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Chronicles of the Anti-Inflation Board

1st Session, 30th Parliament, 23-24 Elizabeth II,
1974-75

1^{re} Session, 30^e Législature, 23-24 Elizabeth II,
1974-75

THE HOUSE OF COMMONS OF CANADA

CHAMBRE DES COMMUNES DU CANADA

BILL C-73

BILL C-73

An Act to provide for the restraint of profit margins, prices, dividends and compensation in Canada

Loi ayant pour objet de limiter les marges bénéficiaires, les prix, les dividendes et les rémunérations au Canada

WHEREAS the Parliament of Canada recognizes that inflation in Canada at current levels is contrary to the interests of all Canadians and that the containment and reduction of inflation has become a matter of serious national concern;

ATTENDU que le Parlement reconnaît l'incompatibilité de l'actuel taux d'inflation avec l'intérêt général, ainsi que la gravité du problème national posé par sa réduction et son

5 endiguement

5

AND WHEREAS to accomplish such containment and reduction of inflation it is necessary

ET qu'il importe en conséquence de limiter les marges bénéficiaires, les prix, les dividen-



Anti-inflation
Board

Commission de lutte
contre l'inflation

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**CHRONICLES
OF THE
ANTI-INFLATION BOARD**

**Anti-Inflation Board
1979**

● Minister of Supply and Services Canada 1979

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Preface

In October, 1975, the prime minister announced the anti-inflation program as a measure designed to reduce the escalating rate of inflation in Canada. The Anti-Inflation Board, which was to administer mandatory controls on compensation and prices, was created to provide a brake on inflationary actions. It was to last for three years and three months.

In November, 1976, the Board commissioned the writing of this document to provide background information on Canada's first peacetime application of wage and price controls. It is presented as a detailed chronicle of events in the hope that students of public administration and policy will find it useful in their analyses of economic conditions in Canada during the 1970s. This account is not intended to evaluate the anti-inflation program or assess its impact on the economy since judgment by those directly involved might appear self-serving. There is also the problem of perspective: the document was begun in 1976 and chapters were written over a period of more than two years.

Each chapter deals with a specific aspect of controls and is presented so that it can be read independently. The source for this history is a combination of Board minutes, Board papers, and the recollections of those who served.

In compiling its chronicles, the Board drew on the talents of many of its capable and dedicated staff, representing a number of disciplines and fields of experience, who served the AIB so well during its brief existence. The Board wishes to express its appreciation for their substantial efforts and especially for their contributions to this document.



Harold A. Renouf
Chairman, Anti-Inflation Board

June 30, 1979

Chronology of the Anti-Inflation Program

October, 1975–December, 1978

1975

- October 13 Prime minister announces controls on prices and incomes, asks full co-operation of nation in implementing anti-inflation program.
- October 14 Minister of finance tables White Paper, "Attack on Inflation: A Program of National Action."

Prime minister appoints Jean-Luc Pepin and Beryl Plumptre chairman and vice-chairman, respectively, of Anti-Inflation Board.
- October 16 Interim Anti-Inflation Board formed under Inquiries Act.

Quebec announces intent to set up its own anti-inflation program.
- October 23 Regional members appointed to Board effective December 15, 1975, for Maritimes, Quebec, Ontario, and Prairies.
- October 24 Canadian Labor Congress (CLC) announces program to push for withdrawal of wage controls.
- October 30 First meetings of Anti-Inflation Board. Agenda: the Board's role, priorities, organization, and tasks at hand.
- November 7 Board announces it will take over the food price monitoring system developed by the Food Prices Review Board.
- December 7 CBC survey shows Canadians favor selective wage and price controls by 3 to 1.

1975

- December 10 Board rejects postal workers' contract with Treasury Board. The matter is referred to cabinet.
- December 15 Chairman announces that Board rulings on prices and profits will be made public.
- Bill C-73, "an act to provide for the restraint of profit margins, prices, dividends, and compensation in Canada," is given royal assent.
- December 18 Anti-Inflation Guidelines released.
- Government announces \$1.5 billion spending cutback.
- December 19 Board launches extensive program to explain Anti-Inflation Guidelines.
- December 31 Administrator of Anti-Inflation Act appointed.

1976

- January 13 Ontario is first province to place its public sector under anti-inflation program.
- January 29 Board makes first referral, a wage case involving Irving Pulp and Paper employees, to Administrator.
- February 2 Agreement signed with Prince Edward Island.
- Agreement signed with Newfoundland.
- February 12 Board member for British Columbia appointed.
- Administrator orders Irving Pulp and Paper to pay \$125,000 for defying an Anti-Inflation Board recommendation on wage agreement.
- February 18 Alberta signs agreement.
- February 20 Guidelines for chartered banks announced.
- February 25 Agreement signed with Manitoba.
- February 27 Agreement signed with New Brunswick.

1976

- March 8 Estimated 40,000 additional firms brought under mandatory control by application of association bargaining.
- March 10 Agreement signed with Quebec.
- March 11 Cabinet asks Supreme Court of Canada to rule on constitutional validity of Anti-Inflation Act and Ontario order-in-council.
- March 22 CLC holds nationwide day of protest. Thousands of workers, representing labor's opposition to anti-inflation program, march on Parliament Hill.
- March 26 Board announces first price rollback, a proposed increase by La Brasserie O'Keefe.
- April 8 Agreement signed with Nova Scotia.
- April 14 Board accepts first excess revenue compliance plan from Canada Starch Company.
- April 15 Order-in-council puts all property and casualty insurance firms under Act and Guidelines.
- April 29 Bill passed amending Anti-Inflation Act to give employee groups right to appeal Board rulings.
- May 25 Changes in prices and profits guidelines proposed by minister of finance.
- June 11 Draft guidelines issued.
- June 23 Agreement signed with British Columbia.
- July 12 Supreme Court rules Anti-Inflation Act is constitutional, but Ontario wrong to impose controls without legislature approval.
- August 8 Gallup poll shows only 23 per cent of Canadians see some success in the battle against inflation.
- August 26 General Foods uses open letter to announce plan to divest \$1.4 million excess revenue.

1976

- September 7 Government announces revised prices and profits guidelines.
- September 8 June Menzies appointed vice-chairman of Board to replace Beryl Plumptre.
- September 16 General Motors of Canada holds average price of 1977 models to average price of comparably-equipped 1976 models to eliminate expected excess revenue.
- October 6 Gallup poll shows 62 per cent of Canadians believe CLC irresponsible in calling for a work stoppage; 32 per cent think CLC acting responsibly.
- October 14 CLC work stoppage and day of protest.
- October 21 Governor-in-council approves new anti-inflation guidelines announced in minister of finance's policy statement September 7.
- October 22 *First Year Report* of Board released.
- October 27 Board releases names of 96 firms with excess revenue.
- December 8 Poll taken in November shows 56 per cent of Canadians support anti-inflation program.
- December 14 Consensus of 10 provincial premiers favors continuation of program beyond March, 1977.

1977

- February 8 Board increases from 274 to 298 the companies required to give 30 days notice of price increases.
- February 12 Gallup poll shows 46 per cent of Canadians—up 8 per cent from previous year—feel living standard going up.
- March 16 Quebec Anti-Inflation Commission abolished by provincial order-in-council.
- March 28 AIB orders compliance audit of 500 professional firms.

1977

- May 4 Gallup poll shows 46 per cent of Canadians feel controls should continue.
- May 6 Jean-Luc Pepin steps down as chairman of Anti-Inflation Board. Harold Renouf, Board member representing the Maritimes, appointed chairman.
- June 13 Board announces marked decline in size of proposed 1977 price increases compared with 1976. Prenotified price increases average 4.1 per cent compared with 6.8 per cent in 1976.
- June 30 Government to amend Anti-Inflation Act to prevent unions and companies from regaining rolled-back wages and prices when controls end.
- July 27 Wage settlements in second quarter 1977 moderate to average annual increase of 8 per cent.
- August 8 Gallup poll shows support for wage and price controls at 58 per cent.
- August 13 Gallup poll shows that 60 per cent of Canadians fear inflation will rise further if wage and price controls removed.
- August 17 Ontario premier pushes for monitoring agency after controls end.
- September 20 Canadian Chamber of Commerce calls for less public spending and quick dismantling of AIB.
- September 26 Six insurance companies with excess revenue agree to return \$3,365,000 to clients through reduced premiums.
- September 30 Supreme Court of Canada rules Manitoba does not have power to apply federal wage guides to its employees.
- October 7 Saskatchewan pulls provincial public sector out of controls effective October 13.
- October 20 Finance minister announces phased decontrol program to begin April 14, 1978.

1977

- October 21 *AIB Second Year Report* released.
- November 9 Alberta announces participation in controls program will end December 31, 1977.
- December 13 Manitoba legislature approves participation in federal anti-inflation program, retroactive to October 14, 1975.
- December 30 P.E.I. announces withdrawal from anti-inflation agreement, effective March 30, 1978.

1978

- February 16 Economic Council of Canada (ECC) asked to monitor wage and price trends.
- February 22 Gallup poll shows Canadians feel unemployment and inflation top national problems.
- March 6 Two Canadian steelmakers raise prices of some products from 3 to 7 per cent.
- March 15 Prime minister announces terms of reference for the ECC's monitoring of wages and prices.
- March 21 Governor of Bank of Canada says Canada making solid progress toward "much sounder economic situation."
- April 4 CLC convention votes against participation in post-controls monitoring body; CLC demands immediate end to wage and price controls.
- April 6 Gallup poll finds 35 per cent of Canadian adults do not feel hurt by inflation.
- April 14 Legislation phasing out wage and price controls given final reading and passage.
- Decontrol begins. Board says about 75 per cent of companies and 62 per cent of employees will remain under controls until end of year.
- Manitoba withdraws from controls.
- B.C. withdraws from controls.

1978

- April 19 1,500 Kaiser Resources coal miners strike to protest AIB wage rollback from 17.8 per cent in first year to 9 per cent, and from 21 per cent in second year to 6 per cent.
- April 20 Administrator fines four Montreal lawyers and one Saskatchewan accountant for failure to provide adequate income information to AIB.
- May 11 Board approves one-year compensation contract between 11 rail companies and Associated Railway Unions. Contract covers 83,000 rail employees.
- May 13 Canada's national per capita income of \$8,410 rated third by the Organization for Economic Co-operation and Development (OECD) out of 24 industrialized non-communist countries.
- May 15 Conference Board in Canada says Canadian consumer confidence slumped in first quarter 1978 because of increased concern over financial prospects, uncertain job market, higher prices.
- May 17 AIB's one-thousandth speech delivered by vice-chairman June Menzies to Canadian Federation of University Women, Orillia, Ontario.
- May 21 AIB compensation and price and profit audit programs to continue through decontrol period into 1979.
- June 14 Statistics Canada reports highest monthly jump in food prices since July, 1972.
- June 15 Creation of Centre for Study of Inflation and Productivity (CSIP) announced by ECC.
- June 24 Gallup poll reveals 55 per cent of Canadian public fear excessive post-control price rises.
- July 7 Finance Minister Chrétien asks AIB to investigate profit margins of large food retailing and processing firms.

1978

- July 15 AIB Chairman Harold Renouf announces that Canadians will face cuts in standard of living for another year before inflationary effects of spiraling prices can be controlled. Drop in real personal income expected in short term.
- July 23 51,000 small and medium-sized Canadian enterprises urge Ottawa to bring in voluntary incomes policy to last at least one year after the end of 1978.
- July 27 Statistics Canada reports average weekly wages in Canada rose 6.45 per cent in last year to May level of \$264.02. Consumer price index increased by about 9 per cent during same period.
- August 12 Wage increases in three months to June 30, 1978, held to 6.4 per cent. Increase is lowest in decade.
- August 26 AIB announces that fresh produce helped drive down food prices by 1.5 per cent during four weeks to August 18.
- September 14 August consumer price index records smallest gain since December, 1975, up 0.19 per cent from July, and up 9.4 per cent from August, 1977.
- September 23 Executive salary increases fell to 7.9 per cent in 1977-1978, the third consecutive year of sharp decline and the lowest increase in six years.
- September 25 CSIP warns that Canadians could face wage and price controls again if they try to get pay increases to match surge in cost of living.
- October 13 Wages in Canada rising about 7 per cent annually compared to 8.9 per cent in 1977 and 13.2 per cent in 1976.
- October 17 AIB issues food study report stating that for major Canadian food retailers and processors overall net profit margins have varied little from historic norms during recent upsurge in food prices.
- November 5 Bank of Canada raises prime rate by half a percentage point to a record 10.75 per cent.

1978

- November 9 Administrator's report shows \$6.7 million recovered from employers and employees as a result of overpayments last year.
- November 13 Conference Board study reveals Canadian earnings up more quickly than those in the U.S. since October, 1975, when controls imposed.
- November 27 CSIP figures indicate that while post-control wage settlements show upward trend in second and third quarter of 1978, no major "bubble" found.
- November 28 AIB asked to make sure 3 per cent cut in federal sales tax is passed on to consumer.
- AIB Chairman Renouf says Canada's wage and price controls were temporary method of dealing with spiraling inflation, not permanent answer to the economy's problems.
- December 20 Gallup poll says support for anti-inflation controls continues at pre-controls level—51 per cent favoring positive government action on wages and other income and 68 per cent on prices.
- December 31 Anti-Inflation Act expires, but AIB to continue processing reports until "summer" of 1979.

CHAPTER I

The Pre-Control Period

“Tomorrow, the government of Canada will ask Parliament for the authority to impose severe restraint upon rising prices and incomes.”

With these words, the prime minister began a national address at 9 p.m. on October 13, 1975, outlining his government's new program for combating inflation. The following day a White Paper, “Attack on Inflation: A Program of National Action,” was released, explaining the program in greater detail.

For those who were to be associated with the program, the announcement marked a new challenge; for those whose incomes were to be restrained under the new law, it signalled a change in expectations. Politicians, public servants, academics, leaders of business and labor, and others in Canada had been involved in a sometimes acrimonious debate over the appropriateness of wage and price controls for more than a decade. Though the imposition of controls did not end the argument, it substituted real events for hypothetical ones in the debate.

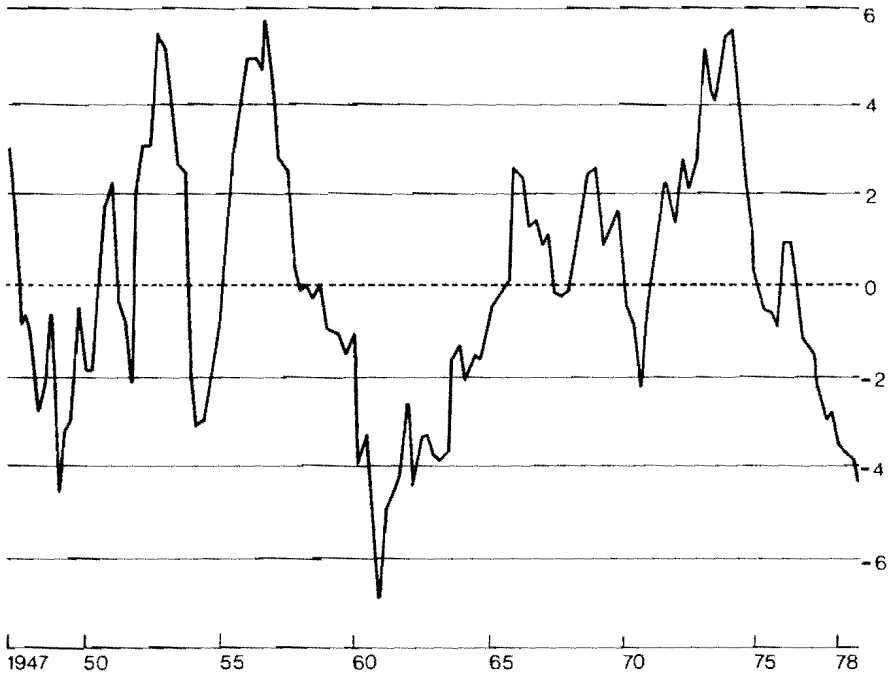
This chapter reviews the debate and discussion leading to introduction of controls in October, 1975, and examines the economic climate during this period. In addition, it looks at the government's earlier economic policy initiatives, and at the events which led to the anti-inflation program announced by the prime minister.

The chapter is divided into four parts. The first is a brief general survey of the economy in the years since the end of World War II. The second part covers the decades between 1946 and 1968, when traditional policies of demand management were relied upon to govern economic activity. The years 1969 to 1972, when the Prices and Incomes Commission focused attention on incomes policy as a supplement to conventional demand management, are discussed in the third part. The fourth part centres on the rapid changes in the economic environment from 1973 to 1975, and on government responses to these changes, which together culminated in mandatory wage and price controls in October, 1975.

Economic Perspective, 1946-1975

A cyclical growth path has typified the contemporary Canadian economy: two or three years of strong expansion with rising levels of employment and prices, followed by a year or two of lower employment levels and lower rates of price increase. The peaks and troughs are shown in Chart 1, which plots deviations from the long-term trend of real gross national expenditure (GNE) to determine the turning points in the cycle.

CHART 1
THE BUSINESS CYCLE
GROSS NATIONAL EXPENDITURE (CONSTANT DOLLARS)
PERCENTAGE DEVIATIONS FROM 1947 TO 1978 TREND



Inflation reached double-digit levels during three phases, all of them expansionary: the post-war boom in 1946-1947; the Korean War boom in 1951; and the expansion of 1973-1974. As Table 1 shows, there were two decades of more moderate inflation between 1951 and 1974. During this period, however, higher levels of inflation tended to be associated with higher levels of unemployment, indicating that Canada was progressively less successful in attaining the dual objectives of price stability and high employment.

TABLE I

| EXPANSION PERIODS AND INFLATION/UNEMPLOYMENT | | | |
|--|---------------------------------|----------------|-----------------------|
| <i>Year:Quarter</i> | <i>Maximum</i> | | <i>Minimum</i> |
| | <i>Inflation (Y/Y % Change)</i> | | <i>Unemployment</i> |
| | <i>GNE</i> | <i>CPI</i> | <i>Rate (% Level)</i> |
| 49:2 to 52:4 | 14.1 (51:2) | 11.7 (51:3) | Not available |
| 54:4 to 56:4 | 4.9 (56:4) | 2.9 (56:4) | 3.0 (56:3) |
| 61:2 to 66:1 | 4.4 (66:1) | 3.4 (66:1) | 3.4 (65:4) |
| 71:1 to 74:1 | 13.4 (74:1) | 9.7 (74:1) | 5.3* (74:1) |
| RECESSION PERIODS AND INFLATION/UNEMPLOYMENT | | | |
| <i>Year:Quarter</i> | <i>Minimum</i> | | <i>Maximum</i> |
| | <i>Inflation (Y/Y % Change)</i> | | <i>Unemployment</i> |
| | <i>GNE</i> | <i>CPI</i> | <i>Rate (% Level)</i> |
| 53:1 to 54:3 | -0.9 (53:2) | -1.9 (53:1) | 4.7 (54:2) |
| 57:1 to 61:1 | 0.4 (61:1) | 0.2 (59:2) | 7.6 (61:1) |
| 66:2 to 70:4 | 2.9 (68:2) | 2.2 (70:4) | 6.5* (72:4) |

* New Labor Force Survey (since summer 1976), Statistics Canada.

In some cases inflation was even lower, and unemployment higher, two or three quarters into the recovery phase. A striking feature of the contemporary Canadian economy is the sharp increase in real income per employed person. Table 2 shows average annual compound growth rates for principal income and employment variables.

Canadian workers enjoyed an average annual increase in real income of almost 3.5 per cent from 1945 to 1975. This sustained increase in living standards contributed to widespread expectation that the future would continue to offer advances in real income.

TABLE 2
COMPOUND RATES OF GROWTH
FOR SELECTED ECONOMIC INDICATORS, 1945-1975

| | |
|--|-------|
| <i>Total Labor Income</i> | 8.99% |
| <i>Total Employment*</i> | 2.38% |
| <i>Average Income per Employed Person</i> | 6.46% |
| <i>Consumer Price Index</i> | 2.91% |
| <i>Average Real Income per Employed Person</i> | 3.45% |

* Old Labor Force Survey (prior to summer 1976), Statistics Canada.

The events summarized in the rest of this chapter represent the federal government's effort to sustain growth in real income, while grappling with the concurrent problems of inflation and unemployment.

1946-1968: Years of Monetary and Fiscal Policies

Mandatory wage and price controls were applied in Canada during World War II. They were readily accepted by most of the population as a necessary means of allocating economic resources for the war effort. When the war ended in 1945, unemployment was the major concern of public policy. There was widespread fear that the economy could not employ in peaceful pursuits the manpower that had been devoted to the war. This employment priority was reflected in a federal government White Paper of 1945 which set out the basis for the post-war economy. If its aim of high and stable employment and income levels was to be achieved, the government stated, "it must be wholeheartedly accepted by all economic groups and organizations as a great national objective, transcending in importance all sectional and group interests."

The concern for high employment soon shifted, however, to a concern about high inflation. Expansionary monetary and fiscal policies, coupled with dramatic increases in consumer expenditures reflecting the pent-up demand of the war years, led to a major expansion in the economy through 1948. The consumer price index (CPI) rose sharply during this period, peaking at a 15 per cent annual rate of increase in 1947. Application of more restrictive demand management policies created a moderate recession in 1949, and brought the annual increase in the CPI down to 2 per cent.

The second major post-war expansion began in late 1949 and lasted until mid-1953. It was amplified by the war in Korea. As in the preceding period of expansion, inflation reached double-digit levels, peaking at a 12 per cent rate of increase in the consumer price index in 1951. Mandatory controls on prices and incomes were considered by the government but judged unnecessary. During the short, sharp recession in late 1953 and early 1954, the consumer price index did not increase.

This relative price stability was to last for nearly a decade. In the 11 years ending in 1965, the average annual rate of increase in the consumer price index was 1.75 per cent, with annual rates of increase between 0 and 3 per cent. This relative stability of prices may be attributed to major resource discoveries which increased the supplies of many commodities; the rising productivity of the work force, particularly in the agricultural sector; and the continuing liberalization of international trade, which served to restrain domestic prices.

Though Canada attained relative price stability in the late 1950s and early 1960s, it was less successful at employing its expanding work force. During the recession of late 1957 and early 1958, which followed the investment boom of 1954-1957, the unemployment rate reached 7.0 per cent. The rate declined only slightly to 6.0 per cent during the weak expansion of 1958-1960, and rose to 7.6 per cent in the recession of 1960-1961.

This apparent conflict between price objectives and employment objectives emerged as a major national issue in the early 1960s. Students of the economy, looking back to the end of World War II, observed that conventional monetary and fiscal policies were contributing to a cyclical pattern. Through failure to achieve sustained economic growth, they charged, demand management was unsuccessful in simultaneously achieving price stability and high employment.

This situation was common to many industrialized democracies that had relied on monetary and fiscal policies to attain high employment, stable prices and balance-of-payments equilibrium. As a consequence, the Organization for European Economic Co-Operation in 1961 published a study of this apparent inflation-unemployment dilemma, recommending the use of national wage policies. The study was one of the first works to stimulate interest in incomes policies.¹

In a 1962 report, the organization, reconstituted as the Organization for Economic Co-Operation and Development (OECD), again argued for incomes policies.² The report advanced what has since become an accepted definition of incomes policy:

What is meant by an incomes policy. . . is that the authorities should have a view about the kind of evaluation of incomes which is consistent with their economic objectives, and in particular with price stability; that they should seek to promote public agreement on the principles which should guide to growth incomes; and that they should try to induce people voluntarily to follow this guidance.³

This policy, or variants of it, had been adopted by several countries since the war, primarily to help correct major balance-of-payments crises.

¹ William Fellner et al., *The Problem of Rising Prices*, Paris, Organization for European Economic Co-Operation, 1961.

² Organization for Economic Co-Operation and Development, *Policies for Price Stability*, Paris, 1962.

³ *Ibid.*, p. 23.

In the early 1960s, however, incomes policies were introduced by such countries as the United Kingdom, the Netherlands, France, and the United States to supplement demand management.

When the Kennedy administration took office in the United States in January, 1961, it was committed to reducing unemployment while preserving price stability. To this end, a set of wage-price guideposts was announced at the beginning of 1962. It was proposed that wage increases be limited to the trend of overall productivity increases and that price increases be equal to unit cost increases (or decreases). The intent was to achieve price stability with the help of price and income guidelines, thereby permitting a more expansionary monetary and fiscal policy to raise both employment and output.

The guideposts announced by the White House had no statutory support, but they had all the moral suasion powers of the office of the president. Announcement of the guidelines focused the attention of the American public on the price/unemployment dilemma and led to several well-publicized clashes between the administration and labor or business groups.

In Canada, too, the price/unemployment dilemma assumed a high profile during this period. Indeed a disagreement over economic policies between the government of the day and the governor of the Bank of Canada led to the governor's resignation on July 13, 1961. As a prelude to the decennial revision of the Bank Act due in 1964, a royal commission was appointed in 1961 to examine monetary policy and the institutions through which it functioned.⁴ The commission conducted a wide-ranging analysis of economic policies and institutions before submitting its report in late 1964. It studied, and heard witnesses on, economic policies for simultaneously attaining high employment levels and reasonable price stability.

One of the policies considered was direct government intervention in determination of prices and wages. Principal evidence came from witnesses from the United States and the United Kingdom, who had some experience with such a policy. The commission concluded that an incomes policy was not appropriate for Canada at that time, but recommended that it be studied further by the newly formed Economic Council of Canada.

The government acted on this recommendation in 1965, requesting that the Economic Council undertake a study of incomes policies. The study, completed in October, 1966, defined incomes policy, reviewed the experience of countries that had applied some form of incomes policy, and assessed the applicability of such policies in Canada.⁵ On the basis of

⁴The Royal Commission on Banking and Finance, commonly known as the Porter Commission after its chairman, was created by order-in-council in October, 1961, and submitted its report in February, 1964.

⁵David C. Smith, *Incomes Policies: Some Foreign Experiences and their Relevance for Canada*, Ottawa, Queen's Printer, 1966.

the report, the Economic Council concluded in its *Third Annual Review* that, while incomes policies should be taken into account as an additional economic tool, their use in Canada was not necessary.

From the point of view of economic policy makers, the years from 1962 to 1966 were the best since World War II. In mid-1961, following almost five years of below-potential growth and employment, the economy began a period of strong expansion which lasted until 1967. During the expansion, exceptionally high levels of employment were attained and annual rates of price increase remained close to the generally accepted objective of 3 per cent. Though rates of price increase remained acceptably low, it is important to note that they showed a tendency to accelerate as expansion progressed. During 1961, the consumer price index was increasing at an annual rate of 0.9 per cent. The rate of increase rose steadily throughout the expansion, and in 1966 reached an annual rate of 3.7 per cent. A moderate recession occurred in 1967, but although unemployment rose there was negligible reduction in the rate of price increase. Thus, when economic growth returned to more acceptable levels in 1968, prices continued to accelerate, not from a reduced rate of price increases, but from the same rate at which they had been increasing at the end of the previous expansion.

At this point, after roughly six years of acceleration in the rate of price increase, inflation began to emerge as the major public policy issue. The late 1950s and early 1960s had been years of relative price stability, and attention had thus been focused on ways to achieve full employment. In the late 1960s, however, concern began shifting to the problem of obtaining reasonable price stability, as greater success in meeting employment objectives was realized.

In 1968 Canada again found itself in the same position as other developed countries. A persistent, accelerating rise in prices was associated with economic policies that had achieved striking success in maintaining high employment and vigorous economic growth over a period of years. Though short-run fluctuations in economic activity continued, recessions were relatively short and did not lead to major increases in unemployment or significant reductions in real income. Indeed, real domestic product per person employed in Canada increased in every year from 1958 to 1967. Economic analysts began to discuss the notion that, if real incomes increased on a more or less continuous basis, individual price and income decisions would attempt to preserve what had come to be expected as automatic increases in income. If this were so, an inflationary bias was being built into the economy. Each successive upswing in economic activity would start prices rising at higher rates than in the preceding expansion.

This apparent inflationary bias was discussed in an OECD *Economic Survey of Canada* published in early 1968, in pointing out the potential value of an incomes policy:

Canada's price/wage performance in full employment conditions suggests that there is need for some sort of incomes policy. A number of

other OECD countries have been active in this field in the last few years. No country can point to any spectacular success in controlling the rise in incomes this way. This perhaps is not surprising; given the nature of the problems involved progress could hardly be expected to be very rapid. There are indications, however, that incomes policy in some countries is beginning to play a useful role. The approach varies from country to country depending upon a number of factors, notably institutional arrangements and the structure, comprehensiveness and attitudes of trade unions and employers' associations. The decentralized character of the Canadian economy may render the evolution of an incomes policy more difficult than in many European countries but this may not be a reason for dispensing altogether with efforts in this direction.⁶

Concern over inflation combined with the recommendations in the OECD report led the government to table a White Paper, "Policies for Price Stability," in December, 1968. The purpose of the paper was to examine the problem of rising costs and prices that has emerged in the past few years; to outline some of the possible causes of this upward price pressure; the range of policies that can be used to combat it; and to propose a combination of policies that should improve our ability over time to employ fully human and physical resources while, at the same time, maintaining acceptable prices and cost behavior.⁷

It was also indicated that the White Paper would be the basis for further consultations with various economic interest groups and provincial governments.⁸

Publication of the White Paper marked a major change in government policies regarding inflation. It led to the introduction, for the first time in a peacetime environment, of policies other than conventional demand management to contain inflation. In addition, it was the beginning of a consultative or consensus approach to the inflation problem.

