributes that Pigou long ago noted for wage cuts as an automatic route to full employment (*Lapses from Full Employment*); through the "real-balance" effect the ensuing price deflation remedy might be more devastating than the original disease. Pigou might be chided for understating the social, political, and economic plight ensuing from fairly universal bankruptcy.

My conviction thus remains, that over both the near future and the long haul, monetary policy is destined to be inefficient in establishing a stable economy. I offer this as a reluctant conclusion; I would prefer being mistaken, for my analysis suggests that new institutions must be organized to cope with the systemic contradiction. In error, the sole result would be that these skeptical views would be demolished by events and we could go on as before -- a very small price to pay for the maintenance of an orderly and venerable economic system.

The Incomplete Fed

The Fed has been fighting inflation over most of its sixty-four years. The dismal inflation history is a result not of the lack of will on the part of the Fed officials, but of a lack of tools for a direct attack on the price problem without dumping us in the unemployment ditch and, over the last decade, without discernible inflation surcease. The last two chairmen of the system were dedicated and implacable inflation foes, yet both left office with prices over fifty per cent higher than at the start of their incumbency. Even as they reminded us of their zeal and the Fed's eternal vigilance, they would intone the lugubrious price statistics. As in the military communiques, they would always see light at the end of the tunnel crowning their valor, yet always the victory has been beyond reach.

After sixty-four years of retreat, and cumulating distress, we would long ago have altered military strategy and probed whether the weaponry was ample for the task. My conclusion has been that an unaided monetary policy cannot usher in a sidewise price trend, at least not without a catastrophic cost in unemployment and festering social and political conflict with irreparable damage to the market economy. Where alternatives compatible with the functioning of a market economy are available, in blocking mild reforms, the friends of the relatively free economy who want it to succeed join unwittingly with enemies who prefer that it fail.

Mischievous Phillips Curve Doctrine

Monetarists nonetheless insist that their tight money medicine, pursued long and relentlessly enough, will stop inflation. How long, and how relentlessly, are subjects too often left vague. Too, circumstances under which they might abandon the pressure are seldom revealed; alternatives, if the policy failed to operate on schedule, are not drafted. In the military, there is at least a contingency plan in case the battle goes awry.

More candid espousal of monetarist recipes acknowledge that the policy can spell unemployment. This is good Phillips curve doctrine but it embeds some bad theory and dubious policy, dangerous to the viability of the market system.

There is no need to dwell on the intricacies of Phillips curves, or their wayward patterns of recent years, or the transformation of what was originally hailed as a predictive law into a less edifying post-mortem on why events misbehaved. The case might be made that the Phillips curve lacks even the staying power of the law of demand in consumer markets under the ceteris paribus proviso.

Most dejecting is the advocacy of a policy that aims to replace one dismemberment with another disfiguration, or to supplant the inflation woes with the unemployment morass. To me it is simply immoral, let alone uneconomic, to recommend unemployment for other people, usually to menace the least adaptable members of our economy with the indignity of a loss of jobs and income. I have said on occasion that advocates of these policies should resign, join the ranks of the unemployed, and become the great inflation fighters. If unemployment is good policy, they should be first to enlist in the battle.

Too, the policy is spurious. It is as if a doctor advises a patient that he can cure him of a coronary ailment by inducing kidney troubles (iatrogenic is the medical word, as Hyman Minsky, Professor of Economics at Washington University, has enlightened us). Most of us would seek a new physician. Medicine aims to eradicate all debilitating ailments, and not to substitute a pernicious malaise for a terminable affliction. In economics, however, we seem less concerned with restoring total health, preferring some impenetrable, often mystic, talk of trade-offs.

The Phillips curve, even when well-behaved, reports relations in labor markets as organized in the past. Not inconceivably, by adopting innovating policies compatible with the market economy, or involving acceptable departures, money wage and salary movements may be moderated to much less inflationary sights without bending too much from the goal of jobs for all who are willing to work at prevailing real wages.

The Destroy-To-Revive Fantasy

Monetary policy, as practiced, entails a curious "destroy-to-revive" fantasy that would stir incredulity in wanderers not steeped in the conventional wisdom.

