

Effects of Wage and Price controls in Canada: 1975-1978 Les conséquences du contrôle des prix et des salaires au Canada : 1975-1978

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Résumé de l'article

Depuis 1960, les problèmes reliés à l'inflation ont donné lieu à de nombreux programmes de contrôle des salaires et des prix en Europe et en Amérique du Nord. Dans la plupart des cas, ces programmes n'ont pas obtenu de grands succès. Qu'en est-il de la récente expérience canadienne en matière de contrôle des salaires et des prix?

L'effort canadien mérite une observation attentive de la part des hommes politiques des pays occidentaux qui projettent l'établissement de tels contrôles.

En 1975, les prix avaient augmenté de onze pour cent pour la deuxième année consécutive. Les taux horaires des salaires montaient à une vitesse sans précédent (12.1 pour cent en 1974 et 13.8 pour cent en 1975). Le nombre des grèves était élevé et la productivité était faible. Les dépenses gouvernementales et la politique monétaire contribuaient aussi à la spirale inflationniste. On pressait le gouvernement de trouver des moyens pour lutter contre l'inflation.

En octobre 1975, le gouvernement adopta des mesures de contrôle des salaires, des prix et d'autres sources de revenus. Il chercha aussi à freiner l'expansion fiscale et monétaire. En grande partie, la responsabilité d'administrer les contrôles fut confiée à la Commission de lutte à l'inflation.

Bien que le programme s'en soit tenu à sa conception initiale et que les délais prévus furent respectés, il fut sujet à des critiques acerbes de la part de groupes d'intérêts. Ainsi dix-sept économistes parmi les plus réputés du pays écrivirent au premier ministre Trudeau une lettre qui mettait en doute la valeur des contrôles et réclamaient leur abolition. La presse s'attaqua au manque de clarté dans l'administration du programme. Le nombre des grèves dans l'ensemble continua de se maintenir à un niveau élevé. Le Congrès du travail au Canada organisa « une journée nationale de protestation » en octobre 1976.

Le programme eut un impact notable sur le taux des augmentations des salaires lequel baissa de quatorze à six pour cent annuellement. Les prix tombèrent à un taux annuel d'environ six pour cent d'augmentation pendant la première année du programme, mais ils étaient remontés à un taux d'environ neuf pour cent à la levée des contrôles en 1978.

Résultat: les effets du programme furent beaucoup plus marqués sur les salaires que sur les prix.

Le taux de chômage à la hausse compliquait l'effort d'implantation de politiques monétaires et fiscales restrictives. Bien que, dans l'ensemble, les taux d'augmentation de la masse monétaire et des dépenses gouvernementales aient été freinés, ils restèrent à des niveaux relativement élevés. On en conclut que, quoiqu'il en soit du succès des contrôles réalisés au Canada, celui-ci est attribuable à cette modération monétaire et fiscale qui se produisit.

Bien que, sur une courte période, les contrôles puissent tempérer les ambitions, à moins que les pressions économiques sous-jacentes ne soient contenues, elles en viendront à manquer de soutien. Aussi les éclatements dans les salaires et les prix peuvent-ils survenir au moment de l'abolition des contrôles. Par conséquent, le programme du Canada continuera à mériter une attention soutenue dans les années à venir.

Effects of Wage and Price Controls in Canada, 1975-1978

Paul D. Staudohar

The author examines the recent Canadian experience in wage and price controls, including an analysis of these controls, the problems confronting their implementation, and certain of their results.

While there is considerable disagreement over how to effectively contain inflation, many observers feel it has become the most serious problem facing advanced Western nations. Since 1960 numerous wage and price control programs, both voluntary and mandatory, have been adopted in Europe and North America. Unfortunately, these incomes policies have not been very successful in combating inflation¹. This paper² examines Canada's most recent experience³ with wage and price controls. Its findings should be particularly relevant in light of President Carter's decision to adopt voluntary wage-price guidelines, and the possibility of future mandatory controls in the United States.

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¹ See for example Murray EDELMAN and R. W. FLEMING, *The Politics of Wage-Price Decisions: A Four-Country Analysis*, Urbana, University of Illinois Press, 1965; Lloyd ULMAN and Robert J. FLANAGAN, *Wage Restraint: A Study of Incomes Policies in Western Europe*, Berkeley, University of California Press, 1971; Jerry E. POHLMAN, *Inflation Under Control?* Reston, Virginia, Reston Publishing Company, Inc., 1976; Alice ROTH and Andre SHARON, *Controls - Who Needs Them? How Europe has Fared Under Incomes Policies Since 1974*, New York, Drexel Burnham Lambert Incorporated, August 1978; Laurence C. HUNTER, "British Incomes Policy, 1972-1974," *Industrial and Labor Relations Review*, Vol. 29, No. 1, October 1975, pp. 67-84; and Robert J. GORDON, "What Can Stabilization Policy Achieve?" *American Economic Review*, Vol. 68, No. 2, May 1978, pp. 335-341.