The policy issue addressed in the White Paper was not a new one. It involved the perpetual conundrum of how to simultaneously maintain a desired level of employment and reasonable price stability. The paper highlighted the problems associated with the effect of accelerating rates of price increase on the achievement of growth and employment objectives. It noted that accelerating price increases impair growth by reducing international competitiveness. At the same time, they contribute to resource misallocation, impede capital formation, increase inequities in income distribution, and restrict the ability of demand management to expand output in an economy with excess capacity associated with high rates of inflation.

The White Paper explained that while the government had accepted the Economic Council's 1965 recommendation that a formal incomes

⁶ *Economic Survey of Canada*, published with the approval of the Economic and Development Review Committee, Organization for Economic Co-Operation and Development, Paris, February, 1968, p. 20.

⁷ Minister of Consumer and Corporate Affairs, *Policies for Price Stability*, Queen's Printer, Ottawa, 1968, p. 3.

⁸ *Ibid.*

policy would be undesirable in Canada, the environment had changed. In particular, the conclusions of the OECD review suggested that serious examination of an incomes policy was warranted. However, the White Paper clearly rejected compulsory and formal controls, accepting the OECD's 1961 definition of incomes policies as voluntary acceptance of guidelines for determining price and income levels. Two key observations were made in the paper: (1) adequate knowledge of the causes and consequences of inflation and of the dynamics of the inflation/unemployment trade-off did not exist in Canada, and extensive research effort was needed; and (2) there was not enough public involvement, particularly by the major economic interest groups in business, labor, and government, in debate and action on the subject of inflation.

The vehicle proposed to overcome these problems was the Prices and Incomes Commission. Describing the proposed commission, the White Paper stated: "While it will be empowered to make recommendations as to government policy, its main function will be to rally a sense of public responsibility leading to voluntary restraint."⁹

For the more than two decades since the end of World War II, the Canadian government, like its counterparts in other democratic societies, had relied upon conventional monetary and fiscal policy to achieve economic objectives. Although there were short-run fluctuations in economic activity over this period, some of them severe, and although at times unemployment and the rate of price increase were distressingly high, the overall record for these years was good. Canada had become a major industrial society through development of its natural resources and expansion of its labor force through immigration. The benefits of economic growth were widely distributed and real incomes rose dramatically. Nevertheless, by 1968 it was apparent that the economic environment was changing, both in Canada and abroad, and that new approaches and new initiatives were necessary to offset future problems. The creation of the Prices and Incomes Commission was the first of these initiatives.

1969-1972: The Prices and Incomes Commission

The formation of the Prices and Incomes Commission was announced by the minister of consumer and corporate affairs in May, 1969, five months after the tabling of the White Paper "Policies for Price Stability." One month later, an order-in-council appointed the commissioners under the Inquiries Act, and called on the commission to "inquire into and report upon the causes, processes, and consequences of inflation and to inform those making current price and income decisions, the general public, and the government on how our price stability may best be achieved."¹⁰

⁹ *Ibid.*, p. 31.

¹⁰ Privy Council Minute P.C. 1969-1249, Government of Canada, Ottawa, 1969.

Commission operations started early in July with a small staff working in the basement of Ottawa's old Union Station. The station was undergoing renovations to become the government conference centre, and the prevailing disorder was symbolic of the commission's early days.

The commission was an independent body with a broad mandate. On the basis of responsibilities outlined in the White Paper and the order-in-council, it could undertake a wide range of research, make policy recommendations to the government, and pursue the objective of voluntary restraint. The commissioners held discussions with the business community, labor organizations, provincial governments, and the federal public service, to arrive at a more precise interpretation of their mandate and chart a course of action. Within the federal public service, a group emerged consisting of deputies to ministers represented on the Economic Policy Committee of cabinet. The commission was to continue an informal liaison with this group throughout its three-year life.

The commissioners strongly believed that the escalating inflation rate was a serious problem, and that if it was not checked the cost in lost employment and output could be very high. All four commissioners had experience in public policy, and were aware that knowledge of the inflationary process was limited; as a consequence, they would have to organize a substantial research effort. Better research, however, was likely to lead to only marginal improvements in policies, and any such improvements would take a long time to develop and implement. They therefore made it their first priority to develop a program of action, designed to produce immediate benefit to the public.

In simple terms, the commissioners believed that the degree of restraint required to achieve price stability through conventional demand management policies was so great that it would result in high levels of unemployment and large losses of output for a protracted period. As a partial alternative to this, they sought voluntary agreement on a comprehensive "package" of commitments and government measures to limit increases during 1970 in all forms of income: wages and salaries, professional incomes, profits, rental and investment income, and taxes. Such a package was intended to supplement conventional monetary and fiscal policies, and thus to permit achievement of reasonable price stability more quickly and with less severe monetary and fiscal restraint than would otherwise be the case.

Throughout July, 1969, the commissioners explored this idea with representatives of major economic interest groups. The response was sufficiently favorable for them to make their plans public. In its announcement, the commission described the main features of its program:

- Agreement will be sought on a comprehensive "package" of voluntary commitments and governmental measures designed to achieve a substantial across-the-board scaling down of price and income increases in Canada during the coming year.

- Commitments will be sought from business, professional and union groups, and governments, to place effective limits for a temporary period on the extent of increases in all the main forms of income in Canada.
- If a “package” deal of this kind can be worked out which appears to have a good chance of widespread public acceptance, it will be submitted for discussion and ratification at a national conference on price stability convened for this purpose, towards the end of 1969 in Ottawa.
- If such an agreement is ratified, a formula will be sought on methods and procedures for dealing with instances of price and income increases contrary to the spirit of the agreement.¹¹

This last point is an important one: the voluntary aspects of the commission’s plan related only to the agreement. Governments, business firms, labor organizations, agricultural bodies, and other economic interest groups were asked to voluntarily enter into an agreement on principles for establishing prices and incomes for a year. Once the agreement was reached, however, it was intended to be binding on all parties.

The commission intended that federal and provincial governments would give the agreement the force of statute, and that sanctions would be made available to apply against those who did not comply. In effect, “voluntarism” ended with the agreement; after that, the “package” was much more like a mandatory system of price and income controls.

Both the federal government and the commission recognized that the government would have to play a leading role in setting an example of restraint. To this end, the prime minister made a public statement on August 13, 1969, outlining the steps the government would take in the 1970-1971 fiscal year. These measures included restraints on public service hiring, a freeze on national defence expenditures, and limits on the growth of existing government programs.

On the same day, the commission met with representatives of major economic interest groups to further discuss its proposed restraint program. Reservations were expressed at the meeting about the viability of the commission’s approach. Some participants from the private sector were uneasy about playing a leading role in formation of the proposed agreement, as they might then be seen as a guilty party by the general public. Nevertheless, it was agreed that discussions would continue, on an individual party basis, with labor, business, and major interest groups. A series of meetings was arranged with representatives of labor, business, and other major economic interest groups. Progress was made at these individual sessions and in early September another, larger meeting was held, attended by representatives from all major economic interest groups. Little progress was made at this meeting, in part because some of those present felt that they were being made “fall guys” for the economic situation. Another round of consultations with individual interest groups was arranged which lasted for the next month.

¹¹ Prices and Incomes Commission, press release, Ottawa, August 6, 1969.

The commissioners were unsuccessful in assuring the representatives of major labor groups that a fair and equitable restraint program could be devised. As a result, on October 17, 1969, the Canadian Labor Congress and the Confederation of National Trade Unions issued an unusual joint press release, formally withdrawing from the discussions. The press release advocated a freeze of one or two years on all prices. In rejecting the commission's approach, the labor organizations expressed the view that an incomes policy could not equitably restrain non-wage and salary incomes such as profits, rents, interest, professional fees, unincorporated business income, and speculation in real estate prices.

Withdrawal of these two major labor organizations from the discussions caused the commission to consider terminating the entire exercise. Other interest groups proposed that discussions continue, however, and they proceeded without further labor involvement.

At about the same time, another event with longer-term implications took place. Canada's largest steel producers announced price increases on their major products. The price increases followed wage and salary increases for their employees, and this combination of wage settlements and price increases generated enough public concern to prompt the commission to undertake a fact-finding study of cost and price developments in the steel industry. The staff formed to carry out the study became the nucleus for the commission's future Price Review Division. The study gave this staff some first-hand experience at administering and interpreting pricing rules.

Consultations with economic interest groups other than labor continued through 1969, culminating in the announcement of a National Conference on Price Stability to be held in Ottawa on February 9 and 10, 1970. The decision to proceed with the conference was based on commitments from the Canadian Manufacturers Association, the Canadian Chamber of Commerce, the Canadian Bankers Association, and the Retail Council of Canada to support price restraint rules.

A communiqué was issued following the conference, outlining the price restraint programs agreed upon. The principle adopted was that any price increases in 1970 would be less than were required to cover cost increases. It was hoped that this would reduce the absolute size of price increases during 1970, while focusing public attention on the cost increases which had led to rising prices. It was also hoped that demonstration of a workable price restraint mechanism would help dispel the apprehensions of organized labor about joining the program.

At a meeting of first ministers on February 16 and 17, 1970, the closing statement of the national conference was endorsed by all 11 governments. The commission's Price Review Division subsequently expanded, and began to administer the pricing rules.¹²

¹² For a complete discussion of the steps preceding the national conference and the commission's operations immediately following it, see G.A. Berger, *Canada's Experience With Incomes Policy 1969-1970*, Queen's Printer, Ottawa, 1972.

Further approaches to organized labor to determine if they would participate in a wage and salary restraint program were rebuffed, for the same reasons as those given the previous October. As a last resort, the commission on June 5, 1970, unilaterally proposed a set of wage and salary guidelines. The guidelines involved a 6 per cent rate of increase in wages and salaries, consisting of 3.5 per cent to offset expected price increases, and 2.5 per cent for national productivity. This unilateral proposal failed to receive enthusiastic support from all provincial governments and, not surprisingly, further antagonized the labor movement. However, the commission proceeded to establish a compensation review division to administer its wage and salary guidelines.

The commission's effort to promote voluntary restraint had received substantial public attention, and had perhaps generated unrealistic expectations. In mid-1970, the economic situation was deteriorating. Though the rate of increase in the consumer price index was moderating, this was to a large extent the result of unusual declines in food costs. Other components of the index continued to increase at unacceptably high rates as did unit labor costs, signaling worsening inflation in the future.

The activities of the commission had raised the spectre of mandatory wage and price controls. In mid-1970, the government reviewed the economic situation and the policy options. Mandatory controls were discussed, although as an option of very low priority. Recognizing that this priority might change, however, the government requested that the commission develop contingency proposals for statutory control of prices and incomes. It was made clear, however, that the government had no commitment to implement such a program, even if the economic situation deteriorated further.

In the summer and fall of 1970, the commission was an active and productive operation. A large public information program was in operation; the Price Review Division by the end of 1970 had completed 200 price investigations and published 40 reviews of price increases; the Compensation Review Division was reviewing wage and salary settlements in relation to the 6 per cent guideline; and a research organization was studying the inflationary process. Resources were available to permit serious examination of a mandatory control program. More important, the commissioners and staff were rapidly acquiring expertise in this area.

By mid-October 1970, the commission had developed the principles of a statutory program. Through five years of expansion, review, and adaptation, these principles remained largely intact. Briefly, they were as follows:

- program to begin with a temporary freeze followed by a more flexible set of rules;
- control of prices in manufacturing, processing, wholesale, retail, utilities, and service industries through the application of margin control limits;
- wage and salary controls that would normally be applied to groups of employees, but in certain cases to individual employees;

- control of rents of existing self-contained residential accommodation; and
- an excess profits tax to apply mainly to larger corporations in cases where margin controls are not normally applicable or effective.

Three features of these principles need comment. First, the selection of a margin control device for restraining prices was based on the commission's operating experience. The pricing rule enforced during 1970 required that incremental revenue from price increases be less than what was required to cover cost increases.

In simple terms, interpretation of this rule involved measuring the increase in the unit cost of supplying a product or service, and assuring that this amount was greater than the increases in unit price. In the majority of pricing studies, including the major review of steel prices, this principle presented difficulties in application. In many cases, there was no standard of measurement from which to derive unit costs. In other cases, cost increases were difficult to identify precisely, and in some cases price itself proved to be a nebulous concept.

Another way of stating the commission's pricing rule is to say that profits per unit of output had to decline or, more simply, that profit margins had to decline. Use of margins eliminated the need to worry about unit measurement and the need to measure incremental revenues and incremental costs. The commission concluded that margins were the most efficient control mechanism.

Secondly, the commission concluded that applying compensation rules to groups made far more sense than applying them to individuals. The objective of a statutory program is to restrain the rate of increase in compensation costs, and the manner in which increased costs are spread among employees is of secondary concern. In addition, it is standard compensation practice to set wages and salaries on a group basis. Making the rules compatible with existing practice was considered a major simplification both for those operating the controls and for those subject to them. The exception for individuals was to apply at the upper end of the income scale for those whose compensation is more commonly set on an individual basis, and who might otherwise be excluded from the controls.

Finally, the commission's proposal for an excess profits tax arose primarily from its difficult experience with export firms. Development of appropriate pricing rules for export firms had proven to be a stumbling block in its initial consultations. In addition, in late 1969 and early 1970, commodity prices, particularly for metals, were increasing dramatically and the commission was under intense pressure to restrain them. Although application of domestic price restraint rules for the benefit of a purchaser in another country was not desirable, there were obvious problems in permitting the domestic income of the seller to rise without limit if the income of the seller's employees were restrained by the domestic rules. The commission concluded that such sellers should be

freed from price restraint, but subject to income restraint through an excess profits tax.

The restraint rules agreed upon at the National Conference on Price Stability were due to expire at the end of 1970. However, the commission was sufficiently satisfied with its progress, and hopeful that the emerging excess capacity in the economy would further dampen inflation, that it sought to extend the rules for the first six months of 1971. The major groups represented at the national conference met in Ottawa in early December, 1970, to explore the possibility of such an extension. They were nearly unanimous in opposing it, and the commission's administration of both the pricing rules and the wage and salary guidelines was allowed to lapse on December 31, 1970.

The commission's staff turned their attention to contingency planning at the beginning of 1971. During the first half of the year, regular consultations were held with the government on alternative approaches to mandatory controls.

Pricing rules were examined in detail. There was concern that the margin approach might be too subtle, and that the public would not understand its effectiveness as a price control mechanism. Coverage of the controls—that is, the groups, individuals, and firms that would be subject to them—was also analysed, and an attempt was made to evaluate comprehensive controls as opposed to selective ones. Alternatives to explicit rules governing prices and incomes were assessed; attention was given to use of the tax system to achieve a similar result. Economic analysis was undertaken to assess the conditions under which controls might be implemented with the greatest likelihood of success, and the best conditions under which to remove them. The commission further considered the idea that it might be necessary to make institutional or structural changes in sectors of the economy during a control program to prevent a resurgence of inflation when controls were removed. Finally, with the Department of Justice, the commission examined constitutional issues raised by controls, and began work on legislation to implement mandatory controls.

Throughout this period, the principles underlying the contingency plan remained intact, although many refinements and improvements were made. For example, compensation guidelines were developed in a way that preserved the real income of wage and salary earners during the life of a controls program.

As the commission refined its thinking, it began to use outside experts to test and expand its concepts. Several national accounting firms provided advice on the concepts being studied, and a number of other advisers from the professional and academic communities were consulted.

Public and government concern about inflation subsided during 1971. Economic performance was weak, and the resulting excess capacity, combined with stable or declining commodity prices, stabilized the rate of increase in the consumer price index at 2.8 per cent, somewhat below 1970's 3.4 per cent rate of increase. The calm was shattered,

however, when the president of the United States announced his new economic policy on August 15, 1971.

One reason why the government had not seriously considered controls was the fact that inflation rates in Canada had generally been lower than those of its major trading partners. Although imposition of controls in the United States led to a re-examination of this position, it was held to be valid; although contingency planning continued, it remained precisely that.

Since its inception, the Prices and Incomes Commission had maintained informal contacts with officials of the United States administration. These officials were aware of the commission's experiences with voluntary guidelines. Following imposition of controls in the United States, these contacts were expanded. Prices and Incomes Commission staff frequently visited the corresponding U.S. agencies: the Cost of Living Council, the Price Commission, and the Pay Board. Firsthand observation of these groups helped in the development of the Canadian plan.

The United States' experience was particularly relevant since the principles adopted there were similar to those proposed in Canada. The major price control mechanism in the U.S. was a margin rule. The compensation guideline was based on a combination of expected price increase and national productivity and, like the Canadian model, it was applied to employee groups. The United States program exempted exports, however, since the export of commodities is relatively much less significant there.

Towards the end of 1971, the commission's research program was nearly complete. Its members were forming more precise views about the inflationary process and the role of price and income controls in moderating this process. As time passed, the commission became increasingly convinced that mandatory controls had a role to play. In a discussion paper written in early 1972, it observed that since the objectives of economic policy were expressed in terms of specific quantitative results (an inflation rate, an unemployment rate, and so on), in this context "the primary function of incomes policy . . . is the creation of an economic environment in which people might recognize that escalating inflation is not the dominant characteristic of their economic future, and . . . change their expectations accordingly."¹³

The commission concluded that it is virtually impossible, barring an unprecedented recession, to alter such expectations without comprehensive price and income controls, backed up by a monitoring organization and sanctions for those who do not comply.

This view is reflected in the final report of the commission, published in the summer of 1972. The report analysed the causes and processes of inflation in Canada since the early 1950s, focusing on the problems created by accelerating inflation associated with slack demand and high

¹³ Unpublished working paper, Prices and Incomes Commission, Ottawa, March 23, 1972.

unemployment. It rejected the popular notion that this situation is caused by the increased market power of strong groups in our society, and focused the blame on transmission of external inflationary pressures into Canada, along with the processes of adaptation and expectations within the country. Although the commission expressed no great love for mandatory controls, their potential benefit in relation to the costs of alternative policies (in particular, restrictive demand management) led the commission to recommend them as an important policy alternative.¹⁴

Before winding down in the fall of 1972, the commission had prepared its contingency plan in detail, including work on systems, procedures, organization, public information, staff training, and other administrative details. In the light of the subsequent experience of the AIB, it is interesting to note that the commission estimated the staff requirement for a comprehensive system of price, wage, and rent controls to be 1,200 people.

The burden of maintaining the contingency plan fell to a much smaller group than that. Arrangements were made by the government to maintain a small nucleus of people who had worked on the plan, and who would continue to refine and improve it as much as possible. In the next three years, this group was to explore many avenues for achieving price restraint, in addition to improving the contingency plan.

1972-1975: Exploratory Years

The Prices Group was created within the Department of Consumer and Corporate Affairs on September 1, 1972, to continue both the contingency planning of the Prices and Incomes Commission and research into prices and incomes policies for dealing with inflation.¹⁵ Although for budgetary purposes the Prices and Incomes Commission had reported to Parliament through the minister of consumer and corporate affairs, it was an independent body whose principal contact with the government was through the group of senior officials referred to earlier (deputies to ministers represented on the Economic Policy Committee). With the formation of this group, the Department of Consumer and Corporate Affairs began to take a more direct responsibility for policy to combat inflation, although it consulted other departments regularly on economic policy.

The Prices Group began by compiling the work of the Prices and Incomes Commission, and by preparing a review of the United States program from the time of its introduction on August 15, 1971. The group identified aspects of the contingency plan that required further work or policy guidance and, late in 1972, took steps to resolve them.

¹⁴ For an analysis of the commission's final report see G. K. Kardouche and F. Caromazzo, *Wage and Price Controls for Canada?*, C.D. Howe Research Institute, Montreal, 1973.

¹⁵ Initially called the Special Studies Group, the name was later changed to reflect its primary activity.

Emphasis was placed on developing a proposal for regional administration, preparing an economic review of conditions under which controls might be imposed, and examining the type of reporting authorities that would be necessary. In addition, the group worked on legislation for the proposed temporary freeze, further developed a public information program, made arrangements to quickly obtain offices and associated facilities, and worked on a plan for organization and staffing of the controls administration.

The recession of 1970-1971 was followed by an economic expansion throughout 1972 and 1973. As the Prices and Incomes Commission had predicted, the rate of inflation rose as the expansion continued. External events as well as worsening inflation focused attention on the government's anti-inflation policy. In January, 1973, the United States adopted a less restrictive and less comprehensive controls program. The United Kingdom, which had imposed a freeze in 1972, introduced a flexible system of controls in the spring of 1973. A further domestic complication affecting Canadian policy was the change in October, 1972, from majority to minority government.

Amid these uncertainties, an unexpected phenomenon was occurring. Agricultural production dropped well below normal levels in a number of countries in 1972. The resulting shortages, particularly of grains, led to an explosion in food prices in late 1972 that was to last for three years. In response to this situation, in January, 1973, the government appointed a Special Committee on Trends in Food Prices, composed of 25 MPs with a mandate to "inquire into and make recommendations on the trends in food prices in Canada and factors domestic and foreign which account for these trends."¹⁶ The committee existed for one year and made several reports to Parliament. In its first report, it called for appointment of a Food Prices Review Board to study and report on changes in certain specific food prices. The government, acting on this recommendation, by order-in-council May 25, 1973, appointed such a board to

monitor price movements of a comprehensive series of food products, and to issue reports thereon, at three-month intervals, and to inquire into the causes of particular food price increases in any class of food products, and to issue reports thereon, with all dispatch, including recommendations where the board considers appropriate to do so.¹⁷

Like the Prices and Incomes Commission, the Food Prices Review Board reported to Parliament through the minister of consumer and corporate affairs.

Confronted with a 15 per cent annual rate of food price increase and a seriously upset public, the board's early days were difficult. Its small staff began a review of some sectors of the food industry, and began reporting to the public on price developments. It soon became apparent that in order to gain public confidence, the board needed more clout. On

¹⁶ Food Prices Review Board, Final Report, *Telling It Like It Is*, Queen's Printer, Ottawa, 1976, p. 25.

¹⁷ *Ibid.*, p. 29.

August 21, 1973, a third mandate was added to the initial two: “to inquire into any increase in the price of any food item where such increase may be unwarranted, and, where the board deems necessary, to publish a report thereon without delay.”¹⁸

Food prices increased at a 16 per cent annual rate in 1974, and at a 13 per cent annual rate in 1975, the last year of the board’s existence. However, the board pursued its mandate with vigor and precision, issuing many reports detailing the questionable pricing policies of some suppliers, illustrating the inflationary bias of some government policies, and advising consumers on how to get better value for their food expenditures. The board was set up in response to an exceptional inflationary situation. To some extent, it represented an attempt to bring about voluntary price restraint, while recommending structural changes to overcome inflation in a specific sector of the economy.

As 1973 progressed, inflation continued to worsen. The consumer price index, excluding food, had risen at a 3.8 per cent annual rate in 1970, 3.5 per cent in 1971, and 3.7 per cent in 1972. In 1973 it was running slightly over 5 per cent. While unit labor costs had risen at a 5.8 per cent annual rate in 1970, 3.6 per cent in 1971, and 5.5 per cent in 1972, by 1973 they were increasing at a 7.5 per cent annual rate, suggesting even worse inflation ahead. There was increasing concern that the acceleration in food prices would lead to higher wage settlements, thereby further raising unit labor costs and accelerating the entire inflationary process.

In the latter part of 1973, the Prices Group continued to work on the contingency plan; to establish the nature, size, and degree of independence of the control boards; methods of enforcing compliance with controls; public relations and information programs; and the ramifications of possible consultations with the provinces, labor, business, and consumer groups. The contingency plan would have permitted rapid imposition of a temporary freeze, although some administrative work was still needed for a more flexible control period.

At the same time, the government was monitoring the economic environment to determine appropriate policy responses. Unusual developments in the external environment were making it extremely difficult to form domestic policies. All principal industrial countries were experiencing high rates of real growth. It appears in retrospect that they may have been operating under excess demand conditions. These conditions contributed to large and rapid increases in the price of commodities, compounded by shortages of agricultural products.

The government focused on the following seven variables to determine the appropriateness of compulsory price and income controls:

- the rate of overall price increase;
- wages per unit of output;
- profit rates;

¹⁸ Ibid.

- prices of farm products at the farm gate;
- international commodity prices;
- degree of slack in the economy;
- the public's attitude to controls.

Analyses conducted late in 1973 indicated that about 40 per cent of domestic inflation (as measured by the consumer price index) was imported, and beyond the control of government policy. Apart from international transmission of inflation, the domestic economy was running at high levels of employment and output, and it was considered doubtful that controls would be effective under these circumstances. Thus government policy continued to aim at easing the process of adjustment to higher rates of price increase, for example by indexing some forms of transfer payments, increasing subsidies on some food products, and intervening in the domestic price mechanism for crude oil and natural gas. It was recognized, however, that if the peculiar international circumstances abated with no consequent abatement in domestic inflation, mandatory price and income controls could become necessary.

The worsening inflation carried over into 1974. Excess demand and short supply of agricultural products were compounded by the sudden upward shift in energy costs resulting from the OPEC-induced rise in crude oil prices in late 1973. As a consequence of these factors, inflation reached double-digit proportions early in 1974 for the first time since the Korean War. Prices of some products were rising dramatically, as were the profits of their suppliers. In 1973 and 1974, the share of GNP accounted for by profits was the highest since 1951, the last recorded year of double-digit inflation.

The government continued to believe that mandatory controls were inappropriate in the prevailing economic environment. However, it felt compelled to act against what it and many members of the public regarded as "excessive" and "unwarranted" price increases. As a result, "an act to amend the Combines Investigation Act in relation to profiteering practices" was introduced in the House of Commons on April 29, 1974. The underlying premise of the bill, which became known as the anti-profiteering bill, was that suppliers who enjoyed market power could take undue advantage of the inflationary environment to increase their prices and incomes.¹⁹

The intent of the bill was to control abuses of market power rather than to enforce general price restraint. For this reason, it was considered part of competition policy.

The anti-profiteering bill was initiated by the Department of Consumer and Corporate Affairs, and the Price Group was active in preparing it. Some of the bill's content was based on the contingency plan for price control. In essence, it would have enabled the government temporarily to freeze prices on goods where there was evidence of profiteer-

¹⁹ Hansard, May 1, 1974, pp. 1937-1940.

ing. In certain circumstances, it would have permitted the government to roll back prices. It provided that where a board operating under the Inquiries Act, such as the Food Prices Review Board, found the price of a commodity increased to permit the supplier to realize a profit margin greater than customarily obtained, the governor-in-council would declare the product subject to the provisions of the bill. If a product was so declared, the supplier would be required to provide 30 days' notice of proposed price changes, and to justify such changes by demonstrating that the profit margin on the product was not being increased. In cases where prices had been increased to realize profit margins greater than those in some historical base period, the supplier could be required to roll back his prices. Revenue derived from profit margins higher than those "customarily obtained" was considered excess revenue. Under terms of the bill, it would either have to be refunded to past purchasers of the product, given up by price reductions to future purchasers of the product, or paid to the Receiver General for Canada.

The bill was not well received by the public. It was seen as an inadequate device for fighting inflation, a more important concern to the public than the nuances of competition policy. In addition, the notion of "customary profit margins" was considered ill-defined and unfair by the business community. Shortly after it was introduced, the government was defeated in the House, an election was called, and the bill died on the order paper with the parliamentary session. However, we have an example of the way the bill might have operated.

Shortly after its introduction, increases were announced in the price of some steel products. Public concern over the inflationary effects of these increases caused the government to appoint a commission of inquiry to investigate steel price increases. The commissioner was specifically directed to consider "customary" profit margins, and the possibility that steel producers were exercising market power by withholding supply.²⁰ Had the bill become law, and had the commissioner found that price increases resulted in higher than customary profit margins, the government could have intervened in steel pricing. Neither event came to pass, but the inquiry represents a further example of selective investigating and reporting of price changes.²¹

As inflation accelerated, so did the rate of increase in wages and salaries, producing further inflation. During the summer of 1974, government economists continued to examine the seven variables enumerated above, and to give serious consideration to imposition of wage and price controls. They were increasingly convinced that deflation brought about by demand management would be slow and painful, involving a long period of high unemployment and low output. The need was becoming more acute for a policy that would help to stabilize the economy at a lower rate of inflation.

²⁰ P.C. 1974-1177, Privy Council Office, May 22, 1974.

²¹ *Steel Profits Inquiry*, Queen's Printer, Ottawa, 1974.

Although recognizing the need for such a policy, the government, which had been returned to office in a July election, remained adverse to mandatory controls. Once more it chose a voluntary arrangement to attempt to restrain the rate of price and income increases. This time, however, voluntarism was clearly identified as a government priority. Ministers became directly involved in the process, and there was no resorting to an independent agency such as the Prices and Incomes Commission.

At the time the decision was made to seek a voluntary consensus, in early September, 1974, the Ad Hoc Committee of Senior Officials on Inflation was created. The committee was essentially the same group of officials (although different individuals) who had acted as liaison with the government for the Prices and Incomes Commission.

In the throne speech of September 30, 1974, the government spelled out its plan for combating inflation, including proposed legislation similar to the earlier anti-profiteering measures. The speech went on to say:

There must be greater awareness of the need for restraint by everyone in what each seeks to secure in incomes, profits, prices, or taxes if inflation is to be mitigated. Demands to secure more than the economy can provide, or indeed for those who already have a respectable return to seek to benefit relatively from inflation, must be resisted, and the government believes it has clear responsibility in this area. Just as no one group in society should benefit at the expense of others from inflation, so should no one group shoulder an unfair burden.

The government has therefore initiated a series of consultations with the principal groups in our society—business, professions, farmers, labor, and provincial governments. They will be asked what proposals they can suggest and what contribution they are willing to make to defeat inflation. They will be asked how productivity can be increased. They will be asked if improvements can be made to the basically adversarial nature of the collective bargaining system, leading toward a joint search for solutions to mutual problems. Representatives of the private pension industry will be asked to explore jointly with government ways of protecting pensioners against inflation. The government will ensure that these consultations deal with the problems of those lacking organized power in the economy and retired people, for in many cases they are the ones adversely affected by inflation.