Every time the economy approaches full employment, we are warned of the danger of inflation ahead and cautioned against the economy "overheating." The sequel involves a tightening of the money screws, and deliberate retardation of the growth rate and job access. Sighting the Promised Land, a bugle call to retreat is sounded.

This is bewildering. Every time we show signs of robust economic health we are coerced into iatrogenic sickness, with the economy dropped into a recession tailspin. After the repressive process runs on for a time, we gather our courage to denounce government for stop-go tactics, and to sound some clarion calls (by Keynesians) for renewing the march to the fuller employment gates. Money policy is eased, to build the economic patient to better health -- not to complete vigor but, for his own good, this is presumed to make him susceptible to later illness. Only the worst symptoms of joblessness are mitigated.

Thus we are perennially trapped below our best performance, and deliberately so condemned. We are compelled to adopt a posture of dedicated underachievement at best, and significant frustration at worst. Systemic masochism earns the more euphemistic name of "fighting inflation."

Despite this "destroy-to-revive" tactic, we have not dislodged the price spiral. (Currently, another tight money venture is in process). We have, however, sponsored a sputtering economy, rather than a market system riding smoothly at peak efficiency. Monetary policy, despite good intentions, has mired us in an abject outcome compared to an optimal and presumably attainable goal.

THE ASSAULT ON THE LAWS OF ARITHMETIC

Over the last decade especially, we have been engaged in a mad assault on the laws of arithmetic. Average productivity over the longer term has been inching ahead by two to three per cent per annum; money income -- with money wages and salaries comprising the seventy-five per cent bulk of the total -- has been leaping by eight, ten, twelve ... per cent or more. In the United Kingdom and Australia, to name but two countries, the more herculean feat was essayed in 1974 and 1975, with pay increases approaching a twenty-five per cent annual pace. Consternation ensued when prices vaulted in concert.

A Basic Truism

A price level surge is imperative whenever a sharp discrepancy occurs between average income and average productivity. Our inability to apprehend this homely truth is amazing for the results must follow:

(1) $PQ = Y$, where P = average price, Q = aggregate real output, Y = income

$\therefore \quad P = (Y/Q) = (Y/N)/(Q/N) = (y/A)$, where N = employment, y = per employee income, A = average product = Q/N.

Regardless of what the Fed does, so long as average income[2] including wages, salaries, profits, rent, depreciation, etc. per employee runs faster than average productivity, the private sector price level is bound to fill the gap.

Futility of Monetary Policy Under Outsized Pay Increases

To make average money wages and salaries stand out more prominently in the price equation, from $PQ = Y - kwN$, then:

(2) $P = kw/A$, where k = average price markup

(or the reciprocal of the wage share, from $k = PQ/wN$).

Year-to-year, k is reasonably constant, showing slight downward drift over time. Since about 1950, on the score of the k-factor P should show about twelve per cent lower! P is thus bound up with the flex in unit labor costs (w/A), climbing almost exactly in unison.

Some may characterize this as a "wage-push" theory of inflation. This is a cultivated error: money wages and salaries are simultaneously the chief ingredients of costs, on the supply side of the price equation, and the mainspring of consumer demand, responsible for about eighty-five per cent of consumer purchases. "Cost-push" and "demand-pull," rather than being disparate phenomena, are simultaneous strings in consumer markets emanating from the same money wage phenomena.

Neither in (1) nor (2) are there any separate terms for money, to link money quantities to the price level. Money plays an indirect role

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[2] I generally use Gross Business Product (GBP) for the income concept.

in affecting output and jobs, and thus (as under Phillips curve doctrine) through unemployment levels it can deflect the money wage trend. Tight money, presumably, will rein in the $w(t)$ path over time and thereby work a meliorating price level impact, at least where Phillips curves are well-behaved so that labor militancy does not impair the relations. Tight money, however, by retarding investment, may defer plant modernization and thereby contain the $A(t)$ course. Through this channel tighter money may be (mildly) inflationary.

Instant Billionaires?