² This paper has benefited from the helpful comments of Joseph B. ROSE, Mark MUELLER, Gary N. CHAISON, Edward MAHER, and Dennis PROVOST.

³ Mandatory controls were adopted during World War II and a voluntary program existed between 1969 and 1972. For a more detailed description of the Canadian experience, see *Canadian Perspectives on Wage-Price Guidelines: A Book of Readings*, ed. by W. D. Wood and Pradeep Kumar, Kingston, Ontario, Industrial Relations Centre, Queen's University, 1976.

THE PRE-CONTROLS PERIOD

In 1975 prices in Canada rose by 11 percent for the second consecutive year⁴. Among other problems, inflation strained the country's ability to compete in world markets and reduced business' capacity to expand operations. Accompanying the rapid rise in inflation were pressures on the federal government to devise a plan to check it.

While there was hardly unanimity as to the primary cause of inflation, the government attributed the rise in consumer prices to cost-push factors. In particular, there was mounting concern over trends in compensation as unions attempted to either "catch-up" or preserve gains in real earnings during a period of accelerating inflation. Negotiated increases in base wage rates, which had averaged eight percent annually between 1970 and 1973, were being offset by the emergence of double-digit inflation in 1973. As a result hourly wage rates began increasing at a record pace (12.1 and 13.8 percent in 1974 and 1975), easily outdistancing price changes⁵. Larger wage settlements were accompanied by a worsening strike record. Man-days idle due to work stoppages reached an all-time record in 1975 of 10,908,810, or nearly twice the volume of strike activity experienced in 1973⁶.

Both the rise in compensation levels and a lag in productivity placed an enormous strain on unit labor costs in Canada. As Kumar observed:

In 1975, however, labour costs became the major source of price increase: more than nine-tenths of the rise in the GNP price deflator during the first half of 1975 was due to unit labour costs⁷.

Indeed, the labor cost and productivity picture was significantly worse in Canada than in the U.S. By 1975, unit labor costs in Canadian manufacturing were on a par with the U.S., whereas five years earlier they had been 15 percent lower in Canada⁸.

4 Statistics Canada, *The Consumer Price Index*, Vol. 56, June 1978, p. 5.

5 In addition, wage settlements were considerably higher for government employees than the all-industry average. Labour Canada, *Wage Developments 1976*, Ottawa, Collective Bargaining Division, 1977.

6 Canada Department of Labour, *Strikes and Lockouts in Canada, 1973-1975*.

7 Pradeep Kumar, "The Current Canadian Wage Scene: Major Trends and Patterns", in *Canadian Perspectives on Wage-Price Guidelines: A Book of Readings*, op. cit., pp. 288-290. During this period, labor's share of national income returned to its 1971-1972 level. In the intervening years corporate profits and investment income were the predominant income components of inflation.

8 *Ibid.*, pp. 290-291.

Government expenditures and monetary policy also contributed to the inflationary spiral. Total government expenditures increased by nearly 25 percent in 1974. The money supply was expanding at an annual rate exceeding 20 percent in both 1974 and 1975. This underscored the need to augment any program of wage and price controls with fiscal and monetary restraint.

PROGRAM AND GUIDELINES

In October 1975 the Canadian government opted for mandatory wage and price controls along with a strategy of gradualism with respect to monetary and fiscal policies. This approach sought to minimize the tradeoff between price stability and higher unemployment. Unlike the initial phase of President Nixon's control program, there was no freeze imposed on prices and incomes. Instead, the program was to be phased in as collective agreements expired, and guidelines were established in anticipation that controls might be required for up to three years. The anti-inflation program had four major elements.

- (1) Fiscal and monetary policies aimed at increasing total demand and production at a rate consistent with declining inflation.
- (2) Government expenditure policies aimed at limiting the growth of public expenditures and the rate of increase in public service employment.
- (3) Structural policies to deal with the special problems of energy, food and housing, to ensure a more efficient and competitive economy and to improve labour-management relations.
- (4) A prices and incomes policy which establishes guidelines for responsible social behaviour in determining prices and incomes of groups, together with machinery for administering these guidelines and ensuring compliance where necessary⁹.

Compliance with these objectives was sought through legal compulsion and moral suasion. Subject to legal enforcement were firms with more than 500 employees. This encompassed the nation's 1,500 largest companies. Firms in the construction industry with more than 20 employees were covered, as were professional groups such as doctors, lawyers, accountants, and engineers. The federal government and its agencies were also subject to

⁹ *Attack on Inflation: A Program of National Action*, Policy Statement Tabled in the House of Commons by the Honourable Donald S. Macdonald, Minister of Finance, October 14, 1975, Ottawa, Government of Canada, 1975, p. 3.

mandatory regulation, as were provincial and local governments which elected to participate. Groups not specifically covered were strongly encouraged to comply.