The federal government believes that it has the responsibility of playing the leading role in bringing Canadians together to discuss their common problems and challenges and develop proposals for their solution. The government intends to fulfil its leadership role with vigor and determination. These meetings will form part of a major effort by the federal government to enter into a dialogue with all segments of the Canadian community.²²

Responsibility for the consensus program was assigned to the minister of finance. His deputy was named chairman of the Ad Hoc Committee.

The Prices Group, which had much of the available expertise on price and income restraint, remained within the Department of Consumer

²² Hansard, September 30, 1974, pp. 4-8.

and Corporate Affairs. At the start of the consensus program, however, the Department of Finance assumed operational responsibility for similar activities to that of the Prices Group.

The minister of finance discussed the consensus approach in his budget speech of November 18, 1974. The six-week interval between the throne speech and budget speech had been largely devoted to preparation for the consensus program, and little more was added to the earlier announcements. The minister did acknowledge, however, that factors contributing to inflation had shifted in the past year, and that many inflationary pressures were now rooted in domestic cost developments. The excess demand conditions of late 1973 had given way to rising unemployment in Canada and many other industrial countries by late 1974. Commodity prices, including prices of agricultural products, were for the most part stable or declining in the latter part of 1974. However, there was a continuing relative upward adjustment in the price of energy.

Shortly after the November budget speech, a meeting of federal and provincial finance ministers was held, at which the policy options available to the federal government were reviewed. At this point there were three choices: severe restraint in monetary and fiscal policy; imposition of mandatory controls; or a further attempt at consensus. No government favored the extreme use of demand management because of the high levels of unemployment which would probably result. Since there was equally limited enthusiasm for mandatory controls, consensus remained, if not much loved, the preferred option.

After its creation in September, 1974, the Ad Hoc Committee had organized a group of officials to work for it as a task force. With the task force, the committee prepared three reports for the government, dealing with public announcement of the consensus program, the forms of consultation which the program would entail, and the background of current inflation which led to the need for consultation.

In November, 1974, the task force officially became the Ministerial Inflation Consultations Secretariat, or MICSEC. MICSEC reported to the Ad Hoc Committee, which in turn reported to the Cabinet Committee on Economic Policy.

At the same time, the Ad Hoc Committee proposed a series of 25 consultation meetings between early January and March, 1975. The meetings were to involve various economic interest groups, and a federal delegation consisting of three ministers, one member of the Ad Hoc Committee, and one representative for MICSEC. By January, 1975, detailed schedules had been prepared and letters of invitation, background papers, agendas, and a public information program were under way. The first meeting was held on January 22, 1975, followed by 21 other meetings by March 25.

The aims of the meetings were to assess the degree of concern about inflation, solicit proposals on ways to reduce the rate of inflation, and determine whether participating interest groups were willing to co-operate to achieve greater price stability. On the basis of these meetings, the

government concluded that all economic interest groups regarded inflation as an extremely serious problem, and that resolution of the problem required government leadership. Doubts were expressed about a solution imposed unilaterally by the government; no party was blamed for the prevailing inflation.

The discussions produced substantive agreement on the need to limit wage and salary increases, although a standard percentage limit was opposed. Similarly, there was general acceptance of the need to limit price increases, although emphasis was placed on the need to increase retained earnings and levels of investment. There was some sympathy from business representatives for limits on dividend payments. Government representatives were advised that the government itself must set an example in management of its own affairs, and should also consider providing better economic education and information for the public. In the meetings with representatives of labor groups, emphasis was on longer-term problems such as labor-management relations, housing supply, food prices, and excess profits arising from land speculation.

Although no group at the exploratory meetings was asked for, and indeed no group was prepared to make, a commitment to co-operate in a voluntary restraint program, all groups indicated a willingness to continue the discussions.

Early in 1975, there was mounting evidence that price inflation was abating. However, lags in the transmittal of these lower rates of price increase to reduced rates of wage and salary increase meant that current wage and salary settlements still reflected the escalating inflation of 1974. On the basis of the exploratory discussions, the government was faced with a number of choices: to pursue the consensus exercise; to adopt a wait-and-see attitude in the hope that inflation would gradually subside; to take a more active stance by intervening in particular price and income increases; or to appoint an independent board or commission to pursue a restraint program at arm's length from the government.

The Ad Hoc Committee put forward a set of proposals as a basis for further discussion.²³ The key element in the proposals was that a set of restraint rules should involve a gradual winding down of inflation rather than an effort to sharply and abruptly reduce it. The proposals involved setting price targets based on a reduction of two percentage points per year, over a three-year period, in the rate of inflation prevailing at the start of the program. Wage and salary guidelines consistent with the price target could then be determined by adding national productivity to the price target in each of the three years. The results were checked for consistency by estimating their effect on income shares, and the rate of change in average real income per employee. Explicit price targets were set to counter a growing trend in bargaining for workers to protect themselves against the highest expected rate of inflation. The committee

²³ The committee prepared a number of reports on possible restraint rules; the most important of these was tabled in the House of Commons on May 8, 1975.

also recommended that the wage and salary guidelines be designed to permit the maintenance of current real wages, to allow those groups which had fallen seriously behind in the recent inflation to catch up, and to provide for sharing of productivity between employees and employers.

In relation to prices and profits, the committee proposed that prices in the first year of the program be increased dollar-for-dollar to reflect increased costs, with a margin control system coming into effect in later years. Similar rules were advocated for professionals. At this stage, it was thought that dividends should be excluded from any guidelines. Export firms were presenting the same problems to the committee they had presented to the Prices and Incomes Commission. The committee's initial proposals recommended that such firms apply two price systems: one price for the domestic market, another for the export market. No explicit proposals had been formulated on how the voluntary program might be administered, but the general preference among committee members was for an independent review body for compensation and prices and profits sides of the program.

In reviewing the commitments it might undertake in a voluntary program, the government decided they might include such policies as application of compensation guidelines to government employees; non-inflationary steps to improve economic growth; measures to encourage capital investment; measures to increase the housing supply; specific limits on annual increases in government spending; tax revenue tied to the rate of economic growth; a program to expand economic education; steps to initiate tripartite discussions on labor-management relations; and establishment of monitoring to ensure compliance with voluntary rules. To some extent these proposals were based on the Prices Group's initial contingency plan, with modifications by MICSEC officials and the Ad Hoc Committee, while the proposals for government action came out of the exploratory discussions.

Results of the exploratory meetings, and an outline of proposals the government planned to make in the event of a further round of talks, were conveyed to a meeting of first ministers on April 9, and to a meeting of provincial finance ministers on April 10. The provinces generally supported the proposed plan, and set up a task force composed of one representative from each province to follow unfolding events.

A special government/CLC task force was operating at this time. Each party in the exploratory meetings between government and organized labor had concluded that further clarification of positions was required. In April, a more detailed version of the proposals was prepared, and further discussions were held with interested parties, particularly the CLC.

The CLC continued to express its concern over such issues as the inequity of the position of low-income workers relative to those with high incomes, acceptance of higher profits on the condition that they be associated with higher levels of capital investment, and inadequate coverage of interest rates and export firms in the proposals for restraint.

As the proposals were refined in preparation for meetings in early May, quantitative details were filled in. The price target for the first 12 months of the program was set at 8 per cent, to be reduced by 2 per cent per annum or 0.5 per cent per quarter. Permissible compensation increases were to be based on the price target plus national productivity, with some allowance for additional compensation if the price target was exceeded and a provision for catch-up if a group's real income had declined in past periods. Special rules were also included for the benefit of low-income workers, and the notion of a \$2,400 maximum increase was introduced, \$2,400 representing an 8 per cent increase in a \$30,000 salary.

On the prices side, proposals continued to be based on a dollar-for-dollar passing on of the cost increases, with the same basic principle applying to professionals. Treatment of export firms remained undecided, although the previously suggested two-price system was now regarded less favorably, and the notion of tax measures was suggested as an alternative. In addition, concern was being expressed about exclusion of dividends from the restraint rules. The need for some restriction was suggested. The method of administering the voluntary program remained undecided, although a series of options including a tripartite board, a public interest board, and separate "prices" and "wages" boards were under review.

A document outlining proposals for voluntary restraint in some detail was circulated to key participants in the discussions on May 1, 1975.²⁴ The document was obtained by a reporter for the Toronto *Star*, which ran a detailed story on the proposals in its May 5 edition. The leak caused some difficulty, particularly for representatives of organized labor, since a special meeting of the CLC executive was to be held on May 7 to discuss an appropriate response to the proposals. Once the proposals were in the public domain, there was less room for negotiation between the parties.

At the May 7 meeting, the CLC executive declared the proposals unacceptable. They issued a public statement indicating that any set of proposals acceptable to the CLC must include measures to improve the housing supply, tight control of rents, regulation of oil and gas prices, a negative income tax for wage earners earning less than the industrial composite (the average wage received by a Canadian worker), explicit measures to reduce unemployment, tight controls over professional fees, increased old age pensions, a link between corporate tax concessions and capital investment, restraints on the incomes of export firms, and restraints on mortgage and consumer interest rates.²⁵ Though more detailed than the 1969 statement issued upon its withdrawal from the Prices and Incomes Commission's consensus discussion, the CLC statement reflected a consistent approach: organized labor saw basic structural change as a *quid pro quo* for supporting a restraint program.

²⁴ Ibid.

²⁵ Canadian Labor Congress, press release, May 7, 1975.

The ministers of finance and labor met with the CLC executive on May 12 in an attempt to reconcile the congress's position with the government's proposed rules for voluntary restraint. While each party left the door open for further discussion, there was a large enough gap between their positions to make agreement unlikely. One further meeting was held two days later with representatives of the business community. While the participants strongly expressed the view that something must be done, no firm proposals emerged. This meeting marked the informal termination of Canada's second unsuccessful attempt to attain voluntary agreement on an incomes policy.

At this stage, Finance Department officials began to consider the possibility of legislating mandatory price and income controls. Near the end of May, the government reviewed all its policy options. Overshadowing this review was the budget speech, scheduled for June 23, in which the government would have to declare its intentions with regard to economic policy. Ultimately the government chose to remain firm in its past policies, and rejected mandatory wage and price controls.

The budget speech went to some length to review the government's policy deliberations and to explain why controls had been rejected. It was carefully explained that the rejection was not based on principle but on a lack of public support for an incomes policy. In the budget, however, the government adopted a restrictive fiscal policy, involving no net new economic stimulus, and announced increased restraint on government spending including limits on growth of the public service.

The consensus program was not the only policy considered as a means of restraining rising prices in the period following the election of July, 1974. Anti-profiteering legislation, which had died on the order paper when the election was called, was still being developed by the Department of Consumer and Corporate Affairs. In September, 1974, just as the consensus program was being launched, Consumer and Corporate Affairs was also reviewing a number of options the government might adopt to restrain prices, including comprehensive wage and price controls; a prenotification provision for specific price increases, with government having rollback power; negotiation of fair industry-wide prices by government and suppliers; disclosure of product-line profits; and standby legislation which could be invoked in the event that particular price changes became a matter of public concern.

Over the winter of 1974-1975, the department prepared a proposal based on the last of these options, which became known as the price justification bill.²⁶ The proposal, completed in the spring of 1975, was intended to put some teeth into voluntary price and profit guidelines if consensus was achieved. If voluntary agreement could not be reached, the proposal might reassure the public that no "rip-offs" would be permitted by firms taking advantage of inflation, shortages, and market power. The

²⁶ Notes for an address by the Hon. A. Ouellet to the Retail Council of Canada, March 5, 1975, p. 10.

bill was designed as a device of last resort, to be invoked only for a product or firm where all other government powers of suasion—tariffs, taxation, and government procurement to induce price restraint—had failed.

By the terms of the draft proposal, if a price was increasing unusually fast, and it was likely to affect the cost of a broad range of products or services important to a large part of the Canadian public, the governor-in-council could declare the product or firm subject to the provisions of the legislation. The provisions required that, for a product or firm declared subject to the rules, any price increase must be justified on a dollar-for-dollar basis. In addition, large suppliers of a product would be obliged to prenotify the government of any planned price increases. The effect of a declaration would last for one year.

Two aspects of the price justification proposal warrant attention. First, it was based on unit cost standards, as opposed to the margin control standards proposed for the earlier anti-profiteering legislation. This reflected the view within government that consumers understood individual prices but not profit margins; in effect, that a margin control rule was too sophisticated and complex to win public support.

Secondly, the preparatory work for the bill was largely the responsibility of the Prices Group in the Department of Consumer and Corporate Affairs. The group had devoted little effort to the contingency plan while it was under consideration, and at this stage the Department of Finance was supervising the consensus exercise and was itself endeavoring to formulate rules for the restraint of prices and incomes.

Following the breakdown of consensus discussions, some two months elapsed while the June budget was finished. Both Finance Department officials and the government reviewed the economic situation and the policy instruments available to them. In early summer, it was decided that policy alternatives should be examined in greater detail, and that economic forecasts should be reworked in view of the changing world environment. It was generally expected that the mounting world recession would so reduce demand that the prevailing rate of price and wage increase in Canada would be moderated.

As summer progressed, however, the economic situation in Canada deteriorated further. Inflation was not changing significantly, labor costs were accelerating, and unemployment was rising. By early fall, government economists were convinced that Canada faced continuing double-digit inflation, high rates of unemployment, sluggish rates of growth, and further depreciation of the exchange rate. Wages were still adapting to the high rates of price increase in the two preceding years. The effects of this adaptation were compounded by a tendency to use short-run contracts, greater use of cost-of-living indexing, and decreasing productivity. As a further complication, Canada's inflation was worse than that of its major trading partners, thus limiting growth prospects. In the second quarter of 1975, for example, wage settlements in the first year of major

collective agreements were running at 22 per cent per year in Canada compared to 9.8 per cent per year in the United States.

Disturbed by the darkening economic outlook, in particular by the deteriorating employment situation, the government instructed the Ad Hoc Committee to present a proposal for mandatory controls by the end of September. No commitment had been made by the government to implement such a program but the need for decisive policy was increasingly evident. On the basis of the summer's work, the committee prepared a review of all policies available to the government for restraining inflation. Efforts were made to find compatible policies that would preserve existing fiscal arrangements, demonstrate restraint of government expenditure, address major structural issues in the economy such as energy price and supply, recognize difficulties in labor-management relations, and above all avoid new increases in unemployment through application of restrictive demand management. In late September, the government concluded that mandatory wage and price controls were necessary if these objectives were to be met.

More than a decade after the Porter Commission and the Economic Council had stimulated discussion of incomes policies; more than six years after the Prices and Incomes Commission began the first attempt at consensus; more than four years after controls were introduced in the United States; and more than a year after the announcement of the second attempt at voluntary consensus; mandatory controls became a reality.

Despite the work of past years, however, the first two weeks of October, 1975, were traumatic ones for those involved in the program. The decision to impose controls came while the Department of Consumer and Corporate Affairs was still occupied with work on the price justification bill. Thus the Department of Finance, with little technical expertise, was working on the restraint rules, while those who had been involved in contingency planning were spread throughout the government.

Nevertheless, a White Paper was drafted, and the necessary legislation was prepared in time for the prime minister's address to the nation on the evening of October 13. Even after the program had been announced and put into operation, however, the major challenge of economic policy—the dilemma of achieving price stability along with high and rising levels of employment—remained: "There are only two alternatives: either we live within our means, or we endure permanent and worsening inflation, an inflation that is already endangering our employment and income prospects."²⁷

²⁷ Prime minister's office, news release, October 13, 1975.

CHAPTER II

The Anti-Inflation Program: Concept and Guidelines

Chapter one summarized the background to the announcement of the anti-inflation program in October, 1975, and reviewed the events in 1974 and 1975 leading to that announcement. Subsequent chapters describe various parts of the controls program and the way they were administered by the Anti-Inflation Board.

Before beginning a detailed review, it will be useful to examine briefly the economic situation in 1975, the objectives of the federal government's economic policy and the main options available to government, and to introduce the controls program in broad outline.

The Economic Situation in 1975

By late summer 1975, it was evident that Canada faced severe economic problems, problems that existing policies were unlikely to cope with quickly or effectively. It was a time of worldwide recession. In the third quarter of 1975, both real gross national product and industrial output were running below the levels of a year earlier. Unemployment, which had dropped below 5.5 per cent in 1974, surged upwards to reach nearly 7 per cent in March, 1975.

High unemployment was combined with high rates of inflation. The consumer price index was more than 10 per cent above its level in the summer of 1974, while wage settlements had escalated even more rapidly. In each of the first three quarters of 1975 the average increase in the first year of collective agreements was more than 20 per cent. Through late 1974 and early 1975, Canadian unit labor costs were rising at an annual rate of more than 18 per cent. These increases were far above those among Canada's major trading partners. They seriously threatened Canada's international competitive position, thus jeopardizing chances of providing the rapid increases in employment the country needed.

In late 1974 and early 1975, there had been signs that the rates of price and cost increase would begin to subside. A mildly encouraging deceleration of rates of price increase was reflected in the consumer price index over the first few months of 1975, and in the industry selling price index beginning late in 1974 through the first few months of 1975. In addition, international commodity prices had fallen throughout most of 1974 and the first half of 1975 from their historical highs of early 1974.

However, expectations of continuing high rates of inflation had become deeply entrenched and created resistance to the market forces that might otherwise moderate the rates of price and income increase. As outlined in chapter one, the Canadian public had been through successive rounds of strong expansion followed by periods of weaker economic performance. Through it all, they had seen the rate of inflation climb upwards. Repeated attempts to cope with the problem had failed. Indeed, it seemed at times that governments were more concerned with cushioning the impact of problems caused by inflation than to tackle inflation itself.

During the summer of 1975, economic forecasters were predicting some deceleration in the rate of inflation, although the forecast rates were still very high. By early fall, most were raising their inflation forecasts. A survey showed that about one-half of all consumers expected inflation to get worse.

The Policy Choices

It was recognized that the success of any attempt to bring inflation under control would depend on demand management, on fiscal policy and monetary policy. Just as a high growth rate in total demand was the major cause of the inflation in industrial countries in the 1970s, so moderate management of demand was essential to resolve the problems caused by inflation.

The question remained, however, should government rely exclusively on fiscal and monetary policy to do the job? The traditional route would have been to bring about substantial moderation in the growth of total demand through sharp reduction in monetary growth, combined with a restrictive fiscal stance. No doubt this approach would sooner or later have wrung inflation out of the system, or at least reduced it substantially. However, it would have involved substantial cost in terms of lost output and increased unemployment. Canada had tried this approach in 1969-1970 and the memory of that episode was still fresh. Sharply restrictive monetary and fiscal policies had driven the unemployment rate up rapidly, and before a solid reduction in the rate of inflation had been achieved the government felt obliged to shift to strongly expansionary policies.

In 1975, the economy was even less likely to adjust quickly to monetary and fiscal policies since the expectation of inflation was even more firmly entrenched. The evidence suggested that these expectations would be slow to adjust to the more restrictive stance of fiscal and monetary policy and that in all probability individuals and businesses would continue to press for substantial increases in incomes and prices. To the extent that they did so, a given reduction in the growth of total demand in the economy would effect output and employment more than inflation. Transition to lower rates of inflation would thus be costly for

the economy as a whole, and for those who would be without jobs in particular.

It appeared that the central element of a program to lower the rate of inflation—moderation of total demand growth through fiscal and monetary policy—might be effectively supported by some sort of incomes policy.¹ Although this incomes policy, however successful it might be, would not instantly change expectations about the future course of prices and incomes, it could rapidly bring individuals and businesses to act as if their expectations had changed. To the extent that increases in incomes and prices were scaled down, the loss of output and employment associated with fiscal and monetary restraint would be reduced. In effect, the role of an incomes policy would be to hasten the transition to lower rates of inflation and reduce its real cost.

Designing a Prices and Incomes Policy

As chapter one recorded, the main questions to be settled in deciding on a prices and incomes policy had been analysed and tested during the months and years before October, 1975. Should the program be voluntary or mandatory? How comprehensive should it be regarding the forms of income to be restrained? How ambitious should program objectives be? How much time would be required to achieve those objectives? What administrative apparatus should be set up to carry out a controls program? These issues are briefly reviewed in the following sections as background to a description of the program itself.

SHOULD THE PROGRAM BE VOLUNTARY OR MANDATORY?

In light of Canada's experience with voluntary arrangements, this was not a difficult question. The Prices and Incomes Commission had concluded that a voluntary approach might be worse than nothing. Nonetheless, a second attempt at voluntary restraint was made in the consensus exercise of late 1974 and early 1975. This time the failure was complete; agreement to support and abide by voluntary guidelines could not be reached. A central difficulty was the fear that voluntary restraint would not be practised by all. A mandatory program could provide assurance that all those subject to the rules would observe them. It also seemed evident that nothing short of a mandatory program would focus national attention on the need to bring the economy into better balance.

¹ This does not mean that the government wanted to curb consumer spending, particularly in light of the expected lessening of business investment and the program commitment to restrain government spending, at a time when the economy was slack and savings were high. Restraint of demand for increased money incomes was the essential objective of the program.

HOW COMPREHENSIVE SHOULD THE CONTROLS BE?

There are two dimensions to this question. First, what kinds of incomes and prices should be controlled; second, how many of those who have significant influence over a particular income or price should be controlled?

Earlier discussions in Canada pointed to the need for rather broad coverage of the forms of incomes. It will be recalled that the matter of dividend restraint had come up during the consensus discussions of 1974-1975. The case for imposing limits on dividend payments was related to the need for visible equity and balance in a restraint program. (If "my" wages are restrained, why not "their" dividends?)

It was generally recognized that support for any program of wage restraint would be strengthened by covering all the main forms of income and of income-earners. Although the same proposition was generally true with respect to prices, there are strong arguments for exempting some prices from control. Import prices, for example, could not be restrained by any Canadian controls apparatus, and it could be argued that there was no need to control the prices at which Canadian exporters sold their products in foreign markets.² Farm prices might also present a special problem because of the danger that attempts to control them would create supply difficulties.

Having decided what kinds of income and prices would be subject to control, how many of the income-earners or price-setters should be covered? It was clearly impractical to enforce controls on every price and income in the economy; administration of such a program would have collapsed under its own weight. Nor should it be necessary to have fully comprehensive controls since the restraint of some would have a restraining effect on others through competitive market forces.

On the question of comprehensiveness, the answers might range from widespread coverage to a limited number of the largest and most powerful entities in the economy. To strike a balance the program would have to bring about a cooling of inflation and at the same time minimize the cost and complexity of administration. In other words, the coverage should be just broad enough to do the job. Judgment, if not pure guesswork, would play a large part in the final decision.

HOW AMBITIOUS SHOULD THE PROGRAM BE?

Would it be best to institute a relatively severe short-term controls program or a more gradual approach? Those who supported the quicker approach emphasized both the psychological advantages of a dramatic attack on inflation—perhaps beginning with a complete price and wage freeze for a few months—and the potential difficulties of maintaining an arbitrary controls system for any length of time. On the other hand, it

² The question of making income from export sales subject to the guidelines was a difficult one for both the Prices and Incomes Commission and the Anti-Inflation Board. The subject is discussed at some length in chapter four, "Price Restraint."

was argued that a program designed to reduce the rate of inflation to a given level in a short time could create severe strains in the economy and impose substantial costs on some groups in society. If the transition to lower rates of inflation were spread over a somewhat longer period these costs and strains might be reduced. Moreover, as noted earlier, the evidence suggested that it would take some time for markets and expectations to react to the changed circumstances. Although controls could immediately begin to hold down rates of price and cost increase, it would take some time for the impact of fiscal and monetary policy to feed through to the point at which the lower rates of increase were supported by the general economic environment, and it would take some time for expectations about inflation to subside.

One complication was the fact that *relative* increases in the price of some forms of energy, some commodities, and perhaps some classes of rents would be necessary to ensure adequate supplies. Similarly, it was recognized that the wages of income groups which had fallen seriously behind in either an absolute or a comparative sense would have to rise. It would be difficult to explain how a program intended to fight inflation could recommend that some prices and wages should rise relative to others.

ADMINISTRATIVE REQUIREMENTS

Among the kinds of board considered to carry out the proposed price and income policies, a public interest board—composed of persons not identified with any special interest groups and selected on the basis of their expertise in problems within the board's jurisdiction—seemed best suited to a program that would depend to a great extent on voluntary compliance.

In conjunction with this thinking, the Anti-Inflation Board was established on October 14, 1975, by legislation that would give it a high degree of independence. In addition, it would have the power to obtain information, to monitor changes in prices and incomes, and to investigate significant changes; to apply the Anti-Inflation Guidelines to individual cases; and to inform the public of its findings on the causes of inflation.

The key to the Board's limited powers was voluntary compliance. The Board could investigate, interpret, and make recommendations with respect to the appropriate actions in individual cases. If it was not able to modify these actions to conform to its recommendations, it would refer the cases to a separate enforcement arm of the program, the Administrator.

The Administrator, after reviewing the case, could order compliance with the Guidelines with the full force of the law. Provision was also made for appeal from the Administrator's order to an Appeal Tribunal.³

This apparent limitation of the powers of the Board—to interpret and seek compliance with the Guidelines but not to enforce them—

³ These and other aspects of administrative law are examined in chapter five.

reflected its primary role. It could neither establish nor amend the Guidelines; these powers clearly rested with government. Similarly, it could not enforce application of the Guidelines.

The Anti-Inflation Program

The October 14 White Paper set out a program consisting of four main elements:

- fiscal and monetary policies aimed at increasing total demand and production at a rate consistent with declining inflation;
- government expenditure policies aimed at limiting the growth of public expenditures and the rate of increase in public service employment;
- structural policies to deal with the special problems of energy, food, and housing, to ensure a more competitive and efficient economy and to improve labor-management relations; and
- a prices and incomes policy which would establish guidelines for responsible social behavior in determining prices and incomes of groups, together with machinery for administering those guidelines and assuring compliance where necessary.

Although the first three elements are outside the scope of this volume, the first two were of such importance to the success of the program that they warrant a brief review.

Fiscal and Monetary Policies

“The success of the government’s whole program for achieving sustained lowering of the rate of inflation, together with a sustained recovery of the growth of output and employment, will depend crucially on its success in keeping the overall level of demand in the economy growing at a pace consistent with successively lower rates of price increase.”⁴

This was to be the central task of fiscal and monetary policy. As chapter one has recorded, the government repeatedly rejected tight monetary and fiscal policies to restrain inflation because of their high cost in increased unemployment and lost output. Nor could it be presented as an equitable program since an undue share of the burden would fall on those losing their jobs and on other groups particularly affected by the restraint program. The overall demand management policy had to be consistent with the dual objectives of lowering the rate of inflation and reducing the level of unemployment.

The government’s fiscal stance was set in the June 23, 1975, budget. At the same time, the Bank of Canada announced its intention to allow

⁴“Attack on Inflation,” policy statement by Hon. D. S. Macdonald, minister of finance, Ottawa, Queen’s Printer, 1975.

the money supply to expand at rates consistent with moderate real growth and declining inflation.

Government Expenditure Policy

Government expenditure policy took the form of a commitment to hold the growth of federal government outlays within the rate of growth of the economy as a whole. The public commitment to such targets—as a demonstration that restraint was needed to ensure success of the program and to avoid the adverse effects of higher taxes or larger borrowings—was a new element.

The support demonstrated by the provincial governments in adopting similar targets was felt to be essential to the success of the program and to achievement of the federal government's own expenditure targets, given the size of federal transfers to the provinces.

Structural Policies

In recognition of the longer-term context of the economic problem, structural issues and policies were included in the program. Some of the apparently deep-seated inflationary bias in the economy was ascribed to longer-run structural factors, which were as political and social in character as economic. In general terms, multiple excess demands for both private and public goods and services were beyond the capacity of the system to produce.

To begin with, there were immediate problems in energy and housing. In the longer run, there were concerns about food and other resources. In all these areas, special factors appeared to be inhibiting supply and increasing costs while consumption and demand continued to grow strongly with rising incomes.

A second structural issue was the longer-run inflationary influence of the expanding role of a government which, whether by regulation or the redistribution of income, was “protectionist” in intent.

A third area of concern was labor-management relations. Progress in this area seemed essential to any long-run improvement in price stability under conditions of high employment. Any incomes policy would have to show that the scramble for excessive wage gains was bound to be self-defeating for the labor sector.

A Price and Income Policy: The Initial Guidelines

Initial price and income guidelines were outlined in the White Paper. They reflected the long process of discussion and development described in chapter one. As the White Paper notes:

These guidelines are based on the principles proposed by the government in the consensus discussions of last winter, a description of which

was tabled in the House of Commons by the Minister of Finance on May 8 (1975). These proposals had benefited greatly from the discussions with representatives of business, labor and the provincial governments.⁵

The results of these discussions are also reflected in the final decision on the duration of the program. Since a reduction of two percentage points a year in the consumer price index (CPI) was consistent with a “gradual winding down of inflation,” three years was considered sufficient both to accommodate this process and to underline the temporary nature of the controls program.

Central to the design of the controls program were target rates of increase in the CPI, the index chosen to measure changes in price levels. The initial guidelines established these targets at an annual increase of 8 per cent in the first year of the program, 6 per cent in the second year, and 4 per cent in the third year. The targets were incorporated in the compensation guidelines as a “basic protection factor” (BPF). In addition, for each of the three years of the program, the compensation guidelines included a 2 per cent allowance for the long-run average increase in national productivity. Thus the central compensation guidelines for the three years were 10 per cent, 8 per cent, and 6 per cent respectively.