The general theory must be correct. Otherwise we could raise average money wage and salary incomes not by two or three per cent per annum for a steady price level, or the eight, ten, twelve per cent figures of recent years, or the egregious twenty-five per cent numbers of the United Kingdom and Australia, but by a thousand or millionfold: why not make everyone an instant billionaire? Why oppose the fulfillment of instant happiness? After all, if money incomes have nothing to do with inflation, and money control by the Fed can inhibit the price level excrescences regardless of wage increases, there should be no objection; there need never be any strikes by people unhappy over their money income lot if price levels are not upset by outsized general pay upheavals.

In concurring that there is a "right," or optimal, pace of average money wage gains, we are assenting to the ubiquity of incomes policy. Too, there is implicit a recognition that money policy, unaided by a supplemental conscious -- or fortuitous -- gearing of w's and A's, cannot usher in a flat P-trend.

Productivity and Costly Regulations

The productivity term A stands prominently in the price level equation. Historically, productivity growth was measured at two or three per cent per annum, with three per cent leaning to the high side. The 1970s estimates disclose a shade below two per cent.

Tight money, it was observed, by impeding plant modernization may have had a (mild) inflationary bias. Recent ecological concerns, with pollution and safety drum-beats, have fostered enactment of new regulations and stricter enforcement of old ones. In terms of (1) and (2), insofar as a steel mill has to install scrubbing devices, say, it deflects capital sums from steel-making equipment, indirectly reining A. Likewise, in hiring personnel to clean up the air or to conform to safety rules, the number of employees per ton of steel tends to depress the A-term. Regulatory consequences can thus retard productivity growth rate.

It is easy to oppose sin -- or excessive cost raising, or superfluous productivity-depressing, health and safety regulations. Others will be better informed to cite particulars. Largely, however, their removal contributes a one-shot productivity booster, conceivably with delayed impacts. Big irresistible productivity gains are more likely to follow fresh innovations and technological triumphs.

OTHER INFLATION THEORIES

Many would fault big business for excessive price markups as the decade's inflation source: the available evidence invalidates this view.

Others indict the federal deficit. Yet the last fifty budget years have seen only nine years of surplus, often of piddling size and yet, until the last decade the price level performed reasonably well. In 1933, with a deficit of about fifty-five per cent, the price level actually fell. Deficits are hardly the indomitable inflation-maker despite the popular rhetoric. More detailed analysis would reveal the deficit theory, when undraped, as a crypto-money theory of inflation amenable to a monetary remedy.

Government Debt and Expenditure

Government debt, comprising the residual cumulation of deficits, also gets its share of inflation calumny. Fact: since 1945 private debt has plunged far faster. Until recent years, the big public debt lurch occurred between 1930 and 1945, in a period when the price level behaved "orderly," again by modern standards. Relative to GNP the federal debt has declined sharply over the last generation.

Bombed by Proposition 13, though never really out of season, current onus is directed to government expenditure, especially the federal government though its aggregates are outpaced at the state and local level in recent years. The projected $500 billions federal outlays for fiscal 1979 would, in 1963 prices, be about $240 billions. Government outlays under even unaltered programs cost more as a consequence of inflation: when defense hardware prices go up, when civil servant pay climbs to match private sector trends, budget outlays inevitably advance. Relative to GNP, federal absorption of output has not been making greater inroads on the recent aggregates.

Although it braves heresy to say so, if government expenditure "causes" inflation, then other forms of expenditure must also be included, especially insofar as government outlay has not gone up disproportionately. All this, however, presumes that stagflation is a story in excess real demand -- a view which I reject. One would presume, however, that our people would oppose wasteful government outlay in inflation season or out.

More difficult to fathom is the conviction that taxes be chopped with a meat axe while government outlay cuts are evaded, or trimming ordered without assessing military or social consequences. Tax slashes without outlay containment would feed larger deficits, with implications for monetary theories of inflation.

To illustrate the penchant for concentrating on the less significant while the substantial slips away, total employee compensation now amounts to $1.4 trillion. At compound rates of 10 percent, in just over three years the mere augmentation will overshadow the $500 billion federal 1979 outlay. At an eight per cent annual escalation, the feat will take under five years. Containment of the wage and salary climb, and thus civil service pay and the price of government procurement, would appear to be the best route to repressing government expenditures.