The price guidelines allowed increases only if costs increased. Alternatively, firms were expected to reduce prices if costs fell. The compensation guidelines established a "basic protection factor" which permitted increases of eight percent in the first year of a unilateral compensation plan or collective agreement, six percent for the second year, and four percent for the third year¹⁰. An additional two percent per year was allowed for national productivity increases. Also possible was an "experience adjustment" ranging from minus two percent to plus two percent depending on the earnings experience of groups prior to implementation of wage controls. Minimum and maximum dollar limits were placed on compensation. At one extreme, any increase of \$600 a year was permissible, whereas the upper limit on wages and salaries was set at \$2,400. (Employees were permitted in program year two to earn up to \$3.50 per hour or \$7,000 per year without being subject to the guidelines.)¹¹

Some important exceptions to the controls and guidelines should be noted. For example, food and energy prices were exempt. In addition, firms were not required to establish prices that would perpetuate or create a loss in their overall operations. Wage increases above the guidelines were also permitted if: (1) an employer would have difficulty attracting or retaining employees; (2) an historical relationship existed between employee groups; or (3) other special circumstances existed.

Administration of the program was vested in three independently operating agencies: (1) the Anti-Inflation Board (AIB), (2) the Office of the Administrator (hereafter Administrator), and (3) the Anti-Inflation Appeal Tribunal (AIAT). The AIB's principal function was to monitor and identify changes in prices and wages that exceeded the guidelines. It also had the

¹⁰ The "basic protection factor" was designed to protect wages against future price increases.

¹¹ Beside the controls on wages and prices, increases in profits, dividends and rents were also limited. Firms operating in the non-distribution sector were required to limit pre-tax profits as a percentage of sales to 85 percent of the base period margin. (The base period was either the five fiscal years prior to October 14, 1975, or the most recent fiscal year ended prior to May 1, 1976.) Firms in the distribution sector were required to meet a similar margin test of 95 percent. However, all firms were allowed to earn a maximum rate of return of eight percent on their equity, regardless of base period experience. The initial general guideline on dividends was that they could not exceed dividends paid during the previous fiscal year. Finally, responsibility for rent controls was placed in the provincial governments, each of which established their own program.

task of seeking to persuade parties to modify proposed actions that were not in compliance. Most of the day-to-day regulation under the program was carried out by the AIB. Its staff size peaked at 917 employees in March 1977¹². The Administrator's role was to act on specific cases referred to him alleging violation of the guidelines. If the Administrator found that the guidelines were breached, he could order compliance and recover excess payments or receipts. He could also impose a penalty of 25 percent of the excess compensation. Penalties of up to \$10,000 and/or two to five years imprisonment were established for individual violations, as well as individual fines of up to \$5,000 and/or imprisonment for one year for failing to comply with an order of the Administrator. The Administrator's decisions could be appealed to the AIAT (within a 60-day period), which was empowered to accept, modify, or overturn the Administrator's decisions. AIAT decisions were appealable to the courts.

Thus the government tried to establish specific standards with some flexibility to allow for exceptions in unusual cases. Although a large number of changes were made in the guidelines, notably on profits and appeal procedures, the structural content of the program did not greatly change until the process of decontrol began in April 1978. The remainder of this paper examines implementation problems, and trends in compensation, prices, and fiscal and monetary policies prior to and during the controls period up to decontrol.

IMPLEMENTATION PROBLEMS

In their thoughtful piece on the recent United States experience with wage and price controls, Schultz and Dam identify an important theme: that the advocacy process has a great impact on the administration of controls¹³. Expectations, and notions of equity that spring from interest groups, often do not comport with program goals. As the authors put it:

Issues that were formerly submerged in a specialized bureaucracy dedicated to a special interest are thrown into a more general governmental policy-making framework and into public discussion. New considerations are brought to bear, and old ones are reweighted. Often the political repercussions of such a reweighting are severe and may even bring down the whole program. In any event, the advocacy element in the making of public policy is thrown into sharp relief during the administration of wage and price controls¹⁴.

¹² Anti-Inflation Board, *Second Year Report*, Ottawa, Minister of Supply and Services Canada, 1977, p. 18.

¹³ SCHULTZ, George P., and Kenneth W. DAM, "Reflections on Wage and Price Controls", *Industrial and Labor Relations Review*, Vol. 30, No. 2, January 1977, pp. 139-151.

¹⁴ *Ibid.*, p. 140.

The "advocacy element" at work during the Canadian controls does not appear to have had as significant an impact as it did in the U.S. from 1971-74. In the U.S. the chorus of advocacy for removal of controls - especially as they revealed dislocations in the economy and poor performance in checking prices during Phases III and IV - was largely responsible for the demise of the program. In Canada the controls for the most part followed their initial prescription and time path. However, administration of the Canadian program was subject to sharp criticism and efforts by interest groups to hasten its removal¹⁵.