The original guidelines provided for the possibility that these price targets might not be achieved during each year of the program. If the CPI increased by more than the BPF in a given year, the excess would be added to the BPF in the following year. The Guidelines stated, however, that if the CPI increase was *less* than the BPF for a particular year, no downward adjustment would be made to the following year’s BPF.

In the period prior to the introduction of the program, some groups had achieved higher than average compensation increases while others had fallen behind the average. The arithmetic guidelines allowed for some correction of these disparities through an “experience adjustment factor” (EAF). The compensation increase of each group over a specified period prior to controls was compared with the CPI increase over the same period plus 2 per cent per annum for national productivity increase. The arithmetic guidelines of those who had fallen behind would be increased by up to 2 per cent in each year, while the allowable increase for those who had done well in relation to the consumer price index before controls would be reduced by up to 2 per cent a year.

Thus the initial structure of arithmetic guidelines for compensation was as follows:

| | <i>First Year</i> | <i>Second Year</i> | <i>Third Year</i> |
|-------------------------------------|-------------------|--------------------|-------------------|
| <i>Basic Protection Factor</i> | 8% | 6% | 4% |
| <i>National Productivity</i> | 2% | 2% | 2% |
| <i>Experience Adjustment Factor</i> | ± 2% | ± 2% | ± 2% |
| TOTAL | 8% to 12% | 6% to 10% | 4% to 8% |

⁵ Ibid.

In an effort to make the rules as equitable as possible, numerical income guidelines were introduced which permitted minimum increases up to \$600 a year (or increases up to \$3.50 per hour) regardless of past increases, and limited increases to a maximum of \$2,400 a year (representing an 8 per cent increase, the initial basic protection factor on an annual salary of \$30,000) regardless of the compensation history of the group in question.

In addition there were a number of exceptions, or relieving features, in the Guidelines, notably the provision for exception on the basis of long-established historical relationships between closely related groups. This exception was particularly relevant in light of the decision not to abrogate contracts made prior to October 14, 1975.

Increases in professional fees were to be governed by the same general principle of income improvement that would apply to a salaried professional person. Determination of fees was to be based on the amounts necessary to cover the increased costs of providing services plus a net income improvement of up to \$2,400 a year. However, professionals could increase their incomes by more than the maximum limit through work load increases, although not through fee increases.

Dividends were in effect frozen during the first program year. Exemptions were granted in limited instances.

Guidelines for the control of prices and profits followed the same general principle as the control of other forms of income, i.e., price increases were to be limited to allowable increases in net costs.

The form of the Guidelines, while different for different kinds of suppliers, was designed to yield approximately equivalent results in terms of profit shares of gross national product over the life of the program. Examination of the shares of the major components of the gross national product had been undertaken for the period 1962 to 1974. These component shares had fluctuated over time on a cyclical basis. The 1975 shares for wages and salaries and for profits were compared to the overall trend in the period selected. Wages and salaries were noted to be below trend and profits above. It was concluded that the selected price targets could be achieved through restoring these components to their respective overall trend level. Cost pass-through to prices on a dollar-for-dollar basis has a depressing effect on the profit margin when profits are measured as a percentage of sales. This cost pass-through concept would limit incomes over the life of the program in such a manner as to return the respective components to their overall trend levels in a less inflationary manner and still provide for real income increases to labor of 2 per cent, or the long-run average annual increase in productivity.

There were two kinds of price and profit guidelines: a *unit cost rule* for firms able to allocate costs to individual products, with the choice of either the last completed fiscal year prior to October 14, 1975, or a period at or near October 14, 1975, as the base period; and a *net margin rule* for firms unable to allocate costs to individual products, limiting percentage pre-tax net profit margins to 95 per cent of their average for

the five completed fiscal years prior to October 14, 1975. These two rules applied to all sectors of the economy except the distribution sector. A variant of the net margin rule was applied to the distribution sector (commonly known as jobber, wholesaler, or retailer) to reflect the fact that its customary pricing policies were generally based on gross margins. In general, such firms were not permitted to exceed the percentage gross profit margin realized during the last completed fiscal year prior to October 14, 1975.

The rule limiting the net margin to 95 per cent of the base period levels had approximately the same margin-depressing effect as the unit cost rule. In the latter case, restriction to dollar pass-through of costs would depress the margin on sales as sales expanded. On the other hand, the net margin rule allowed a mark-up of allowable costs so that the percentage net margin could be maintained. Consequently a deflation factor of 95 per cent was applied to the net margin rule to make it equivalent to the unit cost rule. In neither case were absolute dollar profits depressed by the Guidelines; rather, profit share per unit of output was limited.

Banks and other financial institutions were to maintain the spread between interest rates charged and interest rates paid while increase in service charges were to be justified by operating and other costs.

Regulated industries were subject to existing statutes but were also expected to conform to the Anti-Inflation Guidelines. Provincial governments were asked to apply the Guidelines to their regulated industries in a similar manner.

In the case of the construction industry, the cost pass-through principle was to apply unless cost allocation was impossible, in which case the percentage net margin rule would apply. However, special rules were later developed in response to circumstances peculiar to the industry.

The provincial governments were asked to undertake responsibility for implementing rent control programs following the general principle that increases up to a certain ceiling would be allowed on a cost justification basis. To avert the possibility of reductions in the supply of new rental accommodation as a result of these programs, new structures for which rents had not been established were to be exempt from the controls for at least five years after completion of the building.

As in the case of the compensation guidelines, there were provisions for exceptions or relief from the price and profit rules. The major area of relief related to base periods that were shown to be atypical of the firm's general financial experience. This relief was to allow an 8 per cent return on equity to companies where the Board was satisfied that the base period of a particular firm was indeed atypical.

While these principles were relatively straightforward and adhered to the general concept of limiting the rate of increase in money incomes in nearly all sectors of the economy, their interpretation and application were often exceedingly complicated. In the case of the price and profit guidelines, certain aspects of the rules were the subject of intense debate

amongst Board members and staff. These aspects are discussed at length in the following chapters.

Summary

The economic objectives of the government's anti-inflation program were to bring down the rate of inflation over a relatively short period while permitting the modest economic recovery to continue. Specifically, this meant a reduction in the rate of inflation from about 10 per cent to 4 per cent over three years while achieving approximately 5 per cent real growth in the economy over the same period.

Given these objectives, and a forecast of moderate to strong recovery abroad, the problem was to set demand management policy to achieve the desired output and price objectives, and to attempt to force as much of the adjustment as possible to fall on prices and wages and as little as possible on output and employment.

If the proposed price and income restraint policies were to be acceptable and constructive, they had to be visibly fair and even-handed, yet flexible enough to respond to special circumstances. They also had to be flexible in the sense of being applied with varying degrees of intensity and withdrawn in a way that would not produce shocks and renewed instability.

CHAPTER III

Wage Restraint

Federal-Provincial Relations and Agreements

The Anti-Inflation Act was not binding on the provincial public sector which included provincial and municipal governments; corporations, commissions, or associations controlled by these governments; and other provincial bodies that provided public services, such as educational institutions and hospitals.

However, the Act provided that the provinces could enter one of two kinds of agreements in applying the anti-inflation program. Under the first option (called in AIB jargon a "4-3 agreement" after the relevant section of the Act), the province permitted the Anti-Inflation Board to act on its behalf in applying the legislation to the provincial public sector. Under the second option, a "4-4 agreement," the province operated its own program, which would duplicate the federal system. All provinces except Quebec and Saskatchewan chose the 4-3 option. Although Alberta drew up temporary legislation establishing its own program, the legislation was not put into effect and the province ultimately signed a 4-3 agreement.

In negotiating their agreements, the provinces expressed general satisfaction with the draft regulations for compensation. The one area in which consensus was not reached involved salary increments. Were they to be included in or excluded from the calculation of the permissible compensation increase? The final regulations allowed some flexibility in interpretation of this point, employing a case-by-case approach to the question.

Under the 4-4 option, Quebec agreed to administer its own program in the provincial public sector. The Quebec government also asked for control over the construction sector in the province because of its involvement in that industry through the Quebec "decree" system. (Briefly, Quebec law provides that once a compensation agreement is reached in a particular industry, the terms of that agreement will, by government decree, be applied to all other agreements in that industry.) The federal government agreed to the request and the Anti-Inflation Act was amended accordingly.

The Quebec program was made retroactive to October 14, 1975, coincident with the start of the federal program. Throughout 1976, the provincial Anti-Inflation Commission (Régie des mesures anti-inflationnistes) administered restraint guidelines in the Quebec public sector, parallel with the federal AIB. In January, 1977, however, the new Parti

Québécois government overruled a decision of its Anti-Inflation Commission regarding a compensation rollback in the construction sector. At the same time it announced that henceforth the commission would serve the government in an advisory capacity only. Quebec terminated its control program on March 23, 1977, thus lifting compensation restraints from both the public and construction sectors.

With the demise of the Quebec program, the federal Anti-Inflation Board had to contend with the question of the Quebec decree system as it affected industries other than construction. While the Quebec commission was operating, the two governments had agreed that proposed decrees involving increases above the Guidelines would be reviewed by the provincial commission and referred to the Quebec cabinet for decision. After Quebec's withdrawal from the program, the federal Anti-Inflation Board decided to honor decrees already reviewed by the Quebec commission. In the case of new decrees, the AIB required all employers subject to the federal act and covered by such decrees to report to the Board and be reviewed in the normal way.

Saskatchewan was the only province which chose neither option and did not sign a federal-provincial agreement. It established a system of provincial controls which, while incorporating many features of the federal program, had two significant differences. First, the Saskatchewan program was voluntary, with no enforcement powers stipulated in the provincial act. Second, in a number of respects the Saskatchewan program was more liberal in its interpretation of the compensation guidelines. Employers were able to establish a prairie market rate for the determination of historical relationships. There was also provision for above-guidelines increases in circumstances of "urgent public interest," and if adherence to guidelines would result in a highly inequitable ruling or one that would have "a significant or detrimental impact on the Saskatchewan economy." In addition, all public bodies were deemed to have met the qualification for exclusion of established incremental increases.

In the early months of the program, a number of provincial groups claimed that because an agreement had not been signed by their province, or because the constitutionality of the Act had yet to be established, their compensation increases were not legally subject to control.

In the meantime, the Anti-Inflation Board dealt with such cases on the assumptions that (a) all federal-provincial agreements, when signed, would have retroactive effect from October 14, 1975, and (b) the constitutional validity of the Anti-Inflation Act would be upheld. Both assumptions proved accurate, although the Supreme Court also ruled that federal-provincial agreements were invalid unless passed by the provincial legislatures. Both Ontario and Manitoba were obliged to validate their agreements in this manner.

Although there was considerable controversy as to whether the Anti-Inflation Act took precedence over provincial and federal arbitration awards, the Act and the compensation guidelines presented no major

problems with respect to the labor legislation of each province. The Board took the decision, announced on April 9, 1976, that while the parties involved must respect their obligation to put an arbitration award into effect, this would not preclude the Board from reviewing the settlement in the same way it reviewed any other settlement. This position was confirmed by a federal court decision. On July 26, 1976, the court ruled that the AIB had authority to rule on arbitral awards.

On September 14, 1976, the Administrator of the Anti-Inflation Act upheld the Anti-Inflation Board's recommendation. This order was subsequently appealed to the Appeal Tribunal and the federal court. On February 3, 1977, the Tribunal dismissed the appeal. It ruled that payment of an increase pursuant to an arbitration award could be as much a contravention of the Guidelines as any other payment. This decision was appealed to the federal court and dismissed on June 30, 1977.

Another question relating to provincial labor legislation concerned criteria for "good faith bargaining." Although this issue did not directly involve the AIB, it tended to muddy the waters for AIB staff as they attempted to persuade parties to follow the Guidelines. While some employers argued that they were bound by the compensation guidelines and their final offer could not exceed them, their employees' unions contended that the Guidelines should be ignored because AIB decisions were only recommendations unless they were enforced by the Administrator. The unions argued that it was not illegal to agree to increases above the Guidelines, and that in any event the Guidelines themselves allowed exclusions and exceptions. As a result, there were cases in which the union accused the employer of not bargaining in good faith if the employer claimed the AIB prevented negotiating or agreeing to an increase above the Guidelines.

Although the Board encountered no major problems in applying compensation guidelines to the provincial public sectors where it had been granted jurisdiction, provincial employers and employees occasionally expressed concern over particular AIB decisions. Women's groups, the employer, and employee representatives, for example, vigorously protested the Board's application of sex discrimination exclusions in the compensation regulations in the case of the Winnipeg Health Sciences Centre. The recommended rollback in the case of the Manitoba Liquor Commission also caused controversy and resulted in a challenge to the constitutional validity of the legislation.

While the Board had no mechanism to monitor compensation decisions made by the provincial control agency in Quebec, there were informal discussions among senior staff from the two organizations. On the basis of these discussions, the Board was satisfied that the Quebec decisions were generally consistent with its own. Also, many of the larger public service agreements in Quebec, covering teachers, hospital workers, and municipal employees, had been signed before the start of the program.

Although Saskatchewan had not signed an agreement, AIB staff held informal discussions with their counterparts on the Saskatchewan board and established that the provincial board's compensation decisions were generally consistent with the approach of the AIB.

The AIB and Collective Bargaining

Not surprisingly, organized labor reacted with hostility to the imposition of controls, declaring the restraints on compensation totally unacceptable. Some unions refused invitations to attend seminars explaining the Guidelines, while others advised their members to proceed with negotiations as if the AIB did not exist. On October 14, 1976, the first anniversary of the program, the Canadian Labor Congress organized a national day of protest against controls. Demonstrations were held in front of AIB headquarters in Ottawa and in other centres across the country. Despite these official manifestations of protest, however, the Board received full co-operation from the unions in day-to-day administration and applications of the Anti-Inflation Act.

The Anti-Inflation Board made it clear from the outset that it did not wish to interfere in collective bargaining. Although this objective seemed somewhat inconsistent with the fact that all compensation increases were to be constrained within specified limits, the Board's aim was not to interfere in the *process* which led to a settlement, even though that settlement might subsequently have to be altered as a result of a Board decision. One reason for this policy was that the collective bargaining process often involved non-monetary issues that were not of concern to the Board. The primary reason for maintaining a strict policy of non-interference, however, was that the Board had neither the desire nor the mandate to play the role of conciliator or arbitrator. It did have a mandate to encourage compliance with the Guidelines, and in this context Board members and staff regularly met with negotiating parties to clarify the Act and Guidelines as they applied to a particular situation.

The Board made it a point not to rule on collective agreements until they had been signed and ratified. Often during negotiations, particularly if they were at an impasse, one or both of the parties would ask the Board what figure it would be prepared to accept. In response, the Board would advise the parties to begin by reaching an agreement based on their own interpretation of what the Guidelines would permit. Then and only then would the Board review the settlement and give its decision.

As noted earlier, arbitration awards and "good faith" bargaining became issues during the program. The debate over arbitration awards was primarily a legal one involving the potential conflict between federal or provincial arbitrated awards and the Anti-Inflation Guidelines. If, for example, an employer in Ontario was covered by an arbitration award calling for payment of an x per cent increase to union members, under Ontario labor law that award must be honored. On the other hand, the

AIB might rule that this particular arbitration award was in excess of the Guidelines and must be rolled back. If the employer then complied with the provincial law, it would violate federal law, and vice versa. In such situations, the Board consistently maintained the supremacy of the Anti-Inflation Act. This position was subsequently tested and confirmed in the courts.

A question arose as to whether employers could use the Anti-Inflation Guidelines as a reference point in negotiations under provincial labor legislation and still meet the criteria of good-faith bargaining. In a case involving Canadian Industries and the United Steelworkers of America, the Ontario Labor Relations Board agreed that the Anti-Inflation Guidelines were a major factor in negotiations but rejected the idea that companies could adopt their own interpretation of the rules to avoid the obligation to bargain in good faith. This decision was consistent with the Board's own position that negotiating parties should arrive at a settlement on the basis of their own judgment of what the regulations would permit.

Another important collective bargaining issue surfaced in a Canada Labor Relations Board (CLRB) ruling regarding Cyprus Anvil Mining. The CLRB ruled that because a collective agreement had been rolled back by the AIB, the original agreement was null and void. One practical effect of the ruling was to put the union in a no-contract legal strike position. This raised the disturbing possibility of strikes against the Anti-Inflation Board. Although the Board was prepared to appeal this decision, a settlement was reached by the parties. Since the decision was not adopted as a precedent by provincial labor boards, its potential impact dissipated.

Association bargaining, in which one or more unions negotiate jointly with one or more employers, posed some administrative and technical problems for the AIB. The concept underlying the reference to association bargaining in the Anti-Inflation Act was that, while most employee groups would be covered by the Act because they belonged to companies with 500 or more employees, a number of important industries remained which were fragmented and which had fewer than 500 employees. In the latter case, constraining the increases of the large employer members of the association while the smaller members remained free of controls could have disrupted traditional industry-wide association bargaining. As a result, the Act contained an association bargaining provision under which groups that were determined to be "of strategic importance to the containment and reduction of inflation" could, by order-in-council, be brought under the Act.

In fact, only three orders-in-council were proclaimed under the association bargaining provision. The first designated employers in the construction, grain handling, shipping (including dockworkers—east and west coasts, Great Lakes, and St. Lawrence River), and trucking industries. The Board had some initial concern as to the intended effective date of this order. The government had originally announced that the order-in-

council would be effective on December 16, 1975, but it was not officially put into effect until April 15, 1976. However, amending legislation was eventually passed which made the order retroactive to December 16, 1975.

As the program progressed, other groups which bargained in association but were not covered by the order reported to the Board through their associations, as permitted under the section of the Guidelines dealing with reports. As long as member companies and their unions agreed voluntarily to abide by the Board decision applying to the association, the arrangement created no difficulties. There were periodic rumblings, however, which suggested that some association bargaining arrangements might break apart because non-controlled members were not prepared to comply voluntarily with a Board decision covering the association, thinking they could do better on their own. In general, however, the member companies and unions involved were more anxious to preserve the hard-won stability provided by association bargaining than to make short-term gains by exceeding the Guidelines.

Pilotage authorities and their suppliers were the second group to be brought under the Act by an order-in-council effective May 27, 1976. The order covered the Atlantic, Laurentian, Great Lakes, and Pacific pilotage authorities, as well as private sector suppliers of pilotage services.

The third order-in-council dealing with association bargaining was effective March 30, 1977, and brought certain industries in the British Columbia private sector under the Act, viz., the logging, wood, food retailing and wholesaling, bakery products, and metal fabricating industries.

Policies Evolving From Test Cases

At 8:30 a.m. on October 14, 1975, the telephones began to ring in AIB headquarters in Ottawa and in federal district taxation offices across Canada. At the start of the program, Revenue Canada/Taxation and its 28 district offices helped the AIB respond to questions about the new legislation and guidelines and to distribute information. (See chapter six.) In the weeks that followed, the ringing telephones were accompanied by a flood of mail, telegrams, and delegations. "We are currently in negotiations; what do we do now?" "Where can I get a copy of the Guidelines?" "We are provincial public servants but our provincial government has not yet signed an agreement with Ottawa—are we subject to controls?" "We are about to sign a collective agreement. May we come to Ottawa and talk to someone about it?" "The union has told us they will go on strike at midnight tonight unless we sign an agreement which is above the Guidelines. What should we do?" "Will the rules allow us to provide our v.p. with a company car?" "We are a subsidiary of an American company. Are we covered?"

At the start of the program, answers to these and hundreds of other questions could be slow, vague, and even contradictory. An answer given

frequently was “Put together what you consider a reasonable case under the Guidelines, send it in, and we will take a look at it.” At an early briefing seminar, participants were advised that if the Board could not give an answer to a specific problem and action had to be taken, they should do what was reasonable within the spirit of the Guidelines.

Unlike British and American wage and price restraint programs, the Canadian version did not provide for an initial 60- to 90-day freeze. Consequently, in the case of compensation in particular, the program was plunged into reality from its first day of operation. On that first day, and for several weeks after, the Board was equipped with only a few tools, specifically:

- a brief order-in-council setting up an Interim Anti-Inflation Board under the Inquiries Act;
- the government White Paper “Attack on Inflation,” which contained a scant four-page outline of the compensation guidelines;
- a board consisting initially of two members, shortly thereafter expanded to six members;
- a hastily assembled staff, borrowed from other government departments, who had experience in personnel, compensation, or labor relations.

At the outset, however, it was obliged to function *without*

- a comprehensive anti-inflation act (the Act was not proclaimed until December 15, 1975);
- agreements with the provinces concerning application of the restraints to the provincial public sectors (the first was signed on January 12, 1976, and the last on June 22, 1976);
- a set of regulations (these were approved and issued on December 18, 1975);
- reporting forms (compensation forms AIB-1 and AIB-2 were released on January 28, 1976);
- an organized information program (launched in December, 1975); or
- technical bulletins explaining the fine points of the compensation guidelines (the first of these was issued on April 29, 1976).

It was thus on a rather fragile foundation that the Board began its task of responding to questions about the program and deciding on specific compensation cases. With only general guidelines to work with and a pressing need to get on with the job, the Board was inevitably drawn into a case-by-case approach. These first decisions would inevitably be taken as precedents and demonstrations that the Board intended to be flexible or rigid, accommodating or tough.

Flexibility was built into the compensation guidelines in the form of four concepts outlined in the White Paper. These were *prior commitment*, *special consideration*, *experience adjustment*, and *historical relationship*. The first two were specifically designed to provide flexibility in the initial stages of this transition, although all four concepts were intended to ease the transition from a free to a restrained economy through gradual lowering of compensation increases and expectations.

The concept of prior commitment meant that all collective agreements and compensation plans agreed to prior to October 14, 1975, would be exempt from the Guidelines, even though they provided for increases after October 14, 1975. One effect of this provision was that some groups which had signed multi-year contracts shortly before the program began (for example, certain groups in the steel and construction industries) did not come under the Guidelines until late in the program or they escaped it entirely.

In general, the Board was not concerned with cases of prior commitment that had clearly taken place before October 14, 1975. In these instances, the employers were simply not required to report. In some cases the nature of the commitment or the date of it was less clear, in particular when the claimed prior commitment took place very close to October 14, 1975, or a verbal agreement had been reached prior to October 14 but no memorandum or collective agreement had been signed. In other cases, a memorandum of settlement had been signed before October 14 but had not been ratified until after that date. In these instances the Board was obliged to review the case and to decide on the validity of the claim.

The special consideration provision was intended to apply to cases "where contracts expired and negotiations are under way, where the expired contract was signed prior to the beginning of 1974." In effect, the provision was designed to give some relief to groups that in 1972 or 1973 had signed multi-year contracts providing for wage increases in the latter years of the agreement which proved to be relatively low in relation to the rapid rise in the cost of living.

The experience adjustment factor (EAF) also permitted some "catch up" to groups that had fallen behind in the two or three years before the introduction of the program. Over the life of the program this flexibility could amount to a maximum of plus or minus 2 per cent for each guideline year. Thus, over three guideline years the EAF could result in allowable increases that varied by as much as 12 per cent.

The fourth and final provision for flexibility in the compensation guidelines was the concept of historical relationship. If an employee group was able to demonstrate a historical relationship with another group, the Guidelines stipulated that "the employer may in a guideline year increase the total amount of the compensation of all the employees in the group by such further amount as is consistent with the objectives of the Act."

The effect of these four concepts quickly became evident. Although early information about the program had focused on a 10 per cent allowable increase in the first year made up of an 8 per cent basic protection factor and a 2 per cent productivity factor, it soon became clear that application of these "relieving provisions" resulted in a wide range of permissible increases. This led to adverse public reaction from those who viewed early Board decisions as arbitrary, inconsistent, and, in some quarters, overgenerous. The Board's critics frequently had the 10

per cent guideline in mind and interpreted any departure from it as capricious behavior.

The First Six Months: October 14, 1975 to April 13, 1976

The first major compensation cases to come to the Board's attention were in the public sector, a sector that had not been high on the popularity charts. At the federal level, this was largely because of the letter carriers' strikes and settlements. At the provincial level, strike activity and substantial public sector wage settlements combined to produce increasing public resentment. In general, the public was concerned that governments at both levels had contributed to inflation by lack of restraint on spending.

Before the introduction of the anti-inflation program, two-year teachers' settlements, providing for increases in the 30-40 per cent range, had aroused adverse public reaction, particularly when their tax effects became known. About the same time, questions were being raised about the quality of education. Although these were directed primarily at the curriculum, the teachers themselves were part of the controversy.

The Board soon found itself deeply involved with Ontario School Board cases. Two-thirds of the province's school boards had signed agreements before October 14, 1975, and thus were not subject to the Guidelines during the life of their agreements. One of the last boards to settle prior to the program was the Metro Toronto Separate School Board. On November 7, 1975, the AIB issued one of its first public statements. The statement notified the school board that a tentative contract agreement reached on August 29, 1975, but not ratified until after the announcement of the Guidelines would be accepted as a prior commitment. The contract provided for a 32.2 per cent increase in teachers' salaries for the current year.

Of the one-third of the Ontario teachers' agreements immediately subject to the program, the Hamilton elementary and Toronto secondary school cases were among the most prominent. This was partly because they were seen as the first test cases for the AIB and, in the Toronto case, because negotiations were accompanied by a two-month strike.

In the subsequent teacher cases, the main issue was often a claimed historical relationship with another teacher group, either within the same board or with adjoining boards. In many of these instances, the actual relationship was strong, and the proposed increases thus appeared to qualify for exception as "increases necessary to maintain long-established historical relationships in closely related groups."

In its deliberations on historical relationship cases, the Board was faced with two frequently conflicting considerations. While it was obliged to permit exceptions to the Guidelines, it was also bound to its overall mandate to restrain inflation. In an attempt to meet both objectives, the Board ultimately took the position that recognizing even a very strong

historical relationship did not imply the *immediate* restoration of that relationship, and it made clear that such relationships might "have to be modified in the short term." In its first compensation ruling on November 28, 1975, the Board recommended that the proposed first-year increase of the Hamilton elementary teachers be reduced from 26 per cent to 18 per cent. The Board argued that because the elementary teachers were eligible for a plus 4 per cent experience adjustment factor over the next two years while the secondary teachers were constrained by a minus 4 per cent EAF over the same period, a gradual return to the traditional relationship between the two groups would be permitted.

On the same day, the Board issued a statement concerning the Metro Toronto secondary school teachers. It reiterated the Board's position that in the context of a program of restraint, historical relationships might have to be modified in the short term. At this point, the collective agreement between the Metropolitan Toronto School Board and the Ontario Secondary School Teachers Federation had not been concluded, and the parties had asked the Board to indicate what percentage increase it would accept. To avoid interfering in the collective bargaining process, the Board declined to respond to the request. In a statement made on November 28, 1975, it "urged the parties to return to the bargaining table in an effort to reach an agreement that more properly reflects the anti-inflation policy of restraint."

The teachers, who had been on strike since November 12, 1975, were ordered back to work on January 19, 1976, by the Ontario government and made subject to binding arbitration. The provincial arbitrator awarded them a salary increase of 39.2 per cent over two years. This was equivalent to the Metro School Board decision in early November, which the AIB had described as "excessive" in its November 28, 1975, statement. According to the Board's calculations, total compensation increases resulting from the arbitrated award were approximately 24 per cent in the first year and 10 per cent in the second year (in contrast to the permissible arithmetic guideline increases of 12.29 per cent and 12.00 per cent in the first and second years respectively). The Board recommended that the first-year increase be reduced to 20 per cent, noting that despite the group's close historical relationship with the elementary teachers of the same board, it could not accept immediate restoration of the full historical relationship.

While the Hamilton and Toronto teacher cases were being considered, the Board was called upon to make a decision in a third major public sector case, this time involving a proposed collective agreement between the Treasury Board and the Canadian Union of Postal Workers (CUPW). Earlier in 1975, the letter carriers, with whom the postal workers claimed a historical relationship, had received a 38 per cent increase over a 30-month contract. The Board recognized the historical relationship in its December 10 decision but once again qualified this position, concluding that the proposed agreement "exceeds the amount it could accept in light of its responsibility under the anti-inflation pro-

gram.” Balancing its recognition of the historical relationship against the requirement of restraint, the Board saw justification for “an amount somewhat below that in the proposed agreement.” The amount negotiated was equivalent to an annual rate of increase of 17.75 per cent over the 30-month period of the agreement. This contrasted with an annual rate of 11.63 per cent (over 30 months) permitted under strict application of the arithmetic guidelines.

The Board’s press release concluded by stating that since discussions with the parties were unlikely to lead to changes in the proposed settlement, in accordance with the order-in-council establishing the Interim Anti-Inflation Board, the matter would be referred to the federal cabinet for consideration.

On December 11, the cabinet overturned the AIB ruling and allowed the agreement to stand as negotiated. The prime minister said that the cabinet had decided it was in the greater public interest to let the agreement stand, but stressed that the move would neither weaken the federal program nor reflect on the competence of the Board. On December 15, Anti-Inflation Board Chairman Jean-Luc Pepin responded that, while the Board respected the cabinet’s decision, it had felt obliged to reject the postal settlement to preserve its credibility for future rulings.

Closely following the teacher and postal decisions was the Board’s first major private sector case, involving Irving Pulp and Paper and the Canadian Paperworkers Union. The case was significant both because it established the importance of industry compensation patterns and because it was the first case to be referred to the newly-appointed Administrator, the “enforcer” of the program.

The concept of industry patterns was an extension of the idea of historical relationships. It soon became evident to the Board that, when an industry had a fairly cohesive bargaining pattern, the Board must not only examine the current relationship of B to A, but it must also keep in mind a potential series of historical relationship claims linking C to B, D to C, and so on.