SOME ASPECTS OF MONETARY THEORY

Emphasis here on the wage-productivity nexus as the price level-maker make remarks on where money fits in obligatory. Discussion inevitably must be brief.[3]

[3]Further elaboration appears in my Capitalism's Crisis and Keynes, Keynesians and Monetarists.

Modern quantity theory doctrines link money supplies primarily to money incomes, finding the connection of money supplies to prices and to output variations more perplexing. In the symbols of the old income equation of exchange of $MV = PQ$, implied is:

$$(3) \quad m(\Delta M/M) = (\Delta P/P) + (\Delta Q/Q),$$

$$\text{where } m = [1 + (\Delta V/V)/(\Delta M/M)] = (\Delta Y/Y)/(\Delta M/M)$$

Murkiness -- or indeterminateness -- enshrouds whether money supply changes affect primarily the P's or the Q's, the latter welcomed and the former ordinarily rejected in economic policy. In adumbrating the steady money rule of, say, three per cent annual money increments, there is an implicit proviso that the money swell will sustain the $(\Delta Q/Q)$ increment rather than spill over to generate a ΔP splurge.

From the wage-cost markup equation (WCM) of $P = kw/A$, or from $MV = PA = kwN$, it follows:

$$(4) \quad m(\Delta M/M) = (\Delta k/k) + (\Delta w/w) + (\Delta N/N)$$

If we neglect k in (4), as with $\Delta k = 0$, and if money wage jumps are excessive, and taking m (= the money income elasticity at values conjectured in monetarist studies) nearly constant, then a failure of money supplies to balance money wage hikes will have impacts on employment, ΔN. In (4) the potency of money policy for WCM theorizing emerges, with Q and N being hit by the Fed's slingshot, instead of P being brought directly to hand.

From the WCM:

$$(5) \quad (\Delta P/P) = (\Delta k/k) + (\Delta w/w) - (\Delta A/A)$$

By-passing k, P reflects a tug of war between w and A. From (5), determinateness is imparted to (3) with $(\Delta P/P)$ resolved by the WCM elements and $(\Delta Q/Q)$ a resultant of money supplies.

The Potency of Monetary Policy

Monetary policy thus retains its clout in WCM theory. With reasonable constancy in m, whether money policy is expansive, neutral, or constrictive depends on $m(\Delta M/M) = (\Delta P/P) \gtreqless (\Delta w/w) - (\Delta A/A)$.

Table 1 indicates the variety of potential economic situations. Whether the economy lands in row 1, 2, or 3 depends, in WCM arguments, on the wage-productivity nexus. Whether column 1, 2, or 3 is our lot rests on monetary policy. Others may elect different names for the circumstances which fill the matrix. To make separate provision for unemployment, a twenty-seven cell, or three dimensional table, testing our facility for devising names, would have to be erected.

TABLE 1

The ΔP and ΔQ Matrix Pursuant to ΔM Action

ΔP \ ΔQ	+	0	-
+	Growthflation	Stagflation	Slumpflation
0	Growth at Constant Prices	Stationary State	Recession
-	Deflationary Growth	Steady State Deflation	Depression

INCOME GEARING: THE TIP PROPOSALS

All economic systems that pay out money incomes, whether a capitalist or a collectivist model, must adopt some method of gearing money incomes to output flows. The market economy has hitherto relied on an indirect tie, namely, the control over money supplies in the thought that the MV aggregate, equal to Y, money income, can thereby be managed. My remarks have assayed the imperfections in the system, or the effect in $Y = kwN$, on the N variable when Δw has flounced disproportionately; too, when unemployment has grown politically intolerable, the ΔM variations have invariably had to be relaxed.

My thoughts then have gone to ways to gear average money incomes more closely to productivity developments, and in a manner compatible with the enterprise economy. With P(t) reasonably flat over time, monetary policy should then be able to stabilize the Q's and N's in the acceptable incomes policy, monetary policy should be able to pursue, more or less, the steady money rule. In this sense monetary and incomes policies can be mutually reenforcing.

