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Introductory remarks by

Henry C. Wallich
Member, Board of Governors of the Federal Reserve System

at the

Meeting of the Allied Social Science Associations

Session on

"Providing Wage Incentives and Price Stability"

Chicago, Illinois

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TIP (Tax-based Incomes Policy) has made progress. Some years ago it started out as a theoretical proposition. Today it is being drafted into a bill. In the interim, it has received intensive exploration by theorists and tax technicians. The present session is another round in this process. The career of TIP is an example of how an idea can move out of the universities and research institutes into the public arena.

TIP has not yet jelled into a single model. This is reflected in the legislation now being drafted in Senator Proxmire's Senate Committee on Banking, Housing and Urban Affairs. As that project now stands, it is an all-purpose TIP, capable of being adapted to any particular version, or combination. The legislation embodies both a carrot and a stick approach. It can be applied with broad or with limited coverage of firms. It could be temporary or designed to be permanent. It could be adapted also to a voluntary approach.

TIP has moved into the foreground because inflation has shown itself more resistant than expected to alternative means of combatting it. Inflation has clearly accelerated, from the 6 per cent area into the 8 per cent area, and threatens to accelerate further next year. Fiscal and monetary policy have not succeeded in decelerating it.

I would nevertheless reject the view sometimes heard that TIP is the only game in town. TIP, if adopted, would have to be supported by adequately restraining fiscal and monetary policies. Its enactment could not be viewed as providing a carte blanche for expansionary policies.

At present, there are public discussions of guidelines for wages and prices. TIP could be viewed as a form of guideline, but a guideline with teeth in it. It could thus help overcome the weakness that beset the Wage and Price Guideposts of the 1960s which lost their credibility once they had been breached in a single major case. A TIP wage guideline could be breached frequently, and should be breached whenever employer and employees had good reason for settling above it. But TIP would impose a penalty, in the form of a higher tax or, under a carrot approach, through loss of the bonus for restraint. Thus TIP would exert steady pressure against inflation.

TIP so far does not have a great deal of political support, although the legislation being drafted seems to have aroused some interest in the Congress. TIP distinctly lacks popularity with business and labor. But it shares this unpopularity with other potential candidates for forceful action against inflation -- such as wage and price controls, very high interest rates, and drastic cuts in government expenditures.

TIP is tough, but we have run out of pleasant options. To let inflation run is really no long-run option at all. The same or even more drastic remedies would confront us at higher levels of inflation, plus possibly a severe recession. I hope it will not take such higher levels to convince people of the need for action. Resistance to TIP could probably be reduced, moreover, if a version limited to large firms were chosen. This would also reduce its administrative complexity.

TIP has received criticism on theoretical as well as administrative grounds. This is highly desirable. No novel scheme should be proposed for implementation without thorough discussion and evaluation. As I read the present state of the discussion, TIP presents problems but is fundamentally sound and doable. Obviously it is no panacea, and its effectiveness will depend on the strength with which it is implemented, i.e., on the magnitude of rewards or penalties for meeting or exceeding the guideline.

I would like to say a word against the charge sometimes made that TIP is onesidedly directed against labor, and that it might exert wage restraint without exerting price restraint. In that case, profits would rise and labor would bear a burden from disinflation when in fact there should be no burden on either labor or capital.

The theoretical and empirical arguments against such an outcome are well known and I shall not repeat them. But there is no need to rely on them because in any event an outcome adverse to labor can be guarded against. This can be done by means of an increase in the corporate income tax that would be designed to keep the after-tax share of profits in the GNP at some benchmark level. Such a tax increase would be an "excess profits tax" on the profits of the entire corporate sector instead of those of individual firms. If the need for it were to arise at all, the rise in the corporate tax rate would probably be slight, with minimal negative disincentive and allocational effects. The bill being drafted in the Senate Banking Committee provides for such a tax adjustment.

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