In the pulp and paper industry, it was generally recognized that there were three distinct bargaining patterns covering eastern, central, and western Canada. In eastern Canada, the forest section of the industry had reached settlements prior to the introduction of controls. When the program started, the pulp and paper section had been on strike for a number of months following negotiations in early 1975. While Irving Pulp and Paper had not been a traditional leader in the industry, it was the first to reach a settlement in this round of negotiations and was thus seen as a test case by the industry and the union. On December 17, 1975, the Board recommended a reduction of the proposed 23.8 per cent first-year increase to 14.0 per cent, about 4 per cent above the arithmetic guideline. In granting an amount beyond the Guidelines, the Board recognized a historical relationship claim. The parties were also advised that the Board would postpone its review of the second year of the settlement until agreements had been reached in other pulp and paper

mills where negotiations had not yet been concluded, since those increases would be determined in relation to settlements in those mills. The settlement accepted by the Board for the second year was 11 per cent. Thus "14-11" became an acceptable two-year pattern of increases for pulp and paper mills in eastern Canada.

Although both the company and the union wanted to appeal the decision to the Administrator under the terms of the Anti-Inflation Act, only the AIB and the cabinet had the right of referral, where "consultations and negotiations had failed or were likely to fail to modify an actual or proposed change in compensation to bring it within the Guidelines." The company informed the Board of its refusal to comply with the AIB decision, thus permitting the Board to make the referral. As a result of the obvious awkwardness of this situation, the Anti-Inflation Act was amended to permit a dissatisfied party to appeal directly to the Administrator. (See chapter five.)

In the early stages of the program, there was widespread feeling that the parties had nothing to lose by going to the Administrator. In an effort to correct this misunderstanding of the program, the Board explained that the Administrator would make a fresh start on the case, and that the decision could be higher or *lower* than the Board recommendation.

When the Irving case reached the Administrator, it became clear that, under the law, he could accept or reject the Board's recommendation but could not alter it. According to section 44(1) of the compensation regulations, when a historical relationship was involved, the employer could be permitted an exception to the arithmetic guideline, consisting of "such further amount as in the opinion of the Anti-Inflation Board is consistent with the objectives of the Act." In his decision on February 13, 1976, the Administrator confirmed the Board's recommendation of 14.0 per cent in the first year. Not only did this require a rollback from the 23.8 per cent increase which the company had been paying, the Administrator also ordered recovery of excess payments and fined the company for having knowingly contravened the Guidelines.

After section 44(1) of the compensation regulations was amended and the phrase "in the opinion of the Anti-Inflation Board" deleted, the Administrator was able to alter Board recommendations involving historical relationships. In light of this amendment, the union later referred the case to the Appeal Tribunal. The appeal was allowed on the basis of the amendment which had retroactive effect. When asked by the Tribunal to reconsider his decision, however, the Administrator chose to let the original decision stand.

From the early days of the program, cases involving teachers and educational officials demanded a great deal of the Board's attention. In December, 1975, and in early 1976, new school board cases came to the fore.

In its decision concerning the Northumberland and Newcastle Board of Education, the Anti-Inflation Board for the first time applied the \$2,400 maximum increase specified in the Guidelines. The case involved

a group of eight senior officials claiming a historical relationship with the principals who had received a 25 to 30 per cent increase under a collective agreement signed before the start of the anti-inflation program. While the Board recognized the relationship, it concluded that the proposed increases were considerably above the Guidelines and inconsistent with the objective of restraint. The Board's decision was upheld by the Administrator.

Cases involving primary and secondary teachers in other Ontario public and separate school boards continued to flow into the Board. Proposed increases were in the 20 to 34 per cent range over one year, and although the Board normally recognized the claimed historical relationships, it usually recommended a 5 to 10 per cent reduction.

As a result of events in late 1975 and early 1976, the Board's operations were put on a more solid footing. In December, the Anti-Inflation Act was passed, the compensation regulations were approved and the Administrator was appointed. In January, Ontario signed the first federal-provincial agreement; AIB reporting forms became available; and the Board launched a nationwide seminar program to explain the Act, the Guidelines and the forms.

In the early weeks of the program, attention had been focused on public sector and Ontario cases. In the first months of 1976, however, private sector cases from the other provinces began to share the spotlight.

On February 27, 1976, the Board reviewed a two-year collective agreement between the Pulp and Paper Industrial Relations Bureau, the Canadian Paperworkers Union, and the Pulp and Paper Woodworkers of Canada.¹ The settlement covered 13,000 workers and provided for increases of 16.1 per cent in the first year and 10.8 per cent in the second. While the Board recognized a strong historical relationship between the pulp and paper and forest sectors in British Columbia, it emphasized that the circumstances clearly distinguished this case from earlier cases, "particularly the Irving Pulp and Paper decision, where the historical relationship with other groups was not demonstrated to be as close as that which exists here."

Initially, the Board recommended a reduction of the first-year increase from 16.1 per cent to 15.0 per cent, with the proposed second-year increase of 10.8 per cent unchanged. Upon further review, however, the Board allowed the 1.1 per cent as an exclusion for past service pension costs. Since the decision covered all pulp and paper operations in British Columbia, where much of the industry is concentrated, it established an acceptable compensation pattern for the pulp and paper industry in western Canada.

In March, 1976, the AIB dealt with its first major case from Quebec. The Coopérative agricole de Granby and the Centrale des syndicats démocratiques had signed two-year collective agreements call-

¹ The Pulp and Paper Industrial Relations Bureau represented the primary manufacturers of pulp and paper in British Columbia.

ing for increases of 38 per cent to 43 per cent in the first year and 15.5 per cent to 17.5 per cent in the second. In this case, the Board applied a number of the program's relieving provisions to arrive at its recommendation for increases above the arithmetic guidelines. On the basis of special consideration (as defined in the Guidelines), proven historical relationships, and the requirement in this case to attract and maintain adequate manpower, the Board recommended a reduction of the first- and second-year increases to 24 per cent and 12 to 14 per cent respectively.

On the west coast, meanwhile, the Council of Marine Carriers (British Columbia) had negotiated a two-year settlement with the Canadian Merchant Service Guild, the Canadian Brotherhood of Railway Transport and General Workers, and the Seafarers' International Union. The settlement covered licensed and unlicensed personnel in the towboat industry. The case was significant because the Board recognized that the operations of the towboat industry on the west coast formed a vital part of the forest and pulp and paper industries in British Columbia, and that the negotiated settlement established base rates in these industries. In effect, the western Canada pulp and paper compensation pattern, confirmed in the Pulp and Paper Industrial Relations Bureau case, was taken into account in the Board's decision. The proposed increases were about 16 to 18 per cent in the first year and 13 per cent in the second. The Board recommended a 1 per cent reduction in the first year of the agreements.

The City Motors/Hickman Motors decision in April, 1976, was the first major case involving application of the Guidelines in an association bargaining context. The groups involved consisted of mechanics in Newfoundland, represented by the International Association of Machinists and Aerospace Workers (IAMAW), and the Transport and Allied Workers (Teamsters). The settlements provided for increases ranging from 26 per cent to 32 per cent in the first year, and from 10 per cent to 20 per cent in the second. While the Board recognized a historical relationship with non-controlled members of the local automobile dealers' association, in the interest of restraint it recommended that increases be reduced to between 19 per cent and 23 per cent in the first year, and to 6 per cent in the second.

The cases were referred to the Administrator who determined that, for purposes of applying the Guidelines, the City and Hickman employees, along with employee bargaining units not subject to the Guidelines (but which bargained in association with the City and Hickman employee groups) constituted three associated groups, located in St. John's, Gander, and Corner Brook. The Administrator then ruled that the historical relationship clause in the Guidelines did not apply, since the claimed relationships involved bargaining units that were actually members of the same employee group. As a result, the Administrator ordered that the increases be held to the guideline amounts of 8 per cent and 6 per cent, and that any excess payments already made should be recovered from the employers and employees involved.

The cases were appealed to the Anti-Inflation Appeal Tribunal, which reversed the Administrator's ruling. The Tribunal found that the bargaining units of City Motors and Hickman Motors were individual groups for purposes of the Anti-Inflation Guidelines and therefore *could* claim a historical relationship with groups with which they bargained in association. Because the relationship was strong, the Tribunal ruled that the City Motors and Hickman Motors groups were entitled to their full negotiated increases, ranging from 26 per cent to 32 per cent in the first year and from 10 per cent to 20 per cent in the second.

Both these decisions were a source of concern to the Board. The Administrator's decision seemed to interpret "group" to include non-controlled members of an association, while the judgment of the Tribunal implied that a strong historical relationship called for full and immediate parity with the target group.

As the first six months of the program drew to a close, the AIB made its first recommendation on compensation increases under arbitrated awards in the federal public service. The case involved Treasury Board and the biological sciences and forestry groups, represented by the Professional Institute of the Public Service of Canada. Although the arbitral awards of 12 per cent in both cases were within the arithmetic guidelines, the Board recommended that the higher-level increases be limited to the \$2,400 maximum specified in the Guidelines. However, in the opinion of both of the parties involved, this arbitration award was not subject to the Anti-Inflation Act. The case was appealed to the Administrator, the Anti-Inflation Tribunal, and the federal court. All ruled in favor of the Anti-Inflation Board. (The case has been appealed to the Supreme Court of Canada.) From the point of view of the AIB, these decisions solidly established the fact that the Board was not bound by an arbitral award.

As this sampling of early compensation decisions suggests, a rather broad range of compensation increases was permissible under the Guidelines. Not surprisingly, however, it was difficult for the public to perceive any common thread running through them. Some groups seemed to get much more than others; the public sector seemed to get more than the private sector; and the 10 per cent arithmetic guideline seemed more honored in the breach than in the observance. In short, it was all very confusing. Board decisions were variously described as "puzzling," "confusing," or "wildly unrelated," and the competence of Board members was called into question. In some cases, the comments were accompanied by demands for a wage and price freeze.

To refute these allegations, the chairman and Board members took pains to explain that variations among Board decisions were a direct result of the flexibility built into the Guidelines in the form of such concepts as prior commitment, special consideration, historical relationship, and the experience adjustment factor. This flexibility was provided to prevent inequities, particularly those which might have resulted from the substantial increases received by some groups immediately before the

program. To "demystify" its decision-making, the Board had also launched an extensive seminar program, a speaking tour, and other measures designed to improve public understanding of the program.

The Second Six Months: April 14, 1976 to October 13, 1976

While the first six months set important precedents, new issues continued to test the Act, the Guidelines, and their interpretation by the Board.

At the start of its second six months, the Board was faced with a new problem: volume. The Act required all employers with 500 or more employees to report on all their employee groups, regardless of size. This meant that some large private-sector companies reported as many as 150 groups, some with as few as two or three employees. In addition, all employers in the construction industry with 20 or more employees were required to report all employee groups, as were those employers brought under the Act by order-in-council, generally because of association bargaining. In the public sector, the net was cast even more widely with all public sector groups required to report. The result was a flood of reports, many involving small groups such as those in municipal administrations and provincially-chartered nursing homes. By April, 1976, the Compensation Branch had a backlog of 3,845 cases which was growing at the rate of 150 a week.

This enormous volume of cases severely strained the capacity of the Board, since the timeliness of its decisions was important to all employees. If a company and union had spent months on negotiations and perhaps endured a strike, further delays only added to their frustration. As pressures of this sort built up, some companies were pressed into taking the chance of paying amounts over the Guidelines, hoping the Board would eventually approve the increase. Companies were often shocked to discover that the Board not only called for a rollback, but requested recovery action on overpayments. These decisions became an increasingly contentious issue.

The second six months of the program started with the focus on the mining industry, represented by the Inco nickel mining operation at Thompson, Manitoba, and the Rio Algom and Denison uranium mining operations at Elliot Lake, Ontario.

The Inco case involved 2,795 workers represented by the United Steelworkers of America. The negotiated contract called for an increase of 18.51 per cent in the first year, 7.3 per cent in the second year, and 6.29 per cent in the third. The Board recommended a reduction to 12.9 per cent, 7.3 per cent not to exceed 8 per cent, and 6.0 per cent. In reaching its decision, the Board took account of a claimed historical relationship with Inco workers at Sudbury, "but at the same time strongly reaffirmed its commitment to the restraint objectives of the program."

The decision was not favorably received by the parties involved. In further discussions, they re-emphasized the strength of the claimed

historical relationship. A citizens' group from Thompson met with the chairman of the AIB to convey the concern of the community, particularly if a strike resulted from the decision. The Board reviewed submissions from both the company and union and, on the basis of new information supplied, increased its recommendation by 2 per cent in the first year, to 14.9 per cent.

In response to a request by the union, the case was appealed to the Administrator. The Administrator granted an additional 1.9 per cent over the life of the contract so that "a full restoration of that historical relationship may be effected over the three-year period of the program." Of greater significance to the Board, however, was the fact that the Administrator had arrived at a higher figure not by granting a larger amount over the arithmetic guideline, but by recalculating the guideline.

The Administrator's calculation of the guideline was based on the fact that the previous contract had contained a "re-opener." According to his interpretation of the Guidelines, this triggered a new compensation plan with the result that the experience adjustment factor would be related to the re-opener date and not to the starting date of the previous contract. The effect of this recalculation was to raise the arithmetic guidelines in the three years of the new contract from 10.9 per cent, 8.0 per cent, and 6.0 per cent to 12.0 per cent, 9.0 per cent, and 6.0 per cent respectively. To make clear that in future cases a re-opener did *not* trigger a new guideline year, the Board recommended that the definition of "base date" be amended. This amendment was put into effect on October 25, 1976.

The Board's decisions involving Rio Algom and Denison mines were released with the Inco decision. All three decisions were seen to set the "mining pattern" in terms of precedents they established. As in the Inco case, the uranium miners at Rio Algom and Denison were represented by the United Steelworkers of America. The Board's first Rio Algom and Denison decisions were not only regarded as too restrictive, they brought about an unexpected change in the relationship between the two groups, whose compensation packages had traditionally been very similar. To clarify the matter, the union, which was common to both companies, requested the companies to provide them with copies of the AIB-2 reporting forms, which they agreed to do.

Following discussions between the parties and Board staff, the arithmetic was revised, changing both the arithmetic guidelines and the negotiated increases reported in both cases. In the meantime, the Denison workers had gone on strike, the first to protest a Board decision. Board staff met with the parties in both cases, reviewing the new arithmetic and the additional information they had supplied. The Board then reviewed its recommendation and, in its second decision, granted the parties about 3 to 4 per cent above their first-year guideline of 10 per cent, while holding them to their guidelines of 8 per cent in the second year of the contract. In reaching its decision, the Board took account of both the historical relationships involved and the labor market conditions in the

mining industry. It also commended the companies for providing the union with copies of their submissions to the AIB, recommending that other employers do likewise in the interest of establishing a common understanding with their employee groups.

On May 6, 1976, the Anti-Inflation Board rendered its decision on a case involving the Essex County Board of Education and its secondary teachers, represented by the Ontario Secondary School Teachers Federation. Among the issues the case brought into sharper focus was a long-simmering debate on interpretation of the section of the Guidelines dealing with increments. (For more detail on the broad question of increments, see Technical Issues, page 67.) In this case, the Board had rolled back the proposed increases to the arithmetic guideline. However, in reviewing the calculation of the proposed increase, it had approved the exclusion of those increases referred to as increments.

When the Essex County case was appealed to the Administrator, not only was the recommended reduction to the arithmetic guideline confirmed, the Administrator also ruled that the incremental increases were to be included in the proposed compensation increase, thus effectively denying their payment. The Administrator determined that, in this case, the increments did not qualify for exclusion as "increments only paid if the employee has improved or added to the skills or knowledge required in the performance of the duties of the job or position."

The case was further appealed to the Tribunal. The Tribunal ruled that, although increments were rarely withheld, the possibility that they might be withheld was an important consideration for both school board administrators and teachers. The Tribunal thus concluded that the appeal should be allowed. It referred the matter back to the Administrator for reconsideration, and variation of his order to reflect exclusion of annual increments from computation of the salaries of this employee group. The Administrator later appealed the Tribunal's decision to the federal court, which allowed it. The decision of the federal court was subsequently appealed to the Supreme Court of Canada, which dismissed the appeal.

In July, 1976, another case involving increments (among other issues) concerned the Manitoba Liquor Control Commission and its employees, represented by the Manitoba Government Employees Association. The AIB recommended that the proposed compensation increase of 23.48 per cent be rolled back to the arithmetic guideline of 12.0 per cent on the basis that a claimed historical relationship to other Manitoba and Saskatchewan employees had not been established. At the commission's request, the Board reviewed the case but reaffirmed its earlier recommendation.

The commission then appealed the case to the Administrator, who confirmed the Board's recommendation, and ordered that increments be included in computation of the 12.0 per cent increase, as he had found that they did not meet the criteria for exclusion. He further ordered that a proposed 27.0 per cent increase in the "remoteness allowance" be held to 8.0 per cent, and that overpayments be recovered to the extent of

\$300,000, 20 per cent from the employees and 80 per cent from the employer. This was the first case in which a provincial agency was ordered to pay money to Ottawa for a breach of the Anti-Inflation Guidelines.

When the Manitoba Liquor Commission threatened to disobey the Administrator's order, the province's premier appealed to the prime minister on behalf of the provincial employees, warning that Manitoba would probably withdraw from the program at the end of March, 1977, if major changes were not made. The premier expressed particular concern at the excessively rigid application of the wage guidelines, suggesting that some of the decisions made under the program had been inconsistent. The chairman of the Board held a meeting with the premier of Manitoba and as a result of their discussions Manitoba agreed to remain in the program another year.

In this second six months of AIB operations, a major agreement involving association bargaining was settled. The agreement involved the Transport Labor Relations Bureau of British Columbia, representing 97 member companies, and the International Brotherhood of Teamsters, Chauffeurs, and Warehousemen of America, representing their 4,500 drivers and helpers. The settlement came within the Board's jurisdiction by virtue of order-in-council P.C. 1976-91, which brought the trucking industry under the Guidelines. The Board recommended a reduction of the proposed first- and second-year increases from 19.28 per cent and 13.18 per cent to 11.3 per cent and 8.0 per cent respectively, which amounted to an increase of two percentage points over the arithmetic guideline in the first year and the guideline amount in the second. At the request of the union, the case was referred to the Administrator.

The second six months of the program ended with a case which, at the time, was thought to have established an important legal precedent. The Cyprus Anvil Mining Corporation had signed a two-year collective agreement with the United Steelworkers of America, covering 350 production workers in the Yukon Territory. On July 22, 1976, the Board recommended a reduction of the proposed first- and second-year increases from 36.5 per cent and 10.43 per cent to 9.1 per cent and 10.0 per cent respectively. On July 30 the union went on strike. Following a review requested by the parties, the Board recalculated the arithmetic guideline on the basis of additional information and on August 12 revised its original recommendation to 14.0 per cent in the first year and 10.0 per cent in the second. On September 2, at the request of the union, the case was referred to the Administrator, who ordered that the increases be rolled back to the arithmetic guidelines, which he calculated to be 8.0 per cent in the first year and 10.0 per cent in the second.²

From the viewpoint of the Board, the significance of the Cyprus Anvil case lay in the decision of the Canada Labor Relations Board,

² The leader of the New Democratic Party called the decision "an unbelievably destructive perversity" and demanded that the Administrator be fired.

which had been called upon to decide whether or not the strike was legal. The CLRB had concluded that "it [could not] uphold an argument that would mean that whereas the employer is prohibited from implementing a crucial portion of his obligations under the collective agreement, the employees and the bargaining agent are nevertheless compelled to abide by their part of the bargain. To avoid such an obviously absurd result, the board is compelled to rule that the entire collective agreement is null and void."

The press interpreted the decision as an invitation to strike against the AIB, since it appeared to imply that if an agreement was rolled back by the AIB and so ordered by the Administrator, the union involved would be in a legal strike position. The AIB had a similar concern and considered appealing the ruling. However, the CLRB decision did not have the anticipated impact and the spectre of a series of strikes against the AIB never materialized.

As the events suggest, in the second six months of the program the Administrator joined the Board in entering the arena of test cases. By the end of this period, evidence showed that the Administrator very often made a tougher decision than the Board, chiefly because he was given less discretionary power under the Anti-Inflation Act.

The Third Six Months: October 14, 1976 to April 13, 1977

By the end of the first year of the program, with Guidelines, technical bulletins, and reporting forms completed and a series of precedent-setting decisions made, the Board had less occasion to grapple with test cases. From time to time, however, significant cases continued to crop up, notably in the construction industry during the third six-month period of AIB operations.

A case involving the Saskatchewan Construction Labor Relations Council was referred to the Administrator on October 27, 1976, at the request of both parties. The agreement in question, which involved 525 employers and 18 unions covering about 30,000 workers, provided for increases averaging 15.8 per cent. The AIB had recommended a reduction to the arithmetic guidelines, but allowed for a slight upward adjustment to maintain a historical relationship among certain trades, bringing the total allowable increase to an average of 8.9 per cent over a 13-month period. The Administrator confirmed the historical relationship and determined that the allowable increases should be 11.5 per cent in the first year and 7.0 per cent in the second, 3.5 per cent and 1.0 per cent respectively over the guideline amounts. The Board considered this an important and to some extent a pattern-setting case, since the construction industries in British Columbia, Manitoba, and Alberta would be looking at the Saskatchewan agreement as a basis for their negotiations.

The Board subsequently dealt with a collective agreement involving the Construction Labor Relations Association of British Columbia and

the British Columbia and Yukon Territory Building Trades Council. This was a major association bargaining case covering 28 agreements, 830 construction companies, and 40,000 employees in about 180 job classes. In its decision, the Board accepted the proposed guideline increase of 8 per cent plus exclusions of 11 cents per hour for health and welfare and 16 cents per hour for pension. While the exclusions were legitimate under the Guidelines, the Board was concerned at their magnitude in this case and considered requesting an amendment to the Guidelines to put a "cap" on exclusions in the future.

Another source of concern to the Board was the possibility that a pension exclusion might be used for some other purpose, for example, to raise the straight time rate. This could happen if one or more of the 28 agreements did not include a pension plan. To prevent such a situation, the Board considered stipulating in its decision that the pension exclusion could be used only where a pension plan that qualified for the exclusion was in effect. Ultimately the Board did not include such a provision, since it would have upset the historical relationship among the trade groups in the construction industry. These groups traditionally relate in terms of cents per hour of total compensation rather than in individual wage rates and benefit levels.

The other Board decisions that attracted public attention during this period involved the Montreal flour mills. The Board had adopted an "industry pattern" approach for the flour milling industry. All its decisions reflected approval of a common cents-per-hour increase in the first and second years of two-year agreements. The pattern was established in the Toronto area and was followed for other flour milling groups in Ontario, Alberta, and Manitoba. Similar decisions were also rendered for the Montreal flour mills: Ogilvie Mills, Robin Hood, Maple Leaf, and Farines *Phenix*. Following the Board's decisions in January, 1977, however, which involved rollbacks of about 40 cents per hour, employees in the four Montreal mills, represented by the Confédération des syndicats nationaux, went out on strike. The strikes, which continued until July, 1977, in two cases and until September, 1977, in the others, resulted in local shortages of bread and bakery products. Following its review of the case, in consultation with the parties involved, the Board agreed that amounts in excess of its initial decision could qualify as a pension exclusion if so directed and compliance plans were submitted on this basis.

The Fourth Six Months: April 14, 1977 to October 13, 1977

In this period, two categories of employees shared the spotlight: women and executives.

On April 22, 1977, the Anti-Inflation Board recommended a reduction in an agreement covering 1,359 hospital workers at the Health Sciences Centre in Winnipeg. The agreement with the Canadian Union

of Public Employees provided for increases of 16.07 per cent for one year, with the second-year increase to be negotiated. The Board recommended a reduction to 10.94 per cent for the first year, 2.94 per cent above the arithmetic guideline, in recognition of the elimination of sex discrimination in job evaluation. It recommended the arithmetic guideline of 6 per cent for the second year.

The decision brought strong reaction from the union. The national president of CUPE called for the resignation of the Board's vice-chairman on grounds that she was thwarting the elimination of sex discrimination in pay practices, which, it was claimed, could only be achieved by granting the full negotiated increase. The case was also taken up as a cause célèbre by the Manitoba Action Committee on the Status of Women and by the executive of the Canadian Labor Congress. The CLC executive voiced strong objections to the decision, claiming that the AIB had played down the experience of the permissible exclusion for sex discrimination, and in this case had unjustifiably denied it.

At the request of the parties, the decision was reviewed by the Board on June 17, 1977, and, on the basis of additional information concerning the job evaluation plan involved, the Board raised the permissible first-year increase from 10.94 per cent to 12.0 per cent. In arriving at its decision, the Board took note of attempts by both parties to demonstrate that the costs of the new job evaluation plan were related to eliminating differences in compensation based on sex. At the same time, the Board issued a technical bulletin emphasizing three points of its policy on sex discrimination. First, it expressed full support for the elimination of sex discrimination in pay practices. Second, it recognized that such discrimination could be embodied in a job evaluation program. Third, it was obligated to quantify and validate that portion of job evaluation increases directly attributable to elimination of sex discrimination.

Bell Canada executives were drawn into the limelight as a result of the Canadian Radio-Television and Telecommunications Commission (CRTC) hearings on Bell Canada's application for rate increases. The Ontario Ministry of Transportation and Communications, as an interested party, requested information on salaries of Bell executives. These questions, and the responses to them, became part of the public record and were reported by the *Toronto Globe and Mail*. On the basis of information supplied to the hearing, the *Globe* calculated that Bell executives received an average increase of \$13,000 in 1977, and asked how the Board could permit so obvious a breach of the \$2,400 limit on compensation increases. The member of Parliament for Winnipeg North Centre presented a motion to the House of Commons "to take the necessary steps to block this flagrant violation of its own guidelines which limit an annual salary increase to \$2,400." The motion was not brought to debate, however. Meanwhile, the National Anti-Poverty Association, as intervenors in the CRTC hearing, asked the AIB to provide the commission with a written explanation of the application of the wage guidelines. The Board complied, but was not called upon further by the CRTC in this case.

Because the case was so visible and so sensitive, the Board recognized the importance of assuring the public that there had been no irregularities. Consequently, it rechecked the facts of the case. Following submission of the second guideline year report for this group, the Board conducted its customary review of base salaries to reconcile them with those approved in the first guideline year. It found that the company had implemented increases in the first guideline year which were not provided for in the submission approved on June 8, 1976, and which did not comply with the \$2,400 average increase recommended by the Board on that date. According to AIB calculations, the 30 executives had been paid an average of \$6,000 more in the first guideline year than they were entitled to. When Bell Canada was notified of this, it requested that the case be referred to the Administrator. On November 1, 1977, the Administrator ruled that the employer had contravened the Guidelines and that a portion of the total overpayment (\$36,000) should be recovered.

The Bell executives case coincided with publication of a series of articles in the *Vancouver Sun* which purported to show that executives in several companies had received compensation in excess of the Guidelines. The allegations were based on data obtained from proxy statements filed with the United States Securities and Exchange Commission (SEC). The data appeared to indicate that increases above the AIB \$2,400 limit had indeed been granted.

Like the Bell Canada case, the *Sun's* allegations suggested that compensation restraints had not been applied as rigorously to the executive category as to other employee groups, thus calling the Board's credibility as an impartial administrator into question. To refute this suggestion, the Board reviewed each of the cases cited in the *Sun* articles. They established that SEC data in each case either was not comparable with AIB data because the reports covered different periods of time, or the method of reporting compensation differed. The Board determined that for these reasons the companies had not exceeded allowable increases under the Guidelines.

The Fifth Six Months: October 14, 1977 to April 13, 1978

The third year of the program began in an atmosphere of uncertainty. There was increasing speculation that the program might soon be closed out. If it were to continue into a third year, what would the compensation guidelines be?

Decontrol had been considered as early as October, 1976, when the government issued a general discussion paper on inflation entitled "The Way Ahead: A Framework for Discussion." In his budget speech of March 31, 1978, Finance Minister Donald MacDonald stated that decontrol before October 14, 1977, "would not be feasible or desirable" and that the government favored a phased-out approach, in which employers and employees would be released from controls on a first-in,

first-out basis. In May, 1977, the government tabled a discussion paper entitled "Agenda for Co-operation," which detailed three alternative decontrol methods: an abrupt and complete ending of the program, a phase-out by industrial sector, and a timed phase-out determined by date of entry into the program.

On October 20, 1977, a few days after the start of the third program year, the newly-appointed finance minister, Jean Chrétien, announced in a budget speech that April 14, 1978, would be the starting date for a timed phase-out of the program. He explained that for the third program year, starting October 14, 1977, the basic protection factor and national productivity factor of the guideline calculation would be replaced by a single guideline number of 6 per cent, plus or minus any applicable experience adjustment factor up to 2 per cent.

With the date and method for decontrol established and the third program year guideline determined, the decks were cleared for the Anti-Inflation Board to enter the final six months of implementing the compensation guidelines.³

A number of important cases involving the brewing industry were ruled upon in this period. The cases affected about 2,400 workers in Ontario, New Brunswick, and Nova Scotia. The Ontario workers were employed by Labatt's (Ontario), Molson's (Ontario), and Carling O'Keefe Breweries (Canada). Those in New Brunswick and Nova Scotia were employed by Oland's Breweries (1971). Collective agreements in the Ontario breweries provided for increases ranging between 14.6 per cent and 18.2 per cent, while those in New Brunswick and Nova Scotia provided for increases of approximately 29 per cent. All agreements were for one year, effective January 1, 1977, and were made with the Canadian Union of United Brewery, Flour, Cereal, Soft Drink, and Distillery Workers.