Opposition to Price and Wage Controls

Those of us who have peferred market-oriented incomes policy have been concerned with what we contend are modest institutional reforms to protect, to improve, to salvage, to restore, and to perpetuate the market system; the aim is to embed measures to enable it to realize its maximum potential. It is the market system that the policies intend to preserve, rather than to devise grandoise, impractical, and futile plans to supplant it. But the system admits of improvement, notoriously in respect of jobs and inflation.

To dispel any confusion on the matter, mandatory wage and price controls are neither contemplated nor advocated; the quest is for non-interventionist policies. Controls are anathema to the market system: they are bureaucratic, dilatory, harassing, costly to administer and for business to abide; they are apt to be politicized; they induct an army of snoopers and enforcers; they breed a new type of crime engaged in consensual transactions, they thereby erode freedom; they erect a forum for legal histrionics to clog court calendars; they support a retinue of court attendants and jailers; and they outrage vexed citizens.

Nothing advanced here can be remotely interpreted as an espousal of mandatory price and wage controls. My own support for controls would extend only for a brief interlude while measures to be outlined are being legislatively contemplated prior to enactment; for example the Nixon 90 day price and wage freeze in 1971 operated with tolerable effectiveness -- which implies mainly that the economy can stand practically anything for a few months.

The image of Captain Queeg tyrannizing over the theft of a plate of strawberries must not be elevated as the prototype in lieu of private decision making under traditional (or modified techniques) of monetary and fiscal policy, harmoniously meshed with incomes policy in a market system altered in an acceptable evolutionary way to obviate the inflation blight. Private decision making under the corporate income tax is a commonplace, erecting incentives and deterrents to enterprise conduct. Incomes policy can build on this characteristic.

The Wallich-Weintraub TIP

The Wallich-Weintraub TIP (for tax-based incomes policy) is reasonably familiar. Briefly, it is intended to subject firms to an extra corporate penalty income tax if they violate an average money wage and salary norm of, say, five per cent per annum.[4] The TIP object, however, is not to collect taxes but to deter inflationary money income conduct. Firms could surpass the norm, but at a price; like all good legislation that takes account of special cases, therefore, there is an escape valve for those who cannot conform or who prefer to overshoot the target. The analogy is to a posted speed limit which can be transgressed, subject to a penalty. Obviously, a very steep penalty scale builds an almost absolute prohibition, while a modest rate structure entails a less formidable obstacle. On the progressivity of the penalty schedule, differences of judgment can abound.

As the object is not to collect taxes, the normal corporate income tax rates could be reduced so that the estimated treasury tax-take is held constant, or reduced. Inasmuch as monetary and fiscal policy could work more closely toward full employment under less inflationary pay conduct, on balance it should be possible to lower the corporate tax rates. TIP could not be fairly indicted with eroding internal corporate venture capital.

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[4]For a recent statement see my "Proposal for an Anti-Inflation Package," Challenge (Sept. 1978).

TIP could be confined to about the largest one thousand firms, covering about fifty-five per cent of GBP, or the largest two thousand firms responsible, according to available estimates, for about eighty-seven per cent of business output. Legislation could specify firms employing over five hundred, or five thousand employees, etc., or reporting a sales volume of over $5,000,000, or $50,000,000, or whatever numbers judgment condones as reasonable and feasible. As about one half dozen extra lines on a corporate income tax form are entailed (involving known information on the wage and salary bill and number of employees), presumably one auditor should be able to examine ten forms per week or about five hundred per annum. For two thousand firms the administrative personnel directly involved would be nominal, and a trifling cost considering the full employment prize at stake, involving $50 to $150 billions in lost output in recent years. The tradeoff of administrative outlay as against economy gains is overwhelmingly favorable.

<u>TIP Supplements</u>

Labor bargaining would not be precluded under TIP though settlement terms are bound to be more restrained on the principle that firms would not go far to trespass the norms, and unions could not expect to win huge gains. Blue Collar labor could secure more than, say, five per cent if other employees obtained less than the stipulated average. Bargaining would be centered in a dispute over <u>relative</u> pay scales, rather than all pay moving along synchronously, after minor or longer time lags, so that in the end all run faster and all occupy practically the same position in the pay pack.