For example, shortly after the program began, 17 of the country's leading economists sent a letter to Prime Minister Trudeau criticizing the controls and urging their removal¹⁶. These economists believed that the controls would not work and that the government should instead concentrate on cutting its deficit and reducing corporate, union, and government bureaucracy power. As they put it, deficits in government spending (at the federal, provincial, and municipal levels) "where probably the most potent internal source of our rate of inflation"¹⁷.

Also under fire from various quarters, including the press, was a lack of clarity in program administration. This initially centered on the question of appeal of administrative decisions. Under the provisions of the White Paper it appeared that either party or both could appeal AIB decisions to the Administrator, and subsequently to the AIAT, and the courts. In practice, however, it became necessary for the AIB to ask the Administrator for an order to enforce its findings or for the AIB to agree to submit its findings to the Administrator. In effect, access to the Administrator required the consent of the AIB, and it was necessary for a party to contravene an AIB decision in order to qualify for appeal. The conditional nature of appeals caused confusion and vexed those parties adversely affected by AIB decisions.

This was amply illustrated in the AIB's first decision. Irving Pulp and Paper Ltd. paid its employees more than the 14 percent increase allowed by the AIB so that it could qualify for appeal of the AIB's decision. Irving had negotiated the pay increase with the Canadian Paperworkers Union. This prompted the AIB to bring the matter before the Administrator. He ratified

¹⁵ The program did, however, survive a constitutional challenge. John KING, "Supreme Court Rules 7-2 AIB Act Constitutional", *Globe and Mail*, Toronto, July 13, 1976, p. 11.

¹⁶ CHEVELDAYOFF, Wayne, "17 Economists Say Controls Won't Work, Tell Ottawa To Cut Its Deficit", *Globe and Mail*, Toronto, December 3, 1975, pp. 1-2

¹⁷ *Ibid.*

the AIB's 14 percent limit, and required the company to pay \$100,000 for recovery of excess wages, plus \$25,000 in fines for contravening the AIB ruling¹⁸. This time consuming and costly appeal process was remedied by legislative amendment in April 1976. Under the revised procedure either party was allowed to request the AIB to refer a decision to the Administrator for review, with the AIB required to do so.

The Irving case did, nevertheless, indicate the government's tough stance on enforcement. It also encouraged employers to adopt a stronger position in wage bargaining. If a firm could avoid a strike by settling at a higher wage than provided in the guidelines and then wait for an AIB rollback, it could afford to be less rigid in collective bargaining. But, facing penalties for failure to adhere to guidelines, firms would have an incentive to hold the line in negotiations. Even if a firm was forced by hard union bargaining to exceed the guidelines it could not legally put them into effect and could be fined if it did so.

Another attempt to shape public opinion, and thereby undermine controls, was undertaken by the Canadian Labour Congress (CLC). In May 1976, a document titled "Labour's Manifesto for Canada" was adopted by 80 percent of the delegates at the CLC's biennial convention. The convention also gave the federation's executive council a mandate to call a general strike, if necessary, to fight the wage-price controls. Among the grievances cited in the manifesto were the government's rollback of collective bargaining agreements, destruction of the negotiation process, and inequitable application of guidelines¹⁹. This philosophical commitment became a reality on October 14, 1976, when 830,000 employees participated in the CLC's "national day of protest" against the anti-inflation program.

Strike activity was a problem during the controls. After numbering between about 550 to 700 per year in the early 1970's, strike frequency jumped to 1,218 in 1974, 1,171 in 1975, and 1,039 in 1976²⁰. During these years the incidence of strikes, particularly high in French Canada, was more than in nearly all other industrialized countries. Clearly these strikes, whether motivated by wage controls or not, cast a sour note on the government's efforts.

18 *Globe and Mail*, Toronto, February 14, 1976, p. B1, and February 27, 1976, p. B2.

19 BANNON, Sharleen, "Canadian Labour Congress Convention 1976", *The Labour Gazette*, Vol. 76, June 1976, p. 306.

20 Data from *The Labour Gazette*, February, March, and May, 1978.

COMPENSATION

Various data sources indicate that compensation increases declined steadily throughout the controls period (see Tables 1 and 2). Looking first at wages, increases in hourly earnings in manufacturing declined from 13.8 percent in 1975 to 13 percent in program year one. In program years two and three wage increases dipped to 10.6 percent and 6.1 percent, respectively. The same trend is reflected in base wage rates contained in major collective agreements covering 500 or more employees (excluding the construction industry).

Table 1
Annual Rates of Changes in Wages and Consumer Prices

<i>Period</i>	<i>Wages</i>		<i>CPI</i>	
	<i>Hourly Earnings (Mfg.)</i>	<i>Base Wage Rates (All-Industry Average)</i>	<i>All Items</i>	<i>Food</i>
1970-71	9.0	7.8	2.9	1.0
1971-72	7.9	7.2	4.8	7.6
1972-73	8.8	8.1	7.6	14.6
1973-74	13.5	12.1	10.9	16.3
1974-75	15.8	13.8	10.8	12.9
1975-76	13.8	13.6	7.5	2.7
Program Year 1 (10-75-10-76)	13.0	15.0 ^a	6.2	-1.2
Program Year 2 (10-76-10-77)	10.6	7.8	8.8	12.7
Program Year 3 (10-77-4-78)	6.1	6.5	7.5	14.4

^aBased on major collective bargaining settlements

Sources: Statistics Canada, *Canadian Statistical Review*, May 1978; *Employment, Earnings and Hours*, April 1978; *The Consumer Price Index*, July 1978; and *The Labour Gazette*, May 1978.