The Ontario brewing industry requested an above-guideline increase on the basis of a relationship with the British Columbia brewing industry. While the Board did not recognize this relationship, it did recognize a relationship within the province of Ontario. As a consequence the Board asked that the agreements be reduced to the guideline of 6 per cent. The union expressed dissatisfaction with the recommendation and requested that the decision be referred to the Administrator. On June 23, 1978, he ruled that the groups did have a historical relationship with another group, but he was satisfied that the Guidelines would enable them to maintain their relationships within the Ontario brewing industry.

The Ontario breweries later signed a two-year agreement effective January 1, 1978, calling for increases ranging from 4.17 per cent to 5.96 per cent in the first year and approximately 18 per cent in the second. The Board accepted the negotiated increases for the first year of the agreements on the basis that they maintained parity between these

³ A more detailed discussion of compensation decontrol arrangements may be found in chapter seven.

provincial groups. Although the second year of the agreements was not under the controls program, the Board was concerned at the size of the post-control increase, one of the first to come to its attention. In announcing its decision in the case, the Board pointed out that the one-year agreement in 1977 had been reduced to the Guidelines and a historical relationship with British Columbia had not been recognized. It expressed concern about the excessive increase and noted that by 1979 the employees would have on the average more than doubled their wages in six years. The Board expressed concern that increased costs resulting from the compensation increases would be passed on to consumers and pointed out that the companies should accept responsibility for the consequences.

In the case of the New Brunswick and Nova Scotia groups, the Board recommendation of guidelines for the first guideline year starting in January 1, 1977, did not recognize a claimed prior commitment to improve rates of pay to Ontario levels. The union was dissatisfied with the decision covering the Nova Scotia group and requested that it be referred to the Administrator. On August 11, 1978, he ruled that although there was evidence of an informal understanding arrived at prior to October 14, 1975, the understanding did not qualify as a prior commitment as defined in the Anti-Inflation Guidelines, thus confirming the guideline recommendation of the Board. The Board's recommendation in guideline year two was again the arithmetic guidelines.

While prerequisites had been mentioned in the Anti-Inflation Guidelines, they had seldom been raised as an issue, first because they were not required to be reported as part of compensation, and second because they were simply "frozen" for the life of the program. However, on December 22, 1977, Claude Taylor, president of Air Canada, announced that the airline would grant free travel passes to its employees as a reward for good performance in 1977. The passes would be for reserved travel anywhere in the Air Canada system between February 1, 1978, and January 31, 1979, with restrictions at peak travel periods. The extensive media coverage of the story brought it to the attention of the Board for the first time. The Board discussed details of the proposal with the company, concluded that it would violate the Guidelines, and so informed the company. It requested that the company cancel or postpone the scheme. Failing this, the Board would refer the matter to the Administrator. Air Canada took the position that the passes were a gesture of appreciation for a year of marked increase in production and did not in fact cost the corporation anything. Taylor remarked that the AIB letter reflected "a current Canadian attitude that encourages mediocrity." Air Canada decided not to issue the passes, however, closing the case as far as the Board was concerned.

As the program progressed, it became evident that a number of employers had not reported all guideline years for their groups or had not reported at all. With the program entering its final stages, the Board was

concerned about this situation. First, it was obviously inequitable to overlook any group or employer subject to control. Second, the Board wanted to ensure that even though decontrol was on the way, there would be no relaxation of the law in the interim.

As a result, the Board toward the end of 1977 launched a delinquency project to ascertain the status of the compensation reporting system. Results indicated that follow-up was warranted and between January and March, 1978, the Board mailed registered letters to some 8,000 employers who appeared to be wholly or partly delinquent. In doing this the Board was aware that many of the so-called delinquencies would prove to be non-delinquent. A number of possibilities supported this belief: the organization was not in fact subject to control; reports had been filed by a parent organization; reports had been filed under a different name; the organization originally intended to file separate reports for certain groups but had combined them; or the company had ceased operations.

The majority of employers contacted did fall into one of these categories. Of the organizations that were truly delinquent, some immediately brought their reporting up to date, while many required further follow-up in the form of letters issued by legal counsel. A handful of cases were brought to the attention of the Administrator who advised the organizations of their requirement to comply.

Another issue that arose during the final stages was whether or not a final report of actual compensation payments would be required from each employer for each group as it exited from controls. In the early guideline years, the compensation forecast in one guideline year could be verified by checking it against the actual rates reported as base information in the forecast for the following year. However, once a forecast had been submitted for the final guideline year this was no longer possible. Although the Board considered having employers submit an "exit" report confirming whether the rates paid were those approved in the forecast, it decided that enlargement of the Board's audit function to cover a much larger sample of employers would be more appropriate and equally effective. It was hoped that although the audit sample would remain relatively small, its effect would be great, particularly if it covered a broad cross-section of public- and private-sector organizations, geographic locations, and employee groups, including union, non-union, hourly, salaried, and executive. An enlarged audit program was introduced early in 1978. Although the program uncovered isolated instances of variations between actual and forecast compensation rates, they were found to be for legitimate situations covered by the Guidelines.

As the decontrol date of April 14, 1978, approached, no sudden decline was anticipated in the number of compensation cases because of the phase-out approach and the time lags between the beginning of a guideline year, the signing of collective agreements, and compensation reports reaching the Board. (The decontrol process is described in chapter seven.)

Technical Issues and Interpretations

Along with the general policy issues discussed above, the Board was faced with a number of technical questions in interpreting the Guidelines. The most important of these questions are discussed in this section.

INCREMENTS

Of all the technical issues dealt with by the Board, increments perhaps absorbed the most time and attention.

To begin with, the meaning of the term "increments" created some confusion. While its use was fairly common in the public sector, it was less familiar to organizations in the private sector. In the context of the Guidelines, it was intended simply to cover increases granted as steps in the salary range of a particular job, usually on the basis of performance or service.

The question was whether such increases should be excluded or included in calculating permissible compensation increases. Many technical (and some emotional) arguments were advanced about whether or not such increases were inflationary. Those who said they were inflationary saw them in the short term as a second increase in addition to a group's general economic increase. Those arguing the opposite position generally considered increments in a longer-term context, as a distribution device which would not produce a higher average wage rate.

There was a general lack of consensus on the issue. When the program was first proposed to the provinces, some argued for their exclusion while others favored inclusion. The Guidelines ultimately reflected a somewhat ambiguous position on the issue, leaving it to the reporting group to decide whether or not its increments qualified for exclusion from calculation of the permissible compensation increase.⁴

In the event, many groups were reluctant to decide whether or not they met the criteria and they continued to press the Board for guidance. The Board, in turn, not wishing to give a blanket judgment one way or the other, attempted to maintain a neutral position. In the end, the Board accepted the exclusions claimed, unless they were clearly excessive. In the interest of equity, the Board would also suggest exclusion of increments for a group which had not claimed them but was comparable to a group which had done so.

HISTORICAL RELATIONSHIPS AND INDUSTRY PATTERNS

Apart from special consideration or the approval of specified exclusions, the only permissible way to exceed the arithmetic guidelines lay in

⁴ The Guidelines specified for the exclusion of increments: (a) that the employees involved had "improved or added to the skills or knowledge required in the performance of the duties of the job or position," and "(b) that opportunities available to the employee receiving the increment for promotion to another job or position are strictly limited by the number of jobs or positions with the employer at the higher levels."

recognition by the Board of a historical relationship with another employer group. The concept of historical relationships was central to many Board decisions.

The ground rules for deciding historical relationship cases were contained in section 44(1) of the compensation guidelines, which states that "where a group has a historical relationship with another group, the employer may in a guideline year increase the total amount of the compensation of all the employees in the group, by an amount that is not greater than the sum of the amount permitted under the guidelines and such further amount as is consistent with the objectives of the act."

In assessing historical relationship claims, the Board first determined that the relationship had been developed over a number of years and not invented or discovered as a result of the program. The Board recognized three degrees in such relationships which could be roughly classified as "strong," "weak," and "discernible."

Having recognized a historical relationship, the Board had to address the second condition outlined in the regulation, viz., that any extra amount permitted must be "consistent with the objectives of the act." The result of the Board's efforts to satisfy the often conflicting objectives of recognition and restraint was compromise. In most cases, while the Board recognized and made allowance for strong historical relationships, in the interest of restraint it declined to grant the full increase the parties claimed was necessary to maintain that relationship. This position was supported by decisions of the Administrator and the federal court.

While increases were generally expressed in percentage terms, in the case of historical relationships it was occasionally more appropriate for the Board to consider them in terms of cents per hour. If, for example, group B had historically maintained a cents-per-hour differential with group A, though group B's average rate differed from A's, granting the same percentage increase to both groups would distort the traditional cents-per-hour differential.

On the other hand, there were cases in which groups had previously received a common percentage increase, for example, workers and foremen. In this situation, the Board tended to recognize the relationship only to the extent that the previous cents-per-hour differential was not seriously eroded. In applying restraint to historical relationships among groups within a company, the Board attempted to be fair and consistent, minimizing compression, reducing wage differentials, and avoiding inversion, i.e., the possibility of superiors receiving less than their subordinates.

If a case involved a claimed historical relationship with a group in a non-controlled company, the Board usually would not honor the relationship, particularly if the resulting increases would be inconsistent with the objective of restraint. Nor did it recognize claimed historical relationships to "community rates" established through wage surveys, unless the group in question could identify links with specific groups which might qualify as direct historical relationships.

The historical relationship exception also posed technical problems in relation to the basic protection factor and the experience adjustment factor. The basic protection factor was reduced by 2 per cent in each succeeding program year.

The experience adjustment factor affected historical relationships in situations where one group had been catching up with another before the program. If, for example, group B had been catching up with group A, it would be likely to have a negative EAF, thus lowering its arithmetic guideline. At the same time it could be argued that no historical relationship existed in such a case, since group B had been getting larger or more frequent increases than group A and thus did not meet the historical relationship criterion that "for a period of two or more years prior to October 14, 1975, the level, timing, and rates of increase of compensation of the employees in the groups have borne a demonstrable relationship with each other." If catch-up was involved, the Board generally attempted to reach a compromise which neither maintained the existing historical relationship nor reduced the lower-paid group to its earlier position.

The Industry Contact Divisions of the Compensation Branch, which processed exception claims, were organized to parallel the structure of industry. There were divisions covering heavy industry, manufacturing, finance, construction, and so on. Within each division, case officers were able to acquire background knowledge of the industry for which they were responsible.

The office walls of a typical compensation case officer at the AIB were covered with charts, maps, lists, and other information pertaining to the industry with which the officer was dealing. Board staff were aware that in each industry a series of historical relationships might exist. Familiarity with "industry patterns" was thus essential, since approval of a particular increase or recognition of a historical relationship in an industry could set precedents for the entire industry. Wage patterns were particularly evident in the petroleum, meat-packing, flour-milling, and pulp and paper industries.

THE LOW PAID AND HIGH PAID

The design of the anti-inflation program reflected a concern for persons at the lower end of the income scale. Guidelines for minimum and maximum dollar increases were clearly spelled out. Annual increases of up to \$600 a year or increases of up to \$3.50 per hour (raised to \$3.75 in the second year of the program) were allowed in any event. At the upper end of the scale, no employee group could receive an average increase greater than \$2,400 per year, regardless of its recent compensation history.

Calculation of these amounts raised a number of problems. In the case of the low-paid, the \$3.50/\$600 minimum was originally stated in the Guidelines in terms of overall compensation, including benefits as

well as wages. This was not intended, and when the error was discovered the guideline was amended to express the minimum in terms of wages alone, thus liberalizing the provision.

At the opposite end of the scale, the intention had been to allow higher-paid employees a maximum \$2,400 salary increase provided their benefits had not improved. However, it soon became clear that the reporting mathematics required that “roll-up” or “impact” benefit costs, resulting solely from increases in salary, must be charged against the \$2,400.⁵ As a result, if the benefit package was about 30 per cent of salary, the effective salary maximum could be reduced to about \$1,800. To correct this anomaly, the Board provided employers with a formula for calculating the \$2,400 maximum. Its effect was to eliminate the roll-up costs for purposes of this calculation.

Another anomaly resulted from the fact that the minimum and maximum entitlements were fixed, while the percentage guidelines for employees not affected by these provisions were dropping in each program year. This had the effect of liberalizing the entitlements, in relative terms, as the program progressed.

In practice, the minimum entitlement was claimed infrequently, chiefly because the vast majority of employees did not qualify. For instance, if in the first program year a group had a guideline of 10 per cent, a low-paid member of the group would have to have had a rate of less than \$3.18 to qualify for the \$3.50 minimum since the guideline was to be applied before determining whether the minimum had been reached.

At the upper end of the scale, the limit was occasionally criticized as being too restrictive, causing compression and reducing incentive. Although companies with salary ranges sometimes claimed exclusion of increments for executive groups, the Board took a tough position on such claims, specifying in a technical bulletin (AI-17-C) that such exclusions would not be accepted for executive groups. Some higher-paid groups were paid indirect incentives and thus were able to obtain relief from the \$2,400 maximum by selecting the most favorable base year for calculating the indirect incentive portion of their compensation increase. The Guidelines limiting salary increases were also flexible to the extent that indirect incentive pay could be switched to salary, provided the \$2,400 compensation maximum was not exceeded.

Although from time to time there were media allegations that the Board had allowed violations of the \$2,400 limit, in general the Board was able to establish that this was not the case or, in the rare case where such a violation was uncovered, that appropriate compliance action had been taken.

⁵ For example, the increased costs for paid vacation that would result from an increase in salary rates.

CHAPTER IV

Price Restraint

Introduction

On October 13, 1975, the prime minister announced wide ranging controls on prices and profits, and on October 14, the minister of finance tabled the White Paper "Attack on Inflation." This policy statement required that price and profit controls be applied to companies employing 500 or more persons as well as to construction firms employing 20 or more. Price increases were to be limited to increased costs. Profits were to be tied to the dollar-per-unit achieved in a company's base period or to 95 per cent of its base period margin.

This announcement was followed by eight weeks of meetings between the newly-appointed Anti-Inflation Board, Department of Finance officials, and professional consultants. Guidelines were developed which set out the basic programs for control of prices and profits, dividends, and compensation. The Guidelines were released on December 18, 1975.

This chapter is divided into three parts. The first part describes the development of the initial guidelines and their subsequent revision and adaptation to a changing economic environment. The second part describes the modified guidelines as they were adapted to a number of specific areas including petroleum, financial institutions, professional fees and incomes, and dividends. The third part consists of technical notes on the development and application of the prices and profits guidelines.

Part One: Chronological Review

No area of the Board's activities aroused such intensity and duration of debate as the policies and guidelines for restraint of prices. The debate focused on the effects of price control versus profit control and was tempered by two major concerns. The first was the trade-off between equitable application of the Guidelines and the effectiveness of those guidelines. The second was the potential distortions that controls could generate in the marketplace: gains made during the controls period could be negated after controls were lifted because of supply bottlenecks or the inhibition of investment caused by the controls themselves.

The principle upon which corporate incomes (profits) were to be limited was that increases in prices should be limited to increases in costs.

Although the mechanisms in the initial guidelines—unit cost and net margin rules—were to reflect different circumstances and different kinds of firms, they were designed to yield broadly equivalent behavior.

The net margin rule would limit pre-tax net profit margins (expressed as a percentage of sales on a corporate basis, or on a product-line basis where costs of production could be so allocated) to a percentage of the profit margin obtained in the period immediately before controls. Price increases were to be determined on the basis of increases in allowable costs and only to a level where they did not cause increases in profit margins, appropriately deflated. For example, a firm could increase its prices by a percentage equal to its per cent increase in allowable costs if it did not exceed its allowable profit margin.

The unit cost rule would be available to firms that could allocate costs to individual products. Price increases on these products were to reflect only the cost increases for these products. In effect, the *absolute* profit per unit of product was to be held to the profit that prevailed in the base period. This mechanism of price restraint reflected the principle, stated in the White Paper, that price increases should be limited to cost increases alone.

A margin-depressing characteristic of the unit cost rule was part of the design of the prices and profits program. To make the net margin rule broadly equivalent to the unit cost rule, it was adjusted downward to 95 per cent (the so-called “profit deflator”) of the net margin that prevailed during the base period. The intent of this was to make a firm largely indifferent to which rule it chose to use over the full life of the controls program and, more important, to avoid penalizing a firm for its accounting procedures or ability to operate under a more restraining rule.

The regimes described above were to apply to the non-distribution sector, those business activities which did not sell goods or services directly to the public. The distribution sector was subject to a somewhat different regime, described later in this chapter.

The Initial Guidelines, December 18, 1975

Having agreed upon a restraint program consisting of two separate rules, net margin control and unit cost, the Guidelines were issued and published with the necessary forms for submission to the Board.

The essential feature of profit margin control is that, sensibly applied, it can be a desirable substitute for direct control on individual product prices without producing the economic inefficiencies of direct control. The economic objective is to restrain *average* prices while recognizing the necessity of changes in *relative* prices, reflecting changes in consumer tastes or conditions of supply. Scarcity of a commodity as a result of an enhanced demand or shortage of supply requires increased prices in that commodity to allocate available stocks to the highest bidders and to signal manufacturers to increase production. It would be

difficult if not impossible for price controllers to monitor such relative price changes. Furthermore, such direct price control would require a tremendous increase in bureaucracy. Two major determinants for the kind of program selected were the desire to keep administrative requirements to a minimum and to give as much discretion as possible to the private sector for pricing and self-regulation.

Profit margin controls, then, applied on a direct control basis, were judged sufficient to restrain prices. The main assumption was that inter-company price competition and attendant profit margins in the base period would be duplicated in the controls period. It did not matter that a price leader had a high or low base margin, but rather that he be at or below his base margin in the controls period so that his price leadership would be restrained and imparted to his competitors.¹

Although the unit cost rule was designed to be equivalent to the net margin rule, this was not the case because of the definition of the base period. The base period for the net margin rule was the last five completed fiscal periods prior to October 14, 1975. For the unit cost rule, the base period was the last completed fiscal period prior to October 14, 1975. Thus a choice of rules implied a choice of base periods and a choice of a firm's previous financial performance.

Given a firm's financial performance in the previous five years, this implied choice affected the equity of the program. For example, it would benefit a firm that experienced a sustained increase in profit margins in each year of the five years prior to controls to choose the unit cost rule. This rule would allow such a firm to use its most profitable prior fiscal year for the purposes of controls, as long as its accounting systems were compatible with the rule. If its accounting systems were not compatible, the firm would be required to use the net margin rule which made it necessary for it to limit its profit margin to 95 per cent of the average of its five-year base period net margin. Given the circumstances, 95 per cent of a five-year average could be considerably less than 100 per cent of the last fiscal period. Consequently, the choice of rules could imply a substantial reduction in profit margin, largely stemming from which rule a firm's accounting system would support.

Also, firms were allowed to apply different rules (and hence different base periods) to the various parts of their business, thereby securing overall margins higher than those actually earned in any given year in the base period. (For a full discussion of the base period problem, see technical note three, page 112.) Consequently, what was generally referred to as "broadly equivalent behavior" in the White Paper became a gross inequity as a result of different accounting systems and types of business.

The total costs of supplying goods and services were divided into allowable and non-allowable costs. Non-allowable costs included atypical

¹ This "indirect" price impact did not receive full attention until the fall of 1976. Assessment of the initial rules was based on direct impact only, i.e., number of companies and amounts of excess revenue.

or non-recurring costs, income taxes, dividends, excess over fair market value of goods and services in non-arms-length transactions as defined in the Income Tax Act, excess restricted and other expenses not incurred to produce gross revenue from operations. Allowable costs were the only costs that could justify increases in prices and against which the calculations of "adjusted" operating profits were made.

THE PROFIT TEST

In any given compliance period a firm's gross profits (gross revenue from operations minus cost of sales) were adjusted by subtracting the sum of allowed restricted expenses and other operating costs to establish adjusted operating profits. These adjusted operating profits were either expressed as a percentage of sales (net margin percentage) and compared to the target operating profit rate (target net margin percentage) for the purposes of the net margin rule, or compared on a dollar-for-dollar basis to absolute per-unit profits earned in the base period for the purposes of the unit cost rule.

Compliance with the Guidelines was measured by using the test for excess revenue. Excess revenue was often incorrectly perceived as being equivalent to excess profits, however the latter may be defined. Excess revenue was simply the amount by which the adjusted operating profits in a compliance period (initially that portion of a firm's fiscal year that included October 14, 1975, and each subsequent complete fiscal year) exceeded the target operating profits allowed under the program.²

It can readily be seen that one can calculate the allowable profit by multiplying the allowable costs by the target net margin factor ($AC \times TNMF = 990 \times 0.1050 = 103.95$). In effect, the permitted profit margin was a mark-on of allowable costs, and price increases would have to reflect only allowable cost increases so as not to exceed the allowable or

² A simple numerical example can perhaps best illustrate this relationship for the net margin rule. Assume a constant volume of output in the base and compliance periods and a 10 per cent increase in allowable costs in the compliance period.

Let:

| | |
|-------------------------------------|---------------------------------|
| GRO = gross revenue from operations | NM = net margin |
| AC = allowable costs | TNM = target net margin |
| AOP = adjusted operating profits | TNMF = target net margin factor |

Where

$$NM (\%) = \frac{AOP \times 100\%}{GRO}$$

$$TNM (\%) = 95\% \text{ of } NM$$

$$TNMF = \frac{TNM (\%)}{100\% - TNM (\%)}$$

| | <i>Base Period</i> | <i>Compliance Period</i> |
|----------|--------------------|--------------------------|
| GRO (\$) | 1000.00 | 1093.95 |
| AC (\$) | 900.00 | 990.00 |
| AOP (\$) | 100.00 | 103.95 |
| NM (%) | 10 | 9.5 |
| TNM (%) | 9.5 | 9.5 |
| TNMF | .1050 | — |

target profit margins. The common denominator of the price and profit guidelines was therefore allowable costs.

The basic test for compliance with the Guidelines was the determination of excess revenue, i.e., the excess of actual over allowable profit margins. However, day-to-day prices were to be determined on the basis of changes in allowable costs. The dual nature of the annual profit margin test and the pricing rules were designed to facilitate self-assessment of compliance by firms subject to the Guidelines. By limiting price increases to cost increases, profit margins were to be kept at the levels that prevailed in the base period.

Consequently, measurement of the "direct" impact of the program using the number of compliance firms, the dollar amount of excess revenue, and the number and extent of price rollbacks would greatly underestimate the degree of price restraint in the economy. The total amount of restraint could not be estimated with any degree of precision.

DETERMINATION OF EXCESS REVENUE

The basic test for compliance with the Guidelines, as noted earlier, was the determination of excess revenue, which followed an intermediate calculation of "apparent" excess revenue. Certain deductions from apparent excess revenue, contained in section 9 of the Guidelines, were allowed in the calculation of excess revenue. Despite its brevity, section 9 proved to be one of the most troublesome parts of the Guidelines. It provided for four kinds of deductions from apparent excess revenue: (a) a transaction that occurred before October 15, 1975; (b) unusual productivity gains resulting from the activities of a supplier; (c) favorable cost developments that could not reasonably have been foreseen by the supplier; or (d) the continuation of an increase in the adjusted operating profit per unit of that part of his business to which section 16 (unit cost rule) applies that had occurred before October 14, 1975.

Parts (a) and (c) of section 9 generally did not present too many problems. On the other hand, it was particularly difficult to formulate a policy for administration of parts (b) and (d). No satisfactory definition of "unusual productivity gains" was ever established. The basis for such claims as deductions from apparent excess revenue was eventually linked to the investment credit announced by the minister of finance as part of the revised guidelines on September 7, 1976. Prior to these guidelines, a very limited number of claims were approved by the Board as being both material and related to the efforts of the firm.

For those on the unit cost rule, the "continuation" of unit profit as a deduction from apparent excess revenue became, in effect, an alternate base period. Though technically incorrect, the use of this deduction was so widespread that the Board came to the practical conclusion that it was the effective base period against which all subsequent compliance period unit profits would be compared.

A technical bulletin (AI-4-P) issued on January 29, 1976, attempted to restrict the use of the unit cost rule by tightening the definition of

“product.” The problems of monitoring compliance with this rule were twofold. First, the staff had limited capacity to monitor a large number of individual products.³

Second, the nature of the unit cost rule was such that the volume or output measures required identical products in each single application of the rule. There was a suspicion that firms were lumping products that were not really similar in a single application of the rule. However, the bulletin had only a limited effect in displacing firms from the unit cost rule. In effect it exacerbated the problem by generating more products to meet the definition in the bulletin. This simply reinforced the disposition among senior staff to remove the rule from the Guidelines.

PRICING GUIDELINES

The interim pricing guidelines were a mechanism by which firms could increase prices because of increased costs yet not incur excess revenue at the end of their fiscal year. The objective of these rules was simply to guard against the possibility of a firm generating excess revenue solely through pricing actions taken during the compliance year. The rules allowed for a straight cost pass-through in the case of business activities governed by the unit cost rule, and for a percentage increase in prices for a given increase in costs for the net margin rule. The rules also made the Guidelines redundant to the extent that firms had to govern themselves by two sets of rules, one referring to a formal end-of-fiscal-year test using audited financial statements to look for excess revenue, and another which governed day-to-day price movement based on emerging cost developments.

Furthermore, it was noted at the outset that indiscriminate application of the interim pricing rules could in some instances yield widely varying results from the profit rules. This anomaly was the subject of one of the first technical bulletins (AI-3-P, January 29, 1976).

The bulletin outlined the Board’s view of the profit margin test (the determination of excess revenue) and the interim price measurement test. The profit margin test would be the primary determinant in the Board’s assessment of a firm’s compliance with the Guidelines to the extent that a formal annual test could be reconciled with a firm’s audited financial statements. The interim price measurement test was a secondary factor directed towards helping a firm assess the acceptability of a price change without waiting for the end of a compliance period. Also, the Board would be less rigid in applying the pricing test because it was subject to the vagaries of estimation and forecasting. However, firms were warned that if they priced in a manner different from the interim pricing guidelines, their claim to favorable cost developments as a relieving device would be restricted should excess revenue develop.

³ It was not unusual to receive reports covering several thousand individual products for part of one firm’s business.

In effect, the bulletin recognized the possible anomalies between the profits test and the prices test and established the primacy of the excess revenue test in determining compliance with the profit margin guidelines.

DISTRIBUTION GUIDELINES

Companies in the distribution sector (broadly, wholesale and retail trade) were initially subject to special profit guidelines. There were two profit rules based on the concepts of gross margin, net profit, cost of goods sold, and "other allowable costs" (i.e., allowable costs other than cost of goods sold). The general rule allowed a company to earn 100 per cent of its base period net profit margin percentage. If its "other allowable costs" were increasing at a faster rate than its cost of goods sold, however, the company was restricted to earning 100 per cent of its base period *gross* margin percentage, minus its current other allowable costs. This alternative calculation included a minimum target net profit, equal to the company's absolute dollar net profit in the base period. The base period for distributors was the last completed fiscal year before October 14, 1975.

The distribution industry found these initial guidelines very restrictive in several ways. The one-year base period (generally 1974) was found to be unusually low for a number of large firms. The initial guidelines contained no low-base relief, and the second profit rule mentioned above restricted some firms to their 1974 dollar profit levels, even where their volume of business had increased dramatically.

Some of the inequities of the initial guidelines were resolved by the Board on an administrative basis through the low-base relief policy which, depending on the circumstances, permitted the use of a five-year base period, allowance of an 8 per cent return before tax on equity, or the allowance of a return on sales equal to one-half the average return realized by companies in the same general business.

To firms engaged in retail trade, the language and implied methods of accounting noted in the initial guidelines were another concern. An example of this was the notion of product-line reporting, which would prove particularly difficult to apply. To resolve this, the definition of product line in the distribution sector was allowed to be a product group or division of a company for which accounting practice allowed calculation of gross profit margins.

Another concern was the 10 per cent mark-on rule, an interim pricing rule which would have been difficult to administer. From the Board's point of view the 10 per cent mark-on rule would have provided virtually no control on prices, especially when a movement of one or two percentage points was considered significant. As a result, the rule was informally disregarded and attention focused on interim movements of gross margins.

The revised guidelines announced in September, 1976, were much more acceptable to the distribution industry in that they provided the

choice of base periods (one-year or five-year), a low-base relief of 8 per cent return on equity, and a profit rule allowing a company to earn 95 per cent of its base period net margin percentage. The alternative profit rule based on gross margins was dropped, as was the interim pricing rule mentioned in the preceding paragraph.

The pricing rule in the revised guidelines simply required a company to control its prices so that it would not exceed its target net margin percentage. Since there was no pricing rule equivalent to 95(1)(c) used for non-distributor companies, no attempt was made to control the pricing of individual products.

When the revised guidelines were implemented, with a profit rule based on net margin and a choice of base periods, most firms found themselves unrestricted by the program during 1977; market forces had already forced them well below the permitted profit levels. Indeed, a considerable recovery would have been possible during 1978 before the controls program would have had any impact.

EXEMPTIONS

As a general rule, all firms were expected to limit price increases on individual products to once every three months, except on products subject to volatile price movements, such as international commodities, where such limitation would impose a severe hardship. The distribution sector was exempt from this rule for much the same reason.

Prices received by farmers and fishermen for their products were exempted from the Guidelines. Similar exemption was later given to trappers and fur farmers. Also exempted were the rental income of real property, the operations of a supplier located outside the country, exports, and certain operations of the petroleum industry. Exports and the petroleum industry are described in some detail in later sections of this chapter.

PRICE PRENOTIFICATION

The price prenotification system went through a number of phases in the Board's first year.

Initially the firms subject to a 30-day prenotification of planned price increases were selected on an ad hoc basis. Generally they were required to prenotify price increases only on specified parts of their business important to restraining prices or on products with high consumer visibility. In general, firms were to notify the Board of any price changes that would increase projected domestic annual sales revenue for any product line by more than 2 per cent, or for any individual product by 8 per cent or more. Food processors and firms in the distribution sector were excluded.