To strengthen TIP, at least in its early implementation, for firms that agree to pay, for instances, at least one percentage point over the stipulated norm, several corollary features can be devised. The following are illustrative; others will be able to provide better ideas. For example, some firms may face bankruptcy if their offer is rejected and unions strike. These firms may be candidates for temporary loan guarantees to cover payment of fixed costs; the provisions would have to be hedged to prevent collusion, obviously. Likewise, some NLRB penalties may be levied on unions for rejecting the norm-plus contract. Labor and business specialists may be able to prescribe more workable provisions to forestall gross violations of the TIP objective. Prospective supplementary stiffening of TIP reflects the versatility of the approach.

<u>Widening the TIP Settlement Band</u>

The conclusion that the TIP norm, say, of five per cent, would become the <u>minimum</u> settlement figure, need not follow. For example, firms could be allowed a two percent reduction in the "normal" income tax for settlement, say, at from three to five per cent over the previous year's average pay levels. Some have suggested even widening the band, leading to a perverse conclusion that firms which <u>cut</u> average pay would win a sharp tax break.

Obviously, any provision of this sort would arouse labor's ire for fostering "slave" labor. The intention is to block price ascent, not to foster a price level decline! So, some stop on the lower end of the pay band would be critical, to provide for firms that could not match the average five per cent pay norm, but would still qualify for tax benefits with a settlement in the three to five per cent range. (All numbers are purely illustrative though they represent reasonable magnitudes.)

TIP-CAP

The illustrative five per cent annual pay increase, on the presumption that productivity trends of three per cent per annum are resumed, would mean an annual price trend in the two per cent range. By recent standards this would be noninflationary indeed. A flat price level would entail about a three per cent norm and, if future productivity improvements because of higher energy costs are more nearly zero, a more stringent incomes policy will be imperative. In the retrogressive economy, average money incomes would have to fall to realize a steady price level.

Economy-wide productivity is the proper guide for establishing the pay norm, rather than firm or plant productivity. In my early writings on TIP, the basic calculation for the penalty tax was a simple pay average.[5] In my collaboration with Federal Reserve Governor Henry Wallich, a weighted pay average was recommended in order to avert some possible fudging by firms that raised executive pay excessively and then hired many superfluous low paid employees to reduce the average for TIP calculations.

My colleague, Dr. Lawrence Seidman, who has written extensively on the subject, has persuaded me that any wage-padding could only be

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[5]The essays are reprinted in Keynes, Keynesians, and Monetarists.

advantageous on a short term look at the matter: after the first year, the firms would be saddled with a too-costly work force for no possible tax benefit or, in making layoffs, they would encounter the same penalty prospects.

Weighting clearly introduces extra complexities and invites endless controversy on the "right" weights. To immunize some pay grants above the norm, and to evade the weighting aspects while encouraging productivity improvements, firms might be permitted to compute a simple productivity average for TIP reporting, and then to correct the value-added figure per employee by any of a variety of price level indexes to eliminate distorting price changes. If the corrected average productivity (CAP) surpassed the economy-wide productivity growth, employees could share in the special gains. For example, if the firm's productivity calculation was nine per cent or six per cent above the economy-wide figure, the average pay increase could be equal to the norm of five per cent, plus one-third of the six per cent productivity bounty, lifting the wage and salary norm in that firm to seven per cent without penalty.[6]

Labor could thus be an immediate beneficiary of superior productivity performance, with a direct stake in improvements. By and large, however, superior productivity improvements should translate into relative price drops. Firm or plant productivity figures cannot be fully allotted to the firm's employees as a bonus without erecting a discriminatory pay scale through the economy, and blocking output

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[6]For detailed elaboration, see Capitalism's Crisis.

advances by maintaining costs and prices in sectors of even spectacular productivity triumphs.

TIP can thus be fortified in TIP-CAP, with the extra productivity attachment going some way toward dismantling outmoded feather-bedding restrictions.

<u>CAIP: Government Construction and Procurement</u>

TIP or TIP-CAP, because of the tax aspects, would have to clear tax committees of Congress where it is certain to be misconstrued as a tax measure, and subjected to misdirected debate. Faster progress in income gearing or incomes policy might be made on other lines.