A further indication of the dimensions of this trend can be ascertained by examining AIB compensation decisions (Table 2). From the outset of the program to the decontrol stage, compensation (wages plus fringe benefits) declined steadily, with the rates for public employees falling at a faster rate than private industry employees.

Table 2
Compensation Increases Submitted to the AIB and
Average Percentage Guidelines by Program Year

	<i>Cases Under^a</i>	<i>Emps. Under (000)</i>	<i>Prob^b Under</i>	<i>Guide^c Under</i>	<i>Cases Over^d</i>	<i>Emps. Over (000)</i>	<i>Prop Over</i>	<i>Guide Over</i>
Pre Program								
(Before 10-75)								
Private Sector	519	82,930	8.32	9.58	647	130,815	14.66	9.93
Public Sector ^e	226	27,880	8.87	10.68	302	70,818	20.69	11.88
Program Year 1								
(10-75-10-76)								
Private Sector	13,571	1,227,280	8.63	9.92	7,081	1,095,731	11.46	9.12
Public Sector	5,471	623,826	8.91	9.66	4,243	389,600	12.02	8.98
Program Year 2								
(10-76-10-77)								
Private Sector	13,834	1,657,897	7.12	7.85	6,071	786,227	8.93	7.06
Public Sector	5,809	796,234	7.06	7.64	3,255	295,824	8.23	6.95
Program Year 3								
(10-77-4-78)								
Private Sector	4,979	651,445	5.64	6.03	2,035	335,001	6.66	5.36
Public Sector	1,433	208,351	5.15	5.44	729	30,752	6.16	5.33

^aUnder: Compensation groups submitting increases equal to or below the arithmetic guidelines

^bProp: Average rate of compensation increase submitted

^cGuide: Average maximum rate of compensation increase allowed by guidelines

^dOver: Compensation groups submitting increases above the arithmetic guidelines

^ePublic sector includes federal and provincial data

Source: Data sent to the author, by Mark Mueller, Director, Economic Analysis Branch of the AIB. Data compiled by the AIB as of June 14, 1978.

Other AIB data show that the total (private and public) compensation increases submitted to the AIB during the first year of the program were 10.2 percent, a sizeable drop from the pre-program level of 14.1 percent, and that by the third program year average increases were down to 6.1 percent²¹. In each year the average compensation increases submitted to the AIB were less than the average arithmetic guidelines²².

In a study by Auld, et al., which examined the effects that controls had on negotiated wage contracts, it was found that for the first two years of the

²¹ Anti-Inflation Board, *Anti-Inflation Program: Progress Report of the Anti-Inflation Board*, Ottawa, AIB, March 1977, p. 4.

²² *Ibid.*

controls wage settlements were two and-one-half percent lower per year than they would have been in the absence of controls²³. However, it was cautioned that controls may have had a perverse impact on wages for two reasons. First, potentially lower settlements may have been pulled up to the guideline level if that level was too high. And secondly, employers and unions may have settled at higher wages than they otherwise would have, in anticipation of an AIB rollback²⁴.

Increases in productivity of workers, which stimulate real economic growth, serve to reduce the rate of price rises by keeping unit labor costs lower than they would otherwise be. According to estimates by the U.S. Department of Labor, output per hour in Canadian manufacturing rose by 3.3 percent in 1976 and 4.0 percent in 1977. Unit labor costs rose during these years by 9.1 and 5.9 percent respectively²⁵.

PRICES

The number of firms required to pre-notify the AIB of significant price increases grew from 117 in January 1976 to 342 in June 1977. In 1976 the average pre-notified price increase was 8.6 percent; during the first eight months of 1977 the average requested dropped to 4.1 percent²⁶. Despite the increase in the number of firms required to pre-notify on prices, only a partial view of price trends emerges from these data. Therefore it should be further instructive to examine changes in the consumer price index.