Early in November of 1975, the Board contacted 178 large companies requesting information on their sales, pricing policies, and proce-

dures to help in the development of detailed regulations. From this group 117 firms were selected for prenotification.

An important feature of the prenotification system was that the Board intervened only where the increases did not meet the appropriate tests. Should subsequent information (from quarterly or annual reports to the Board) prove the interim justification of the price increase unfounded, appropriate action could be taken after the end of the fiscal year to restore compliance.

By spring of 1976, a review of the prenotification system was completed. It was noted that despite some administrative problems the system was valuable. It provided the Board with detailed and timely information on price increases, adding to its overall knowledge of price developments in the economy. It was also an important element in the overall restraint program.

In June, 1976, the original list of 117 firms, representing more than \$28 billion in annual sales, was increased to 274 firms representing approximately \$52 billion in annual sales, to better represent the industrial sectors and where possible to have the four or five largest firms of a sector prenotify. In effect, the original criteria of consumer visibility and strategic value were expanded to include size of firms and market share. The decision to extend the prenotification population had been announced in the May 25 budget. As well, for technical reasons, between May 25 and June 9 a number of firms producing copper and certain other refined metals were put on a seven-day prenotification list, as opposed to 30 days for other firms.

In February, 1977, the prenotification population was again expanded to some 300 firms and a number of amendments were announced to the thresholds for prenotification. Suppliers were now required to notify the Board of price increases that yielded a 1.5 per cent or more gross revenue improvement within a compliance quarter, as opposed to the earlier 2 per cent. This 1.5 per cent was more consistent with the guideline targets in the second program year. Further, a firm could increase prices in a product line more frequently than every 90 days provided no individual product price was increased more than once in this period. Where the second price increase exceeded the 1.5 per cent threshold, the firm was required to prenotify the Board. Firms were also advised that a substantial price increase was any individual price increase greater than 6 per cent and that the Board would have to be notified of such an increase before it took effect.

Up to this time, food companies had been excluded from prenotification. However, in light of their high public visibility and expectations for higher food prices later in the year, it was recommended that 44 food companies be required to prenotify price increases in selected areas. The recommendation was approved by the Board and made public in June.

The price prenotification system evolved into a fairly comprehensive monitoring and compliance tool. Its success led many to advocate more direct forms of price control and enlivened the debate on the relative

merits of price versus profit control. In any event, its usefulness as a medium for consultation and negotiation to restrain planned price increases, although difficult to measure, could not be disputed.

COMPLIANCE PLANS

A firm which had excess revenue was required to dispose of it in a specified period in a manner acceptable to the Board. This was to be presented as a plan, to be reviewed by the Board.

Excess revenue did not in itself constitute evidence of a direct contravention of the Guidelines. A firm could generate excess revenue by way of non-pricing actions or from actions external to the firm, such as favorable costs for imported raw materials. Two of these situations were recognized in the initial guidelines, specifically, unusual productivity gains and increases in adjusted operating profits resulting from favorable cost developments that could not have been foreseen. The general principle for disposition of excess revenue was that, wherever possible, it was to be returned to its source through price reductions.

The general principles for compliance plans were that all excess revenue attributable to the first compliance period should be eliminated in the first two full fiscal quarters following and that a firm's target operating profit would be adjusted downward by the amount of the excess revenue in the following compliance year. (This latter principle was stated in technical bulletin AI-28-P, November 5, 1976.)

Firms with excess revenue were also to begin quarterly reporting, if they were not already required to do so, until the excess revenue was fully dissipated. These firms could be placed on the prenotification list so that the Board could more closely monitor their pricing actions during the period of their compliance plan.

In October, 1976, the Board issued a technical bulletin on compliance plans (AI-28-P, November 5, 1976) indicating a less benign attitude towards generation of excess revenue and its disposition. Firms were no longer to assume that the Board would accept a compliance plan. The Board reserved the right to refer cases to the Administrator or make recommendations to the firm.

A compliance plan was to be allowed only where a firm could demonstrate that it attempted to observe the pricing guidelines throughout the compliance period. In the same bulletin the Board announced the general policy of not reviewing prenotification of price increases before receiving a quarterly report confirming the elimination of all excess revenue.

It was recognized that pricing actions required for dissipation of excess revenue should be directed wherever possible to the consumer.⁴ Little would be gained by shifting profits from one sector to another without any discernible effect on consumer prices.

⁴ By spring 1977 more stringent pricing policy (specifically section 95(1)(c)) was developed.

In spring 1977 the Board reviewed the question of public disclosure of excess revenue cases and related compliance plans. The stringent confidentiality provisions of the Act prevented the Board from demonstrating the way that both businesses and wage earners were being restrained. In the early days of the Board, disclosure of excess revenue cases largely amounted to brief statistical summaries of the number of firms and the dollar amounts of excess revenue involved. This reflected the fact that most excess revenue situations in the first compliance period were beyond the control of the firms involved, and disclosure would not enhance support for the program.

By the time the results of the second compliance period were available, the Board felt that in excess revenue cases the name of the company and the amount of excess revenue should be published, as well as the products for which the excess revenue was generated and the actions taken to dispose of it. This new approach would allow for exceptions if a firm could demonstrate hardship as a result of such disclosure. It was suggested that disclosure be an additional condition of an acceptable compliance plan. This approach was not accepted, largely because it went beyond the authority of the Board, but it illustrates the importance given to higher visibility for the prices and profits side of the anti-inflation program.

The Draft Guidelines (Issued June 11, 1976)

The highlights of the initial guidelines given above will serve as an introduction to proposals for new guidelines announced in the budget of May 25, 1976, and, following the reaction of the business community to the draft guidelines, the revised guidelines announced by the minister of finance on September 7, 1976. The proposals for new guidelines stemmed from problems inherent in the initial guidelines and evidence that they were not very "restraining."

By early May, 1976, a number of papers summarizing proposed amendments were reviewed by the Board for presentation to the minister of finance. Proposed amendments included two broad changes in the Guidelines: (a) a movement towards a single reporting rule, and (b) a combination of administrative devices that would permit more rigid administration of the program.

There was a general feeling that a price restraint regime had to balance a relatively tight wage control regime. There was strong feeling in the Board, however, that consultations with the business community were necessary before promulgation of the draft proposals, reflecting a general unease with the draft guidelines.

The main characteristic of these new guidelines, outlined in the May 25 budget speech and detailed on July 11, was their complexity. The chairman's letter accompanying the June, 1976, draft guidelines invited briefs to be submitted before the new guidelines were put into effect.

More than 500 briefs were submitted. The request also elicited comment on the price and profit guidelines in general from firms that had been relatively silent on this issue.

The major proposal was to eliminate the troublesome dichotomy of the net margin rule and the unit cost rule and replace it with an overall net margin rule that would apply to all firms. The base period problem was to be alleviated by allowing a choice of the higher of a firm's weighted profit margin for the five fiscal years ending before October 14, 1975, or the margin earned in the fiscal year ending before May 1, 1976 (which for most firms would be calendar year 1975). Consequently, the problems of rule selection and base period selection were to be overcome through testing compliance at the firm level.⁵ It was also proposed that the net margin rule be applied at the product-line level as well. Further, it was felt that as actual excess revenue would be the greater of the sum of excess revenue as measured by the product-line margin test and the excess revenue determined by the overall margin test, the overall test would tend to reduce the number of product lines that firms would otherwise report on. The overall test would also provide a standard for automatically assessing a firm for low-base relief. This dual application of the profit margin test was referred to by staff as the "double cap." It was predicated on the view that allowable price increases must be tied to allowable and related cost increases and the product line was the best vehicle to monitor these price changes. An associated consideration was that the rule would preclude unnatural groupings of products into product lines to secure higher target margins.

Proposals for firms involved in distribution activities were similar though much less extensive. They would continue to meet a net margin test for the whole of their business as was required under the initial guidelines. They would be allowed the same choice of base period as other firms but only 95 per cent of the base period net margins rather than the 100 per cent base margins allowed under the initial guidelines. Further, the gross margin test (100 per cent of base year margins) would be applied at a product-line level rather than at the overall level.

Further deductions from apparent excess revenue were outlined for firms with unacceptably low base periods. For firms involved in non-distribution activities, deductions were to be allowed for the observance of specified pricing and productivity rules. In the area of restricted expenses, the proposed changes called for deletion of charitable donations and expenditures for research and development, and the addition of political contributions. Other proposed changes are discussed later in this chapter.

It was originally intended that these changes would become effective in July and would include transitional rules covering actions before May 26, 1976. An evaluation of the briefs suggested that the original criticisms of the program—disincentive to efficiency and new investment—

⁵ For a more detailed discussion of the base period problem, see technical note three, page 112.

persisted with the draft guidelines. These issues were specifically addressed in the draft guidelines. Their complexity, however, particularly the proposed pricing and productivity credits, seemed to preclude a majority of firms from taking advantage of them, and for those who could meet the reporting requirements, they appeared to be somewhat less than generous.

The reduction in the net margin deflator from 95 to 85 per cent was seen as unduly punitive. Much of the comment focused on the fact that, because of the choice of base period, firms would experience significant reductions in their target operating profits.⁶

General comment that the draft guidelines were unfair stemmed from the retroactive nature of these guidelines, the inadequacy of the transitional rules, and the persistent cost and complexity of complying with the program. In addition, elimination of carrying losses forward to be offset in later fiscal periods against profits before calculating allowable profits was felt to be unfair since the cyclical nature of a firm's revenue did not necessarily relate to its fiscal period.

The principal complaint with the proposed low-base relief was that the 8 per cent figure was low compared with the average rate of return for Canadian industry, or with the cost of borrowing funds. A number of briefs suggested that relief should be provided by product line. (This was implemented after the revised guidelines of September 7, 1976, came into force.)

The double test was seen as an additional and unnecessary restraint which only added to the administrative cost of reporting. It could be inequitable between firms of different size or organization and, as it made no provision for changes in product mix or improvement of unprofitable products, it could be a disincentive to efficiency. The interim pricing rules were held to be somewhat rigid, and susceptible to the dangers of the discretionary powers of the Board.

In summary, the briefs submitted were strongly negative. Criticism went beyond the draft guidelines, reflecting apprehension of the government's ever ending controls and pessimistic views on investment in general. Antagonism to the program was developing.

Staff review of the submissions, and proposals to respond to issues raised by business, were completed in late July. The two major considerations behind the proposals were the need for co-operation from the business community because of the voluntary nature of the program, and the need for more effective and equitable restraint. It was important not to compromise the basic objectives of the program to restrain inflation and at the same time recognize the concerns of business. Public perception of the program was a further consideration. Any "relieving" changes would be seen by others subject to the program as a result of business pressure.

⁶ In effect, the loss of 1974 as a base period for those who were on the unit cost rule.

Both the Board and the business community were concerned with the increasing complexity of the guidelines and the fact that a net margin regime by itself was a disincentive to efficiency. Because of this concern, the Board spent a great deal of time considering proposals that were advanced to give consideration to improved economic performance.

Changes in the guidelines were suggested that would allow firms to retain the additional profits when volume increases and declines in fixed costs per unit of output occurred. In these proposals firms would have been permitted to retain the benefits of any productivity gains.

Despite the importance of this objective, it was not possible to develop guidelines that would be equitable to all firms because of the complexity of such guidelines and the inability of many firms to satisfy the information requirements. It was recognized that there might be a number of issues which could not be corrected within the lifetime of the program.

By the end of August a comprehensive set of proposals were ready, with the exception of the interim pricing rules which were more difficult to establish. Meaning had to be given to the phrases "unduly" and "substantially inconsistent," referring to absolute increases in prices and price increases relative to cost increases.

While consensus was not achieved on the June draft guidelines, the consultation leading to revised guidelines reduced antagonism to the program, reduced the complexity of the guidelines, and brought about a positive response to the uncertain investment climate. This was not achieved without a lessening of restraint from the draft guidelines, however.

The Revised Guidelines (Issued September 7, 1976)

On September 7, 1976, the minister of finance issued a statement on the anti-inflation program and announced the revised guidelines.

While the revised guidelines reaffirmed the two objectives of more equitable and more effective restraint on prices and profits, they represented a considerable simplification from both the initial guidelines and the draft guidelines and more explicit incentives for investment.

The new guidelines were not to take effect until the beginning of the third compliance period, which for a majority of firms would be January 1, 1977. This minimized transitional problems by allowing firms time to arrange their affairs under the revised guidelines.⁷

The main feature of the revised guidelines was a single net margin test for both distribution and non-distribution suppliers. Firms also had the choice of the better of two fiscal periods for their base period: the five fiscal years completed prior to October 14, 1975, or the most recent fiscal

⁷ This was not the case for a firm with excess revenue under the initial guidelines. Monitoring of the dissipation of this excess revenue was required according to an accepted compliance plan in the third period.

year ended prior to May 1, 1976. The advantages of these two features were offset by lowering the deflator on non-distribution activities from 95 to 85 per cent of base period net margins. The deflator for distribution activities was similarly reduced from 100 to 95 per cent of base period net margins.

All firms were allowed to earn a minimum of 8 per cent before tax on their equity as relief from low or falling margins in their compliance periods.

The profit margin test at the product line, or "double cap," was eliminated with the caveat that individual product prices should bear a "reasonable relationship to the costs of producing them." The Board would continue to have the power to request reductions in price increases "where they are clearly disproportionate to the increases in related costs." These two phrases underlined the difficulties of drafting workable guidelines for interim pricing and again became the focal point of debate on the relative merits of price versus profit controls. The problem can be simply stated as the *degree* to which the Board should look at individual prices and the *extent* to which a firm should be allowed to offset cost increases in one part of the business with price increases in another part.

The dilemma, then, was for the government to approve revised guidelines allowing the Board to respond flexibly and act on unjustified price increases, and at the same time not appear to reintroduce the much-disputed "double cap." The Board was able to prevail and thus retain the product-line reporting requirements essential to its operation.

A second major change in the draft guidelines was the introduction of the investment credit, applicable only to those in the non-distribution sector. The nature of this credit permitted firms to use it as a credit against apparent excess revenue up to 10 per cent of allowable profit margins. The result was to raise the margin deflator to a maximum of 93.5 per cent ($93.5 = 85\% + (10\% \times 85\%)$) of base period profit margins.

The investment credit was a response to criticisms from the business community regarding the disincentives arising from the net margin regime. It also provided a way to treat the problem of "unusual productivity gains resulting from the activities of suppliers."

The investment credit, then, was a fairly simple device for meeting the criticism of the initial and draft guidelines. The effect of the calculated investment credit was reflected in the amount by which a supplier's target operating profit could be raised and was the least of (a) the supplier's qualified investments in the relevant compliance period, (b) the increase in a supplier's target operating profits from his non-distribution activities resulting from a 10 per cent increase in his target net margin percentage, and (c) that portion of a supplier's excess revenue derived from his non-distribution activities. The credit was to apply to qualified investments made after August 31, 1976, and to compliance periods beginning after October 14, 1976.

The minister's September 7 statement also made reference to investments made prior to or during the program, specifically to investments

which resulted in a “firm’s compliance period operations” being “fundamentally different from those carried on by it during its base period.”

Directions for handling these “investment exemptions” was provided by an internal policy memorandum in late December, 1976 (no. 20-R).⁸ The same memorandum provided direction for the treatment of “unusual productivity gains” in the initial guidelines. The device used to measure a deduction from apparent excess revenue for unusual productivity included significant investment in fixed assets and cost saving directly attributable to that investment, each of which had to meet prescribed levels. The investment approach was increasingly used as a means to get around the difficulty of measuring productivity directly. While the minister’s statement suggested that the Board would continue to respond to such cases “by assigning to such a firm a new and more appropriate late base period,” this did not happen. The practice of more appropriate base periods was used only to deal with “atypical” base period problems in the early months of the Board.

ATYPICAL BASE PERIODS

Another exception noted in the minister’s statement had to do with application of base periods that were not typical of a firm’s operating results before the introduction of the program. Where the use of these base periods “would seriously harm the firm,” the Board would agree “to an alternate base period which is more representative of the firm’s own historical experience.”

The problem confronting the Board was how to deal with firms having a rising margin under the net margin regime that had not raised their prices since October, 1975. These firms would be subject to excessive restraint in that they would have to lower prices to be technically in compliance. This action could have serious economic effects not only on the firm itself but also on its competitors. The internal policy memoranda that dealt with the problem (nos. 23-R and 45) were not in effect very long largely because they did not look beyond the first compliance period. They were replaced in July, 1977, by a single memorandum on atypical bases (no. 49) which was made public, the sole exception to the general policy of distributing these memoranda within the Board only.

Two kinds of relief from excess revenue were available to firms that could satisfy the Board that their base periods were atypical and that their use would cause serious hardship. The first and most prevalent kind of relief was for the *maintenance* of prices (actual, average, or weighted average selling prices affected by the atypical base period) at the levels of

⁸ Beginning in April, 1976, internal policy memoranda were issued to staff of the Prices and Profits Branch as supplements to technical bulletins for difficult portions of the Guidelines.

October, 1975, for the first three quarters of the succeeding compliance period. Such price maintenance would be deemed a compliance plan to justify non-intervention by the Board.

A second form of relief was available to those who would *reduce* the average selling prices to October, 1975, levels and maintain them at those levels for the following 12 months. Again, such pricing action would be considered a compliance plan. This kind of relief focused on pricing action as the means to achieve compliance. It was available to firms whose actual target net margin percentage was at least 25 per cent lower than that which would result if a 10-year base were used. This was a form of low-base relief that could prove more beneficial to a firm than the general relieving provision of 8 per cent return on equity.

Although these two kinds of relief were called atypical base relief, they more correctly reflected the dilemma of the rising margin firm which had maintained, or could maintain, prices at levels immediately prior to the introduction of the program. The objective of the Guidelines was to restrain prices through a profit margin limitation approach. The designers of the program recognized that the rising margin firm could be called upon to cut prices by reason of the presence of excess revenue in the controls period.

A further provision for a 10-year base period was the sole instance where the Board made allowance for a base period other than what was required by the Guidelines. This reflected a limited number of situations where a firm's profit margin had been declining over the whole of a five-year base period, and where potential recovery would have been precluded by strict adherence to the Guidelines. The Board qualified this situation with the introduction of the hardship criterion as a means to afford a relieving provision, yet still consistent with the basic program objectives. This provision was added to the atypical base provisions.

In summary, this section and the previous three dealing with problems in the initial guidelines, the draft guidelines, and the revised guidelines characterize the final stage in their evolution. The revised guidelines responded to the submissions of the business community in that they were markedly less complex than the May proposals and provided a widely available investment credit, although at a cost of some loss of overall restraint.

STRENGTHENING THE PRICING RULES

Until revised guidelines were proposed in the May budget, there was little serious discussion of the pricing guidelines. Although additional subsections were added to the pricing guidelines, as far as the business community was concerned they were overshadowed by the more stringent profit margin guidelines and low-base relief. The more contentious subsections of the pricing guidelines referred to the prices of individual products within a product line which were not to be increased "unduly"

and “to an extent that is inconsistent with the restraint of inflation in Canada.”

The underlying principle was that, on moving to a uniform application of a profit margin regime on a product-line or total business basis, firms would be expected to price individual products in relation to associated costs. In other words, offsets were generally not to be allowed. The practice of raising prices in a product line on the basis of increased costs in an unrelated product line was to be discouraged.

When it became evident that the “double cap” on profits would likely be dropped, it also became apparent that the pricing rules would have to be strengthened. The problem now became one of applying amended pricing rules at the product-line level—a more natural and logical basis where price adjustments should take place—without appearing to be reintroducing the second profit margin test of the “double cap.”

The strengthened pricing guidelines appeared in Section 95, particularly 95(1)(c), which required firms to control prices in such a manner that “the price of any product or group of products supplied by the supplier during the compliance period does not increase in a way that is substantially inconsistent with increases during the compliance period of costs associated with that product or group of products.” “Substantially inconsistent” was not clearly defined in the technical bulletin on pricing guidelines (AI-20-P, November 5, 1976). An internal policy memorandum on pricing (no. 11), however, stated that where forecast revenues and costs for a given product line in a compliance period would yield an increase in the percentage net margin of 25 per cent or less of that attained in the prior compliance period, and would not result in a margin exceeding the better of its margins in the two base periods, the relevant price increase would be regarded as complying with the pricing guidelines.

In effect, this rule would put a limit on the *rate* at which the firm could return to its target for a given product line by reference to levels attained in the prior compliance period. Further, even if the margin improved by more than 25 per cent but was less than 85 per cent of that product line’s base period margin, the product-line pricing was judged to be in compliance with paragraph 95(1)(c). Where the forecast margin was greater than 100 per cent of the better base period net margin, regardless of whether it represented more or less than 25 per cent improvement over the prior period, the case was automatically referred to the Senior Case Review Committee in the branch.

This memorandum illustrates the difficulty of defining the Board’s discretionary power to intervene “in cases where price increases are clearly disproportionate to increases in associated costs,” referred to in the minister’s statement of September 7, 1976. The need for these discretionary powers was largely pre-empted, however, by the slackening of the economy in the second half of the year. Profit margins were also slipping relative to the allowable or target margins imposed by the program. By early spring 1977, prices had begun to rise again, the

depreciation of the dollar was under way and, given the difference between actual and allowable profit margins evidenced by third quarter 1976 reports, concern was growing as to how these adverse developments might be held in check.

A number of proposals were considered in the branch for a more stringent and comprehensive application of the pricing guidelines, using the general provisions of paragraph 95(1)(c). By early June an approach was agreed upon and articulated in an internal policy memorandum (no. 11-R). All firms on the prenotification list were advised by letter of the highlights of the Board's approach. The substance of it was that a proposed price increase had to meet at least one of three screening thresholds in order to satisfy the Board: product-line margin, cost pass-through, and return on equity. The first two required comparison with the prior compliance period; the third referred to the low-base relief provisions of the regulations. The product-line margin threshold required price increases that would generally result in a 15 per cent or less margin improvement over the previous year. Where the firm's overall profit margin was less than 80 per cent of its target or allowable margin percentage, the product-line margin improvement was to be limited to 25 per cent over the previous year.

The cost pass-through threshold limited price increases to 115 per cent of cost increases in a product line. (Cost increases were measured by comparing total costs in a current compliance period to those in the previous period. Price increases were measured in terms of their total annualized impact on product-line revenue.)

EXPORT SALES

The debate over a proposed export levy centered on two issues.⁹ The first was the desirability of limiting export profits since the program was directed to the domestic economy. It was considered necessary to convince labor and firms subject to control that firms which sold mainly in export markets would not have an unfair advantage by being able to sell at international prices.

The second and more difficult issue was the problem of a two-price system resulting from domestic controls. Should the price differential between domestic and international sales increase, diversion of supplies from the domestic to the international market could become a serious problem. It was in the national interest not to restrain export prices, but at the same time it was necessary to restrain the incomes of exporting firms as a contribution to a national program of restraint.

The White Paper outlined an approach that could result in a two-price system but provided an exception. Where a firm could demonstrate that following a two-price system would be impractical or would

⁹ Tabled in the House of Commons by the minister of finance on December 18, 1975.

harm the national interest, it would be subject to a special levy on all its profits.

The export levy outlined on December 18, 1975, stated that it would be applied only to the export business of firms subject to the Guidelines. The threshold for its application was the lesser of 10 per cent of total sales or \$5 million in the last full fiscal year ending before October 14, 1975. The levy on export sales would be the full amount of the excess of the actual revenue over the target amount determined by the rules of the domestic program. The decision to apply the levy would be made by the Board. Such decisions would not be referred to the Administrator nor subject to appeal, but would be subject to review by cabinet.

The amounts collected under the proposed levy were to be directed towards national goals. Specifically, 90 per cent of the levy would be refundable on a dollar-for-dollar basis for a firm's investment in approved projects. Qualifying investments were to be approved within five years of the end of controls, and made between the beginning of controls and 10 years after their end. Further, 75 per cent of the levy would be refundable at a prescribed date not earlier than three years after the end of controls nor later than 10 years thereafter.

Interested parties were invited to comment upon the proposal, and it was the subject of extensive discussion with provincial finance ministers on February 2, 1976.

The proposal was not well received by most of the provinces, chiefly on the grounds that it would add uncertainty to investment decisions in spite of the investment incentive in the refundable portion of the levy. Consequently, the levy as proposed was dropped by the minister of finance in February, 1976. However, the Board was charged with the responsibility of monitoring the profits of exporting firms, the reinvestment of excess export revenues, and possible diversion of these revenues to export markets at the expense of domestic supply.

All firms were required to submit aggregate data on export revenues, costs, and profits in their regular reports to the Board. This data was used to monitor the movement of export profit margins in the compliance periods relative to the pre-controls period. With the revised guidelines of September, 1976, additional information on investment programs was also required.

The Board was not responsible for ensuring domestic supply of products. This function had already been assigned to the National Energy Board for energy-related goods and to the minister of Industry, Trade, and Commerce (under the Export and Import Permits Act) for nearly all other products. Liaison with these two organizations was the primary means used by the Board to monitor any diversion of domestic supply.

An additional incentive to maintaining domestic supplies was provided in the Guidelines. All the adjusted operating profits attributable to the portion of a firm's export sales diverted from the domestic market were to be included as excess revenue.

Part Two: Special Areas

In a number of areas in the program, the nature of the business activity to be controlled required a distinct set of guidelines (chartered banks, financial intermediaries, professional fees and incomes, and dividends) or a modification of the part 1 initial guidelines (petroleum, construction, regulated industries, the public sector, and the distribution sector).

For each area, the general principle of limiting price increases to net increases in costs was followed; the form of the guidelines reflected the business activity involved. These industries are briefly described below.

Regulated Industries and the Public Sector

Regulated industries were those companies that, in accordance with section 4.1 of the Anti-Inflation Act, were regulated as to prices or profits by federal or provincial regulatory bodies such as the Canadian Transport Commission. The public sector was made up of federal, provincial, and municipal governments, including their respective Crown-owned corporations. The federal-provincial agreements (under sections 4(3) and 4(4) of the Act) excluded the Board from jurisdiction over provincial public sector prices. The only public sector prices to fall under direct Board jurisdiction were the 12 "commercial" federal Crown agencies specified in order-in-council 1976-176, along with provincial organizations specified in federal-provincial agreements. The Board's role, therefore, was to provide advice and consultation on an informal basis to federal or provincial officials, at their request.

Application of the Guidelines was the responsibility of ministers in areas of federal public sector pricing. To the extent possible, the cost pass-through approach was to be used and absolute subsidy levels were to be maintained. In light of an earlier decision by the federal government to implement a "user pay" policy in public sector pricing beginning in October, 1975, it was clear that a conflict with the spirit and intent of the anti-inflation program would develop. The Board's preference for deferring all highly visible pricing decisions that would realize only incremental revenues seemed a reasonable compromise. The Board began to request price prenotification from federal government departments and some input in decisions on federal public sector pricing.

The situation was often difficult for the Board. It received the brunt of the complaints about public sector pricing (over 20 per cent of the total non-food complaints to the end of September, 1976) yet was powerless to respond directly to these public concerns.

The situation was reviewed in March, 1977, in the light of continued and highly visible public sector price increases and unfavorable public reaction to the program. The decision was made to try to formalize the procedures for ministers seeking Board advice on public sector price increases under consideration by Treasury Board.

However the Anti-Inflation Board felt about its ability to implement its program, the government's decision to exclude the Board from jurisdiction over the prices of departmental and many Crown agency services was to prevail.

Petroleum

In the fall of 1973, the federal government undertook to shelter Canadians from rapidly rising international crude oil prices. Since that time it has controlled domestic petroleum product prices in one way or another.¹⁰ Formal price controls ended on December 31, 1978, when the Anti-Inflation Act was allowed to expire, although the power to monitor petroleum prices and to require voluntary price restraint is still vested in the Petroleum Administration Act which as of May, 1979, had not been rescinded.

¹⁰ *Salient Features of the Federal Government's Petroleum Product Pricing Programs*

September 4, 1973. The prime minister, in an address to the House of Commons concerning measures to deal with food prices, cost of living, and inflation, requested the oil industry to refrain from making further petroleum product price increases affecting Canadian consumers before January 30, 1974. The freeze affected the price of gasolines, diesel, and home heating oil west of the Ottawa Valley line and was related to posted tankwagon prices. For business normally transacted at a discount from posted price the prevailing trade price on September 4, 1973, was the maximum price. Other products in the west and all products east of the Ottawa Valley line were permitted to increase in price to recapture increases in cost of imported crude or products.

January 31, 1974. On this date the oil industry was advised by the minister of energy, mines, and resources (EMR) that the price freeze both east and west of the Ottawa Valley was extended to all products and was to continue until April, 1974. Retroactive to January 1, 1974, petroleum importers began to receive oil import compensation to offset increased taxes imposed by exporting countries on January 1, 1974, so that they could comply with the product price freeze request.

April 1, 1974. The price of domestic crude oil was increased and oil import compensation decreased in such a manner that the government's decision to adopt a "single oil price" for crude oil refined in Canada, as announced by the prime minister on December 6, 1973, was implemented. All subsequent crude oil price increases have adhered to this principle.

February 21, 1975. A guideline, superseding all those previously issued, was introduced marking the inception of a second phase of price control. Companies were allowed to reflect in their product selling prices increased non-crude costs, but more importantly they were deemed to be complying with the pricing guidelines as long as they did not sell above their established posted prices. This, of course, allowed the companies much more pricing freedom than had the previous transaction price freeze implemented in September, 1973.