Under the Davis-Bacon Act the government mandates that on government construction, or government assisted construction, prevailing wages must be paid, usually interpreted generously as the highest in the vicinity. Effectively, Davis-Bacon nails a high floor on government-related construction, and inserts a high pay underpinning for the industry. Without general cognizance under Davis-Bacon, and Walsh-Healey which covers minimum wages, the government is effectively imposing an incomes policy; the idea of incomes policy, therefore, is nothing new in our legislative annals.

As matters stand, labor often lobbies with business for construction contracts which mean jobs, and at good pay. After the sums are voted come strikes for still higher pay. It should be possible to limit pay grants, over the life of the contract to an annual increase of five per cent, as well as to cover executive and managerial pay. Pay aggrandizement at government expense and raids on the treasury might be aborted thereby. Penalties could take the form of disallowing magnanimous pay settlements as costs in computing income tax profits; disallowance of cost overruns in contract negotiations; or closing off bids by offending contractors on other government jobs for a period of years.

The idea could be extended to military procurement and to government purchases generally. Inasmuch as the veritable Who's Who in American enterprise engage in sales to government, CAIP (Contractual Award Incomes Policy) could blanket from twenty-five per cent or so of the business sector, and could do something to suppress the wayward pay explosion.

The Okun Variants of TIP

Arthur Okun, in a more recent variant of the original TIP proposal, has tried to hide the "stick" and dangle a "carrot."[7] While his proposal has not been spelled in detail, he endeavored to build foremost on a principle of "voluntarism."

Union employees who agreed to a pay increase of about seven per cent per annum would qualify for a tax credit of about $225 per annum, amounting to about two per cent of a $12,000 income and enlarging their pay increase to about nine per cent. Firms that abided by the norm would also realize a two percentage point or so corporate tax reward.

It is possible to be dubious of the "voluntarism" feature, except as a tactical debating wedge. Too, the exclusion of nonunionized

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[7]Cf. "Innovative Policies to Slow Inflation," Special Issue Brookings Papers on Economic Activity, Number 2, 1978.

employees from a tax benefit would be an inequality. A fairer method would inscribe a three per cent tax credit for all those with employee compensation (or all taxpayers?) of, say, under $12,000, and two per cent for those above this figure, with a $200 minimum and $300 maximum credit.

This feature adopted from Okun could impart real income protection to labor, and make a TIP program more attractive, especially as labor leaders have shown little willingness to analyze the proposal while plunging headlong into advacacy of mandatory price and wage controls.

Nonetheless, the Okun "voluntarism" will not do. Militant labor leaders could aim for fifteen per cent gains while others accepted seven per cent, with the former deriding the latter as "weak" sisters: why accept a $200 tax credit when maybe this much extra can be grabbed off per month by an exercise of muscle and power?

Likewise, a two percentage point corporate tax cut appears too limited to induce firms to stand against extravagant pay demands. By accepting the Okun tax cut for subscribing to the pay norm (or settling slightly below), and invoking a penalty for transgressing the norm, the effective tax stimuli and deterrent can be widened to make pay excesses more costly.

Government Employees and Anti-Trust

Government employees could be held to an annual five per cent pay increase. For conformable state and local pay behavior, federal grants could be made contingent upon compatible pay norms. To prevent government pay scales from trailing private sector trends, government pay scales could be corrected every two or three years to ensure reasonable correspondence.

To counter labor protests that prices are not touched, and to avoid debate over the issue, the FTC might be required to report quarterly on trends in profit margins of firms covered by TIP. Where margins rise unduly, data for reasonable review would be on hand. According to the evidence, however, we can be confident that price margins will not be inflationary so long as wages and salaries are reasonably aligned to productivity.

THE CARTER INFLATION MEASURES

The Carter measures of recent days to subdue inflation provoke comment. On October 24, after twenty-two months of incumbency, and thus about eighteen months late, the President announced a program which, in principle, was based on the theory that motivates TIP proposals. Meeting negative reaction in foreign exchange markets and Wall Street impelled the President on November 1 to impose a fairly drastic set of measures typically described as monetary persuasion.