Price trends in Canada are shown in Table 1 in the preceding section. CPI data shows that during the first year of the program prices rose by 6.2

23 AULD, D., L. CHRISTOFIDES, R. SWIDINSKY, and D. WILTON, "The Impact of the Anti-Inflation Board on Negotiated Wage Settlements", paper presented at the annual meeting of the Canadian Economics Association, May 29-30, 1978, p. 41. (Mimeographed)

24 *Ibid.*, p. 2. Another study noted that while controls reduced wage settlements by about three percent, they did not appear to have a significant effect on real wage increases. Its author concluded: "These results suggest that controls have had an *indirect* effect on inflation through restraining rises in unit costs, even though it is unlikely that controls have had much *direct* impact on price inflation. (Emphasis in the original) Frank REID, "The Effect of Controls on the Rate of Change of Real and Money Wages in Canada", a paper presented at the annual meeting of the Canadian Economics Association, May 28-30, 1978, p. 17. (Mimeographed)

25 U.S. Department of Labor, Bureau of Labor Statistics, "International Comparisons of Productivity and Labor Cost Trends in Manufacturing", USDL 78-443, news release of May 1978, p. 1.

26 Anti-Inflation Board, *Second Year Report*, *op. cit.*, p. 12. The prenotification requirement began in 1976.

percent; in the second year by 8.8 percent; and in the last six months by about 7.5 percent on an annual basis. Since in the year preceding controls prices had risen by nearly 11 percent, the reduction of inflation during the first year of the program is significant. However, some of the reduction was due to uncontrolled food and import prices rising than the overall index. The AIB estimated that CPI components which were subject to controls increased by about eight percent during the first year. This matched the AIB's goal for the first year²⁷.

For the second year of the program the AIB's target for increase in the CPI was six percent²⁸. Since the index rose by 8.8 percent this objective was not met. The moderation in inflation to about a 7.5 percent annual rate for the remaining six months of the program, however, is a positive result. It should also be noted that energy prices, which were not controlled, climbed at a rate approximately twice that of the overall price index from the outset of controls through 1977,²⁹ making the AIB's objectives more difficult to achieve.

MONETARY POLICY

Because it was felt in 1975 that a too drastic curtailment of the rate of monetary expansion would almost certainly plunge the Canadian economy into sharp recession, the alternative chosen was to slow the rate of monetary growth in a series of gradual steps³⁰. Primary responsibility for implementing monetary policy is vested in the Bank of Canada. The main indicator used to measure the money supply is currency and demand deposits. Known as M1, it is not as comprehensive a measure of public transaction balances as the M1 used in the United States. This is because in Canada checks may be drawn on certain interest-bearing savings accounts, whereas in the U.S. virtually all checkable deposits are demand deposits.

From January 1973 to January 1975 M1 rose by about 20 percent. This rapid increase led to the inflationary spiral that was the progenitor of controls. Data on M1 from the initiation of controls to the time that decontrol

²⁷ Anti-Inflation Board, *First Year Report*, Ottawa, Minister of Supply and Services Canada, 1976, p. 2.

²⁸ *Ibid.*

²⁹ Anti-Inflation Board, *Second Year Report*, *op. cit.*, p. 6.

³⁰ Remarks by G. E. FREEMAN, Deputy Governor, Bank of Canada, at the Economic Outlook Conference of the Canadian Association for Business Economics, Ottawa, May 11, 1978, p. 4. (Mimeographed)

began is shown in Table 3. During this period M1 increased by a total of approximately 19 percent. For the first program year it increased by about 5.4 percent. This showed considerable monetary restraint by the Bank of Canada. In the second year (beginning in October 1976) the rate of increase climbed to 9.5 percent. However, it is moderated some during the five months before decontrol.

Table 3
Currency and Demand Deposits (M1) for Canada
October 1975 to March 1978
(millions of dollars)

<i>Month and Year</i>	<i>M1</i>	<i>Month and Year</i>	<i>M1</i>
Oct. 1975	17,395	Jan. 1977	18,639
Nov.	18,342	Feb.	18,791
Dec.	18,298	March	19,046
Jan. 1976	17,733	April	18,930
Feb.	17,818	May	19,269
March	17,737	June	19,730
April	17,632	July	19,607
May	17,885	August	19,824
June	18,138	Sept.	20,024
July	18,096	Oct.	20,069
August	18,204	Nov.	20,473
Sept.	18,402	Dec.	20,841
Oct.	18,335	Jan. 1978	20,646
Nov.	18,416	Feb.	20,873
Dec.	18,638	March	20,732

Source: *Bank of Canada Review*, date published May 4, 1978 by the Bank of Canada, Ottawa, p. 24.

The reduction in the rate of growth in the money supply in the first year of controls was a key factor, along with productivity gains, in causing wages and prices to moderate in 1976. That the rate of inflation began to climb again in 1977 is due to the Bank of Canada's reluctance to continue to apply the monetary brakes, a sharp upturn in food prices, and a substantial devaluation of the Canadian dollar which made imports more expensive.

FISCAL POLICY

Beginning in the mid-1960's the Canadian federal government introduced several new social programs and expanded existing ones. Up to the

time of controls government expenditures had risen much more rapidly than the economy as a whole. Growth in federal spending was concentrated on transfer payments, such as pensions, family allowances, and unemployment benefits³¹. A large portion of this spending was statutorily prescribed and therefore relatively inflexible downward. Many benefits automatically increased with the cost of living.

One of the principal objectives of the anti-inflation program was to limit the growth of public expenditures. Although tax revenues from individuals and corporations alternately rose and fell during the controls period, the government's policy emphasis was directed at expenditures. Starting in 1975 a reduction in the growth rate of spending at the federal, provincial, and local levels occurred. Total government spending had increased by 24.2 percent in 1974. This rate eased to 22.3 percent in 1975, 12.4 percent in 1976, and 9.9 percent in 1977. (See Table 4) This deceleration is commendable, and helped to slow inflation.

Table 4
Government Expenditures National Accounts Basis, 1974-1977
(percentage changes)

	1974	1975	1976	1977 ^a
Federal government	28.7	22.9	9.4	13.7
Provincial governments	22.9	23.8	12.9	12.1
Local governments ^b	18.1	19.0	14.8	7.4
Total governments ^c	24.2	22.3	12.4	9.9

^aFirst half 1977 over first half 1976.

^bIncluding hospitals.

^cIncluding Canada and Quebec Pension Plan expenditures as well as net federal, provincial and local expenditures.

Source: Anti-Inflation Board, *Second Year Report* (Ottawa: Minister of Supply and Services Canada, 1977), p. 3.

Accompanying the spending levels, sizeable budget deficits occurred during controls, since tax rates were not adjusted as a sufficient offset. Cash requirements for the deficits were mostly met through the sale of government securities to the public. Therefore the pressure on the banking system that might otherwise have occurred was minimized, and the Bank of Canada was relatively free to pursue monetary policy without concern over financing the deficit.

³¹ *Attack on Inflation: A Program of National Action*, op. cit., p. 5.

Government expenditures as a percent of Gross National Product rose substantially during 1975 to 41.3 percent, from 37.9 percent in the previous year. (See Table 5) The percentage dropped in 1976, and up to the time of decontrol in 1978 remained approximately at the 1975 proportions. These data indicate that while government spending was at high absolute levels, it kept pace with overall GNP. Given the difficulty of paring social programs, and built-in escalators requiring increases in pensions and other benefits, the relatively high level of government spending may not have been that excessive under the circumstances. As it was the unemployment rate rose by about three percentage points during 1977, and might well have risen more had the government slowed spending more drastically.

Table 5
Government Expenditures as a Percent of the
Gross National Product
(exclusive of intergovernmental transfers)

	1974	1975	1976	1977	First Quarter 1978 ^a
Total federal government	15.4	16.8	15.8	16.1	16.7
--excluding transfers to persons	9.5	10.4	9.8	9.9	10.4
Total provincial governments	11.1	12.2	12.1	12.4	12.6
--excluding transfers to persons	8.0	8.9	8.6	8.7	8.9
Total local governments	8.3	8.8	8.7	8.9	8.6
Hospitals	2.7	3.0	3.1	3.1	3.0
Pension plans	0.4	0.5	0.6	0.7	0.7
Total all governments	37.9	41.3	40.3	41.1	41.7

^aBased on data seasonally adjusted at annual rates.

Source: Data provided the author by Statistics Canada.

Cause for some concern is found in the federal budget proposed in April 1978. This indicates a projected deficit for 1977-78 of \$8.8 billion, up from a deficit of \$3.86 billion in 1976-77³². For 1978-79 a deficit of \$9.25 billion is forecast in the budget³³. The rapid increases in spending scheduled would place considerable strain on the government's ability to check inflation during the period of decontrol and thereafter.

³² Department of Finance, Canada, *The Budget*, presented by the Honourable Jean CHRÉTIEN, Minister of Finance, in the House of Commons, April 10, 1978, Ottawa, Department of Finance, 1978, p. 21.

³³ *Ibid.*

CONCLUDING REMARKS

Some economic theorists posit that institutions possessing market power will voluntarily restrain their actions in accordance with the public interest - and their own long-run interests as well. However, the persistence of economic instability in most Western nations makes this proposition doubtful. Thus incomes policies, featuring wage and price controls, are viewed by others as a contributor to price stability, full employment, and a favorable relative position in international markets. Again, however, experience often shows that wage and price controls, particularly when not accompanied by adequate monetary and fiscal restraint, promise more than they can deliver. Why do controls remain popular in light of this experience? The principal appeal is political - they indicate that the government is trying to do something about the problem.

The Canadian government invoked controls as a result of excessive cost-push and demand forces. It cannot be overemphasized that whatever chance these wage and price controls had to achieve success was primarily dependent on the extent to which the rates of monetary growth and budget deficits were reduced. Controls can reduce expectations for the short term, but unless the underlying demand pressures are adequately contained, expectations will adjust to economic realities. While inflation can be restrained, and even lowered by controls, without concomitant policies that impact on prices the controls will come to lack support. The political imperatives initially justifying them are then likely to reverse toward favoring their dissolution. Therefore it is significant that demand management was included in the Canadian program along with the enforcement of wage and price guidelines for large segments of the economy.