Let's consider the latter first. There was the almost unprecedented full percentage-point tick in the rediscount rate, effectuated by the Federal Reserve. There was also, a two percentage point jump in reserve requirements against certificates of deposit of $100,000 or more. A foreign exchange stabilization fund of $30 billion was organized to discourage the frenzied wave of speculative attacks against the dollar, whose prolonged sinking spell brought soaring import prices. A steeper pace of gold sales was put on the agenda.

Shock impacts were uniformly and dramatically unfavorable. The dollar rose instantly in Tokyo, Frankfurt, and Basel. The stock market, in splendid euphoria, rebounded by thirty-five points in the Dow Jones for the largest single day flourish ever.

Assessments are that the tighter money curbs will, over time, rein in the economy and yield a harvest of recessionary tendencies, especially in the housing industry, with multiplier ramifications through the economy. Prediction of a lagged downturn are thus rife. It may be, however, that as the rest of the President's program falls into place, monetary policy can be eased and that a serious fall-back can be evaded. Time, the great hindsight prophet, will reveal the answers.

The President's non-monetary program, disregarding the inevitable born-again homilies opposing government waste to take the edge off political adversaries, contained three main features:

1) First, a summons to labor to hold pay demands on new contracts to seven per cent per annum.

2) In reciprocity, the President pledged to ask Congress to provide tax "rebates" insofar as price rises exceeded seven per cent. This embeds the Okun "real income insurance" to make the seven per cent norm more palatable to labor. Calculations by the press and economists tended to magnify the possible tax loss though, if the program is successful and prices rise by less than seven per cent, "rebates" will be nil.

The President's description of the rebates was vague. They probably will take the form of tax credits, with rebates only for those who have overpaid withholding taxes. As noted above, it seems to me that this protection should be universal, and not confined to unions volunteering to abide by the program. Too, it can be interpreted as a gesture to advocates of indexing of income tax rates.

To many, the seven per cent norm is too high. For 1980, a six per cent number is in the wings -- designed more to shave the inflation rate than to stop inflation. The pace reflects a concession to opinion that inflation must wind down "gradually," to avoid damage to expectations from a sharp price deescalation. The United Kingdom has dumped its inflation rate from twenty-five per cent to under ten per cent in short order, with benefit rather than deterioration. Under the gradual time-table, nobody will get hurt, according to exponents, except those who have been basely ravaged already.

3) Business firms are to hold their annual price increases to five and three-quarter per cent per annum, or one-half per cent below the pace of the previous year. Sanctions on firms that fail to comply will consist of denying government procurement to them, or removing import protection, or subsidies, or other forms of penalty as yet unspecified. News releases indicate that the price policies of four hundred of the largest firms are to be monitored.

The denial of procurement is a "stock" lifted from a country-cousin of TIP that Chancellor of the Exchequer, Dennis Healey in the United Kingdom, is readying for parliamentary enactment.

While applauding the President for a "better late than never" commitment to subdue inflation, the present program is too bureaucratic for my tastes; monitoring prices and costs smacks of price controls. Too, it is likely to engender bureaucratic hassles when for example, the Department of Defense wants essential component purchases and encounters opposition from the price overseers. The air will be filled with "yes, they did; no, they didn't; and what difference does it make." Snarling is likely to create new headline excitement, but not much surcease from the eternal and infernal immersion in minor aspects of the inflation torment.

Future Prospects?

Contemplating the wage contracts already in the pipeline for 1979, the President's men expect a price eruption of six to six and one half per cent, a miniscule improvement after three Carter years. The 1978 figure should come in at above eight per cent so we are supposed to cheer the snail's progress.

The AFL-CIO George Meany has already voiced displeasure at the package, expressing skepticism of its "fairness" to labor. He has, instead, pronounced his support for mandatory price and wage controls. Some business spokesmen express fears over the price ceilings as a prelude to controls. While opposition has not crystallized, enthusiasm for the measures appears underwhelming.

Still, the President has taken a first step on a necessary journey to bring about a mete of rationality into the wage-price shuffles that have plagued us in generating inflation and evoking the tighter money stagflation response. This I find encouraging. Considering the lack of alternatives, we may have to come to some closer kin of TIP, in lieu of the bureaucratic structure that seems to be in motion.

While such events are seldom predictable, the rocky climb may yet be diverted to mandatory controls, postponing a more rational TIP to the longer future.