Canada's program had a substantial impact on compensation levels, which were lowered from annual increases of approximately 14 percent to six percent. As a result cost-push forces were reduced. Also contributing to this decline, however, was the rise in unemployment to about 8.6 percent by April 1978.

While prices were moderated from the pre-control annual rate of increase of about 11 percent to about six percent in the first program year, they rose in the second year to nearly nine percent. After falling back for a short period the rate of increase in inflation was back up to a 9.2 percent annual rate in mid-1978. As a result the program had a greater impact on compensation than prices. Although uncontrolled energy prices rose at about twice the rate of overall prices during most of the program, Canada is close to a balance between exports and imports of oil and gas. Therefore, little if any correlation is found between inflation and energy imports.

During the first year of controls increases in the rate of money supply were significantly moderated to 5.4 percent. Unfortunately, it rose to a 9.5 percent rate of increase in the second year. It is becoming widely accepted that increases in a country's money supply have a high correlation with future price increases. A lag factor of about six months to a year exists from the time that money supply changes are reflected in the price level. That the rate of price increases dropped during the first program year and the first few months of the second year, while climbing rapidly during the remainder of the second year, reinforces the theoretical link between monetary growth and price increases.

Steady reductions in the rate of government spending, from approximately 24 percent in 1974 to about 10 percent in 1977, had a retarding effect on inflation. However, the rate of increase remained relatively high, and substantial budget deficits are forecast for the 1978-79 fiscal year which could fuel further inflation. The rising unemployment rate complicated government efforts to reduce spending.

A wage and price control program cannot be fully assessed until long after its completion. As evidenced by experience in the United States and Western Europe, it has not been uncommon for wage-price explosions to occur after controls are withdrawn. The post-control period in Canada will therefore deserve careful attention for years to come.

Les conséquences du contrôle des prix et des salaires au Canada, 1975-1978

Depuis 1960, les problèmes reliés à l'inflation ont donné lieu à de nombreux programmes de contrôle des salaires et des prix en Europe et en Amérique du Nord. Dans la plupart des cas, ces programmes n'ont pas obtenu de grands succès. Qu'en est-il de la récente expérience canadienne en matière de contrôle des salaires et des prix?

L'effort canadien mérite une observation attentive de la part des hommes politiques des pays occidentaux qui projettent l'établissement de tels contrôles.

En 1975, les prix avaient augmenté de onze pour cent pour la deuxième année consécutive. Les taux horaires des salaires montaient à une vitesse sans précédent (12.1 pour cent en 1974 et 13.8 pour cent en 1975). Le nombre des grèves était élevé et la productivité était faible. Les dépenses gouvernementales et la politique monétaire contribuaient aussi à la spirale inflationniste. On pressait le gouvernement de trouver des moyens pour lutter contre l'inflation.

En octobre 1975, le gouvernement adopta des mesures de contrôle des salaires, des prix et d'autres sources de revenus. Il chercha aussi à freiner l'expansion fiscale et

monétaire. En grande partie, la responsabilité d'administrer les contrôles fut confiée à la Commission de lutte à l'inflation.

Bien que le programme s'en soit tenu à sa conception initiale et que les délais prévus furent respectés, il fut sujet à des critiques acerbes de la part de groupes d'intérêts. Ainsi dix-sept économistes parmi les plus réputés du pays écrivirent au premier ministre Trudeau une lettre qui mettait en doute la valeur des contrôles et réclamaient leur abolition. La presse s'attaqua au manque de clarté dans l'administration du programme. Le nombre des grèves dans l'ensemble continua de se maintenir à un niveau élevé. Le Congrès du travail au Canada organisa «une journée nationale de protestation» en octobre 1976.

Le programme eut un impact notable sur le taux des augmentations des salaires lequel baissa de quatorze à six pour cent annuellement. Les prix tombèrent à un taux annuel d'environ six pour cent d'augmentation pendant la première année du programme, mais ils étaient remontés à un taux d'environ neuf pour cent à la levée des contrôles en 1978. Résultat: les effets du programme furent beaucoup plus marqués sur les salaires que sur les prix.

Le taux de chômage à la hausse compliquait l'effort d'implantation de politiques monétaires et fiscales restrictives. Bien que, dans l'ensemble, les taux d'augmentation de la masse monétaire et des dépenses gouvernementales aient été freinés, ils restèrent à des niveaux relativement élevés. On en conclut que, quoiqu'il en soit du succès des contrôles réalisés au Canada, celui-ci est attribuable à cette modération monétaire et fiscale qui se produisit.

Bien que, sur une courte période, les contrôles puissent tempérer les ambitions, à moins que les pressions économiques sous-jacentes ne soient contenues, elles en viendront à manquer de soutien. Aussi les éclatements dans les salaires et les prix peuvent-ils survenir au moment de l'abolition des contrôles. Par conséquent, le programme du Canada continuera à mériter une attention soutenue dans les années à venir.