October 14, 1975. The commencement of the anti-inflation program did not change the rules of the game as much as it changed the department responsible for enforcing the rules from the Energy Supplies Allocation Board/EMR to the AIB. Under the anti-inflation guidelines the maximum selling price was the applicable posted price in effect on October 13, 1975. Prices below the maximum allowed could be changed at any time. Since October, 1975, companies have been allowed to adjust their base (posted) prices due to increased crude and non-crude costs; crude costs as announced by the minister of energy, mines, and resources; and non-crude costs as approved by the AIB.

With respect to the marketing of petroleum products, controls meant that product cost increases directly attributable to crude oil, or crude-oil related increases, and those cost increases associated with refinery, marketing, and distribution, could be passed along to consumers in accordance with guidelines issued from time to time. However, no margin on these increased costs was allowed.

With the advent of the AIB regime, the “downstream” petroleum industry came under somewhat stricter pricing controls and, for the first time, profit controls. The main points of the Anti-Inflation Board’s program were:

- The responsibility for monitoring petroleum product prices and issuing product pricing guidelines rested with the AIB.
- The cost pass-through principle for price increases of previous regimes was retained.
- Profit margins (the excess revenue test) for each company’s total “downstream” operations would be evaluated in accordance with section 16 of the Anti-Inflation Guidelines. This section spelled out a base period (last fiscal period ending prior to October 14, 1975) from which the margin test would be measured and permitted only cost pass-through.
- Oil import compensation recipients were informed by the minister of energy, mines, and resources on December 23, 1975, that compensation eligibility was contingent upon adherence to AIB pricing guidelines.

In effect, petroleum suppliers were placed under two price restraint mechanisms—cost pass-through on product pricing and an overall margin restraint mechanism for the suppliers’ business as a whole. It should be noted that the petroleum industry was the only sector under AIB control that was compelled to function under the cost pass-through principle throughout the entire period of the anti-inflation program. As events unfolded, it became apparent that because petroleum companies had generally enjoyed a good 1974 (the base period), the margin test would not in itself result in any significant restraining effect on pricing. No major petroleum company generated any excess revenue during the three-year period of controls. And while the cost pass-through principle appeared on the surface to impose restraint, the extent to which this occurred is questionable. The petroleum industry was experiencing a low growth in demand during the period of the AIB’s three-year existence and this, coupled with severely underutilized refining capacity in eastern Canada (72-75%), it could be argued, restrained prices in the marketplace more than “cost push.”

All “controlled” oil companies were required to prenotify non-crude price increases on the standard 30-day basis. The 90-day rule in respect to price increase intervals also applied to petroleum products, and it encompassed both price increases arising from a government instituted increase on crude oil and those arising from downstream non-crude increases. During the life of the AIB program, crude oil prices were

allowed to rise about \$1.00/bbl. every six months (the exception being \$.70/bbl. January 1, 1977). Consequently, the 90-day rule tended to force suppliers to ask for non-crude cost price increases to be concurrent with the date on which crude oil price increases could be passed on to consumers since they could not raise these same product prices again for a further 90 days. The government's intention was to minimize the frequency of product price increases.

A major difference between the petroleum regime and that which applied to all other segments of industry was the extent to which cost increase forecasts could be incorporated into a request for a price increase. Oil companies had to report their non-crude costs on a 12-month, rolling average basis, and could only include cost increases that would have occurred as of the date a price increase was to be put into the market. Other manufacturers could include forecasted increases in costs to well beyond the date the increase in price was to be implemented.

During the life of the AIB program, there were numerous meetings with groups of oil company executives, with individual oil companies, and with provincial governments to ensure that the companies fully understood the mechanics and the objectives of the oil regime and to enable government to satisfy itself that the companies could, in fact, live with the rather restrictive set of petroleum guidelines. While companies *were* able to live with the Guidelines, they did plead on a number of occasions to be treated like all other manufacturers and to be permitted to include a margin mark-up on all cost increases (i.e., section 95 instead of the petroleum guideline in section 96). The issue never really came to a head, possibly because the industry had difficulty in even recovering costs throughout the life of the AIB because of the surplus of refined product on the market in eastern Canada coupled with the slowdown in demand growth.

In retrospect, one could question the real effect that the downstream petroleum guidelines had on petroleum prices to consumers. In general, oversupply of refined products as well as a very competitive market seemed to be the compelling factors contributing to the restraint of prices during the AIB era. In certain captive markets such as home heating oil, where product is traditionally sold at the posted price level, the Guidelines did indeed afford some protection by not allowing suppliers to sell above the posted level.

However, in some of these markets, characterized by aggressive competition for market share, suppliers even offered discounts to remain competitive. The retail prices of motor gasoline sold through company owned and operated service stations were restrained as these stations were only permitted to increase prices by cost-push amounts. This had the overall result of restraining prices at dealer owned and operated stations which could not very well sell at higher prices. However, here again many retail markets reflected something less than total authorized cost flow-through in pump prices.

Construction

Firms employing 20 persons or more engaged in construction activity were subject to mandatory enforcement. This reflected the distribution of employment by firm size in the industry as well as the regional character of construction activity and collective bargaining. The construction industry was judged to have strategic importance and coverage was further extended to include firms bargaining in association regardless of numbers of employees, as provided in section 3(2)(a)(v) of the Act. As an administrative decision the Board took the view that all the 20 or more employees must be involved in construction activity, hence the number of firms subject to Board reporting requirements would be minimized.

In February, 1976, discussions with the Canadian Construction Association identified two problems in application of the Guidelines. The first was extension of the tender bidding exemption to construction firms employing 500 or more persons, initially available only to those employing between 20 and 499 persons.

The second problem, largely a technical one, concerned how to allocate costs consistently between contracts which qualified for the exemption and others.

The problem of tender bidding was resolved simply by exempting that part of a firm's business carried out under conditions of competitive bidding from application of the Guidelines and extending it to firms employing 500 persons or more engaged in construction activity (technical bulletin AI-17-P, Competitive Bidding in the Construction Industry, November 5, 1976). The test for what constituted competitive bidding was kept as simple as possible.

A review in April, 1976, of the initial guidelines as they applied to the construction industry identified two anomalies. Real property was not included in the definition of a commodity in the Act although it was included in the definition of business. Consequently, firms dealing solely in land were not subject to the Guidelines. This was subsequently clarified by an amendment to the Guidelines. A more serious anomaly was the question of valuation of land brought into production by those whose real property dealings were subject to the Guidelines. Under the Guidelines a firm's profit margin was based upon the historical cost of land. Thus two firms bringing adjacent parcels into development during a compliance period could find themselves in radically different profit positions if one held its lot for years while the other purchased its parcel only recently at a much higher cost. This situation could lead to a decline in real property development, especially on the part of those who held significant land inventories for a long time.

The number of options available to deal with these problems was limited, particularly in light of the government's reference to housing under structural policies in the White Paper, which stated the desirability of an increase in the supply of serviced land for housing. In the end, an

approach using a suggestion from the residential housing industry was adopted and was called the land-substituted cost method (technical bulletin AI-16-P, November 5, 1976).

The substituted cost method was elective to firms for which compliance with the Guidelines might otherwise be particularly onerous, since their allowable profit margins would be significantly affected by the low historical cost of their inventory of land. This elective method provided a modified base for land profits and covered a variety of situations from raw to physically improved land disposed of in either the base or compliance periods. In effect, firms were permitted to substitute an October 14, 1975, market value for the historic cost and to compare profits with an appropriately modified base period.

In the fall of 1976 the Board decided to extend its monitoring of firms engaged in residential construction. Up to that time, companies engaged in construction activity employing between 20 and 499 employees had not been required to report.

Although the competitive bidding exemption removed much of the income of construction firms from application of the Guidelines, this was not the case with firms engaged in residential construction except for the substituted land cost adjustment.

In the residential construction field, coverage of the industry by firms employing 500 or more was considered inadequate both from the point of view of geography and from the number of firms involved (fewer than 15). Consequently additional firms with fewer than 500 employees, chosen on the basis of geographical coverage (53 in number), were requested to report to the AIB from early 1977 on.

Professional Fees and Incomes

The draft proposals for the anti-inflation program stated that professional fees and incomes should be governed by the same general principles applied to other prices and incomes. A working group examined various approaches to controlling professional fees and incomes.

The approach selected allowed a professional practitioner to demonstrate compliance with the Guidelines in one of two ways: (a) by administering his fee schedules in accordance with a specific set of rules; or (b) by restricting his net income improvement on a year-over-year basis.

This approach was codified as part 2 of the Guidelines. A detailed technical bulletin on the program, issued on May 7, 1976, defined a number of policy aspects of the Guidelines (AI-15-P, Professional Fees and Incomes). A week later the reporting forms became available; the first filing began July 1, 1976.

The thrust of the Guidelines was that professional fees should be increased only by the amount required to cover increased costs of providing services and to improve the net income of the practitioner by

the same percentages available to salaried personnel, with a maximum of \$2,400 per year. Provincial governments were expected to use the Guidelines as the basis for setting fee schedules in areas where they have direct control, such as health. Provincial fee schedules would be subject to approval by the Anti-Inflation Board and, if acceptable, all professionals certifying adherence to such schedules would be deemed to be in compliance with the Guidelines. In areas where there were no provincial government fee schedules, professionals were to be individually monitored by the Anti-Inflation Board.

The scope of the program and the problems associated with monitoring a very large group of professional practitioners had to be considered. Section 26(2) of the Guidelines defined the professional services to be monitored. It was estimated that 40,000 firms and 70,000 practitioners would come under the program. The population was constantly changing and no comprehensive listing of professionals was available. This situation led to major difficulties in administering the program. Self-identification of professionals was essential to the administration of a program covering so large a field and having only a dozen staff members.

In early 1977, it was estimated that approximately 20 per cent of professionals had failed to file any reports with the Anti-Inflation Board. The Board authorized a mass telephone campaign designed to identify "delinquent" professionals and to encourage them to file the necessary reports. The Board also decided to enforce its filing requirements by referring to the Administrator professionals who would not comply with the filing requirements.

In all, the telephone campaign identified some 8,000 practitioners who had not filed with the Board. Approximately 70 per cent of those contacted filed voluntarily. The remaining 2,400 were referred to the Administrator who began legal action to obtain the required information. As a result of these efforts, approximately 95 per cent of professionals filed reports.

Of the 40,000 firms reporting to the Board, approximately 20,000 were operating under provincial fee schedules approved by the Anti-Inflation Board. Once the fee schedule was approved, no further verification procedures were carried out by the Board. For professionals not operating under provincial fee schedules, self-regulation was a key ingredient of the program.

However, it soon became evident that many professionals were earning more than the \$2,400 maximum allowed by the Guidelines. It also became evident that most professionals based their fees on very flexible or non-existent schedules.

Earning revenues in excess of the \$2,400 maximum was not necessarily a contravention of the Guidelines. Certain deductions were allowed for productivity gains and prices in effect prior to October 14, 1975. However, in order to ensure that professionals were not contravening the Guidelines, it was necessary to mount an extensive audit program. The audit program was in effect from early 1977 until December, 1978.

Approximately 1,000 audits were carried out in the field. In the main, the audits verified that professionals were abiding by the Guidelines and that only a small minority were in an excess revenue position. In each of these cases a satisfactory compliance plan was negotiated with the professional to return the excess revenue to the marketplace.

Statistical information, combined with the audit findings, confirmed that overall income improvements for professional groups were well within the Guidelines over the duration of the program.

Financial and Related Institutions

This group had three broad sectors. The first sector was made up of the chartered banks; the second sector, firms engaged in insurance activities—property and casualty and mortgage insurance; the third, other financial institutions, principally trust, loan, and mortgage companies.¹¹

Although two of these sectors later came under their own part of the regulations, the thinking at the outset was that part 1 of the initial guidelines could be applied, with modifications, to all three sectors. Although there were similarities among the sectors, they are best reviewed in the context of their own guidelines.

CHARTERED BANKS

The initial proposals for this sector reflected the principles behind the part 1 guidelines. Control on banks would take the form of profit guidelines and interim pricing guidelines.

The profit guidelines in the initial proposals required that the ratio of balance of revenue (operating profit) to total assets in a compliance period was not to exceed 95 per cent of the average ratio in the last five completed fiscal years ended October 31, 1974. This rule was to apply to a bank's total business, including foreign operations, and was to use total assets in place of gross revenue from operations.¹²

A special feature of the pricing guidelines was a Board request to the banks to freeze their service charges for one year from October 31, 1975. They were to seek prior approval from the Board to increase rates charged on personal loans or credit plans. In view of the mandate of the Bank of Canada to determine interest rates in Canada, lending rates were not monitored. The Board decided instead to freeze the average spreads between a bank's average lending rate and its prime rate to that existing at or near October 13, 1975. These two aspects, the freezing of spreads between interest charged and interest paid by the banks and the freeze on service charges, were particularly useful for purposes of public visibility.

¹¹ The general insurance industry was still subject to part 1 of the Guidelines, and later to part 7.

¹² Total business was included since it was thought that banks would not be able to separate domestic and foreign assets.

By early January, 1976, the Board learned that the banks would be able to differentiate earnings and assets of foreign and domestic operations. It also became apparent that special regulations would have to be drafted for chartered banks.

On February 20, 1976, the guidelines for chartered banks were announced. The profit guideline was, in effect, the same as the initial proposal: to limit the ratio of balance of revenue to total assets to 95 per cent of the average ratio during the last five years but ending October 31, 1975, instead of the earlier October 31, 1974, date. An industry ratio average of balance of revenue to total assets was used as a way of introducing a mechanism for low-base relief, specifically a maximum of 1.05 per cent.¹³ This feature was based on the need to maintain the capital adequacy of banks because of the importance to the entire economy of a sound banking system.¹⁴ The announcement also outlined the interim pricing rules, which were to prevent banks from widening the spreads between (a) a bank's prime rate and the rate paid on non-chequeable savings accounts; (b) the average rate charged on new residential mortgages and the current average rate offered on fixed term deposits with a maturity of one year or more; and (c) a bank's prime rate and the current average rate offered on interest-bearing deposits. A provision was also made to adjust for changes in the profitability of foreign operation. The bank's compliance with these rules would be closely monitored. They would be required to file quarterly statements with the Board.

Subsequent discussions led to some modification of the proposals. These draft guidelines were made public on June 11, 1976, along with those highlighted in the May budget. The body of rules for chartered banks was contained in part 5 of the draft guidelines.

One major change was the application of the profits tests to domestic business only. The profit deflator was changed from 95 to 85 per cent, and a choice of base periods was offered: fiscal years 1970-1974 or fiscal 1975. The low-base relief figure was raised from 1.05 to 1.13 per cent, reflecting the differing margins between domestic and foreign operations.

Another feature of the draft guidelines was a special relieving provision that allowed a bank to adjust for any additional excess revenue resulting from the transition to the new rules. Also, a deduction from apparent excess revenue would be allowed for earnings on newly subscribed equity capital, reflecting a concern with the possible disincentive on raising new capital and the resultant effect on capital ratios (assets to equity and debt to equity).

In September, 1976, the Guidelines and technical bulletins for financial institutions were reviewed by the Board. Extension of the freeze on service charges for an additional year was recommended and agreed to by the Board. Also, the investment credit was not to be made available.

¹³ The rate of 1.05 was marginally higher than the actual industry average.

¹⁴ AIB news release, 76 - 24, "Guidelines for Chartered Banks," February 20, 1976.

In the following months the Canadian Bankers Association made representations to the Board and the minister of finance for a lifting of the restrictions on interest rate spreads, alteration of the guidelines for investment credit, and lifting of the freeze on service charges.

The matter of the freeze on service charges was referred to the Board for examination. The position of the banks was that, although a cost pass-through was allowed in interest rate spreads, this was not the case for administration and operating costs. The rate of cost increases in these areas would likely require a large increase in service charges in the post-control period.

In May, 1977, the Board decided to maintain the planned freeze period to October 31, 1977. The matter was reviewed again in October, 1977. The initial recommendation was to cap the average increase of posted service charges at 6 per cent for one year to October 31, 1978, in accordance with the guidelines for compensation increases for the corresponding period. However, the final decision was that the overall increase would be limited to 5 per cent.

OTHER FINANCIAL INSTITUTIONS

Part 6 was developed for suppliers other than chartered banks who engage exclusively in financial intermediary operations. Suppliers such as trust companies, engaged partly in financial intermediary operations and partly in other activities such as estates, trust, and agency operations, were to be subject to both part 6 and parts 1 and 7 of the Guidelines.

The rules for part 6 suppliers were similar to those applicable to the chartered banks (part 5) and were established in parallel discussions with representatives of the industry, in particular with the Trust Companies Association of Canada. Low-base relief was granted, the target net margin percentage being established at not less than 0.71 per cent of assets. This is equivalent to 82 per cent of the industry average return on assets in 1975, as was the case for the banks.

Long-term contract relief was also approved by the Board in July, 1977. This in effect allowed part 6 suppliers who had entered into contracts for lending money (with a maturity of one year or more) on or before December 31, 1976, to calculate their target operating profit on the basis of 100 per cent of the base period margin on long-term contracts still outstanding in a compliance period, and 85 per cent of the base period margin on all other assets.

Pricing guidelines for part 6 suppliers were similar to those for the banks. Suppliers offering five-year personal term deposits and five-year guaranteed investment certificates could not increase the spread between the interest rate offered on these deposits and the interest rate charged on NHA and prime conventional mortgages. There was also a freeze on service charges, extended to October 31, 1978, similar to the chartered banks. However, a supplier with both part 6 and parts 1 or 7 activities

who had frozen fees, commissions, and service charges at levels in effect on October 13, 1975, was able to claim exemption from excess revenue on all part 1 and 7, but not part 6, activities.

PROPERTY, CASUALTY, AND MORTGAGE INSURANCE

A number of problems were recognized at the outset in applying the Guidelines to the property and casualty insurance industry. They were summarized in a staff paper to the Board in early 1976. The industry had suffered substantial underwriting losses in the past few years, especially on automobile insurance. Further, these companies earned substantial amounts of investment income, which traditionally had not been taken into account in determining the profit or loss of a particular line of insurance. Investment income is composed of interest, dividends, capital gains or losses, and miscellaneous items, and falls into three broad categories: income on unearned premium reserves, income on unsettled claims reserves, and income on equity. It was generally recognized in the industry that the first two categories of income are policyholder funds and can reasonably be allocated to classes of insurance. Opposition to this position had been strong in the industry, but companies were gradually including this income in the determination of profit and loss by class of insurance.

The staff paper reported that the industry and the superintendent of insurance were concerned that any program of profit control which made companies unable to earn sufficient returns would cause them to restrict their underwriting activities, and thus cause a shortage of insurance availability or capacity. Of the regimes available in the part 1 guidelines, the product-line approach was assumed to be most appropriate for profit control along with the then-current pricing guidelines.

The property and casualty insurance industry was characterized by a large number of small firms. Companies with 500 or more employees accounted for only 25 per cent of premiums written. Consequently, it was recommended that the whole industry be brought under the mandatory provisions of the Act because of the limited control available to the Board and the industry's high profile. After several years of substantial losses, followed by major rate increases in 1974 and 1975, it was clear that the industry would soon be earning substantial profits. Thus it was urgent that the Board act as quickly as possible.

In February, 1976, after discussions with the federal and provincial superintendents of insurance, the Board agreed to recommend that all property and casualty insurance companies be brought in, with the exception of the accident and sickness branches of life insurance companies. Order-in-council P.C. 1976-911 of April 5, 1976, made this recommendation effective.

The initial guidelines stated that interest income and rental income should be included in gross revenue, while dividends and capital gains (losses) were to be excluded.

A number of alternatives for low-base relief were considered: net income expressed as a percentage of equity, total assets, or net premiums. The last alternative was felt to have advantages over the others. It more closely followed the initial guidelines in that it was income-statement rather than balance-sheet oriented. Since it allowed companies to earn a profit on each premium dollar, it should encourage them to expand their business—a point of some concern to both federal and provincial insurance departments. Finally, this form of measurement placed Canadian companies on an equal footing with foreign branches in the determination of allowable profits since the latter were able to manipulate assets and equity.

In May, 1976, the Board agreed to the recommended low-base relief approach and agreed to allow 3 per cent of gross revenue as the appropriate level. Net income was to include underwriting gains (losses) *and* interest or rental investment income attributable to operations, but not investment income attributable to equity. No special consideration was to be given to enable companies to retain excess earnings. Companies brought in by order-in-council or by virtue of association were required to report only on a yearly basis. The net margin rule was to apply at the product-line (class of insurance) level, subject to an overall cap on the total business. From summer 1976 on, the Board would be preoccupied with property and casualty insurance, especially in securing acceptable compliance plans in light of increasing amounts of excess revenue.

Modifications to parts 1 and 7 of the Guidelines for application to companies supplying property and casualty insurance were outlined in a technical bulletin (AI-23-P) released on November 5, 1976. Prior to this release the Board reaffirmed its decision not to change the low-base relief provision allowed the general insurance industry.

In November the status of the property and casualty insurance industry vis-à-vis the program was again reviewed by the Board. It was noted that excess revenue would be earned for 1977 and 1978 and an overall compliance strategy should be formulated. The three broad options presented by staff for Board consideration were: (a) return excess revenue to source, (b) implement a program of rate reduction, or (c) hold prices and devise some sort of price credit.

The Board agreed that it would not do anything that would cause a company to be unable to meet the solvency requirement of section 103 of the Canadian and British Insurance Companies Act.

The Board agreed to the second option, that companies with excess revenue reduce rates to ensure they did not continue to earn excess revenue; a direct rebate to policyholders was the preferred compliance plan. Companies that had failed to meet the section 103 requirements were to be allowed to keep their excess revenue and allow claims costs and administrative expenses to catch up.

Beginning in May, 1977, the Board announced the compliance actions of insurance companies. These were mainly discounts to policyholders on excess revenue earned in 1976. As consumer complaints on

insurance rates, particularly on automobiles, had actually eclipsed food as the number one complaint in the late summer and fall of 1976, this was a welcome respite.

In October, 1977, the Board again reviewed the status of the property and casualty insurance industry, this time at the request of the Insurance Bureau of Canada, which wanted relief from the then-current guidelines. It was felt that the 3 per cent low-base relief provision did not allow companies to increase their capital rapidly enough to expand premium volume to meet increased demand for insurance coverage. It was also felt that insurance companies were being discriminated against vis-à-vis other financial institutions. The bureau wanted the low-base relief figure increased to 5 per cent of gross revenue, a choice of an alternate base period which excluded the years 1973 and 1974, and companies to be allowed to file on the basis of solvency accounting.

The Prices and Profits Branch reviewed these requests and determined that for the last 20 years the industry had been in the range of 3 to 5 per cent profit on gross revenue, around 4¾ per cent over the last 10 years. If the 85 per cent deflator was applied to this level, the low-base relief would amount to 4 per cent. The revised low-base relief was adopted by the Board. Alternate base years and a change in accounting method were denied.

The branch further noted that most insurance companies would be generating increasing amounts of excess revenue. Consequently, such excess should be dissipated in a shorter period than the one year that had been allowed for excess revenue earned in 1976; customers' rebates, along with cheques to non-renewers, was the preferred method. The branch also recommended that rate actions be taken to ensure that further excess revenue was not earned in 1978.

These recommendations were outlined to the Insurance Bureau of Canada; particular attention was focused on resolution of excess revenue. Severe underwriting losses in the fourth quarter of 1977 reduced the anticipated amount of excess revenue. Even so, a substantial amount was earned. It was returned to policyholders in most cases by June 30, 1978, taking the form of cheques to policyholders, or discounts on renewal or rate reductions with cheques to those not renewing their coverage.

In fall, 1978, the Insurance Bureau again approached the Board to seek further low-base relief. After consideration of the bureau's representations, however, the Board was unable to accede to the request. It did recognize that, in order to make the decontrol period as orderly as possible, a number of options for dealing with 1978 and accumulated excess revenue should be offered the companies. As a result, 1978 compliance plans could take one of three forms: cash rebates, a rate freeze on personal lines, or discounts on renewal and cheques to non-renewers.

The operations of the life insurance industry were reviewed by staff in February, 1976, and special considerations were felt necessary. It was recommended that the federal superintendent of insurance advise the

Board on the appropriateness of rate increases for purposes of interim pricing. Also, life insurance companies would be required to use accounting principles consistent with prior periods and not those of subsection 7(2) of the Guidelines. Because of competition in the life insurance industry, control of companies subject to mandatory enforcement appeared sufficient to regulate the industry. Companies with 500 employees or more accounted for 75 per cent of all premiums written in Canada. By April, 1976, all these companies were placed on the price prenotification list. The compliance test was an overall net margin rule utilizing the industry's accounting practices. Analysis would be carried out by the Department of Insurance and excess revenue reported to the Board.

Dividends

Dividends were included in the anti-inflation program so that the incomes of all segments of society were controlled. For purposes of the program, dividends were defined broadly so that companies could not reduce their excess revenue through the use of dividends or corporate distributions.

The White Paper proposed that dividends for the first year of the program were to be restrained to the dollar level of dividend per share in the last completed fiscal year. The White Paper recognized that there would be a need to increase dividends either to help raise new equity capital, or where a firm could show that its dividend base was atypically low. This became a major guide in case handling. It also provided a base for retroactivity of control of dividends when the Guidelines were issued.

When Bill C-73 was proclaimed on December 15, dividends were controlled as a separate area under paragraph 3(2)(c). Dividends were defined in subsection 2(1) of the Act as follows: "a stock dividend and any other form of corporate distribution, otherwise than upon the winding up of a corporation or the discontinuance of business."

Dividend restraint was based on the first compliance period starting on October 14, 1975, and ending October 13, 1976. The limitations in the amount a company could pay were a series of options, as follows:

- (1) The company was not permitted to declare or pay dividends that exceeded what it paid in its base period, the base period being the last fiscal year prior to October 14, 1975.
- (2) If a company had a demonstrable record of paying annual, semi-annual, or quarterly dividends, however, it was permitted to pay the multiple of the last dividend prior to October 14, 1975, if it was higher than the amount paid per share in the last fiscal year.
- (3) Notwithstanding the above two limitations, all corporations were permitted to pay 25 per cent of their earnings computed in accordance with generally accepted accounting principles, in their last fiscal year prior to October 14, 1975.

If the company was new, no restraint was placed on it for the first 12 months of its existence. Included were rules permitting the consolidation

of dividends when companies were amalgamated and the sub-division or consolidation of shares providing adjustments were made proportionately.

The original guidelines applied dividend restraint to every Canadian company incorporated in Canada and listed on a stock exchange, or that employed more than 500 persons in Canada on October 14, 1975, or after, or was in the construction business employing 20 or more persons. They also applied to all companies associated within the meaning of section 256 of the Income Tax Act as it applied to the above companies and to professional corporations. This guideline was changed soon after the rules were issued, eliminating a large number of small companies. Eventually the rule was applied to every Canadian-incorporated company listed on a stock exchange, or a person or supplier referred to in sub-paragraph 3-2(ii), (iii), (iv), or (v) of the Act.

The Guidelines specifically excluded certain corporations, including mortgage investment corporations, investment corporations, mutual fund corporations, non-resident owned investment corporations, credit unions, and co-operative corporations. They also excluded policy dividends paid by life insurance companies, dividends on preferred stock that were in arrears, dividends on a new class of shares in the first 12 months after issue, dividends in the first fiscal year of a corporation, and dividends of a corporation on a class of shares at least 90 per cent of which were beneficially owned by one or more corporations that themselves were covered by the Guidelines.

By late winter a technical bulletin (AI-11-P, Dividends, March 15, 1976) was issued to resolve questions and problems. The first of these was the meaning of "dividend." The bulletin stated that the capitalization of retained earnings could be considered a dividend for AIB purposes. Where the capitalization of a nominal amount was required for the purposes of a stock dividend, the Board would not consider it a dividend under the Guidelines. Payments on the redemption or cancellation of shares in excess of their paid-up capital were defined as dividends. The principle of ensuring that no stockholder received excessive income through corporate distribution was clearly established.

The bulletin also cleared up the question of a dividend declared before October 14, 1975, and paid after that date. The payment was deemed to be paid on the date that it was declared. This interpretation resolved the problem of a company being able to claim dividends prior to its base period or, if it were to its advantage, to include such payments in its base period.

The concept of "demonstrable record" was clarified. Where a firm could demonstrate that it had paid dividends for a period of time and then ceased to do so, but had paid a dividend prior to October 14, 1975, and after the cessation, it would be deemed to have a demonstrable record. Where a firm had made a large dividend after its fiscal year ending prior to October 14, 1975, but before that date, that amount could be considered as establishing a demonstrable record if there was clear

evidence of the corporation's intention to commence and an ability to continue a dividend policy at that level.

An allowance for firms to use a consolidated basis was also included in the technical bulletin. This interpretation permitted companies that normally reported on a consolidated basis to do so. It also simplified control of dividends as most listed companies filed their public reports in this way.

The bulletin confirmed that corporate reorganization or sale of a corporation would be considered an acceptable reason for payment of increased dividends. The question of increasing dividends for the raising of new equity capital was confirmed as well in this bulletin. In practice the Board required confirmation and justification by outside experts before approval was given.

The question of treating professionals in the same manner for prices and profits and dividend restraint, regardless of the form of their organization, was resolved in this bulletin. Corporations subject to dividend restraint solely because they were a professional corporation and had fewer than 500 employees, were exempted from dividend guidelines if all the corporation shareholders were practitioners as defined under sub-paragraph 25(2)(c)(ii) of the Guidelines.

At this time a large number of dividend requests were received for small construction and small professional firms. The dollar amounts for these cases were relatively insignificant compared to the amounts relating to the multi-national firms, yet their inclusion would greatly increase the administration needed. In addition, dividend control of these small firms was considered unfair since other small companies of fewer than 500 employees were not covered by the price and profit guidelines, let alone dividends. The Board felt that firms with 500 or fewer employees should not be required to report their dividend activities from that time on. This position was set out in bulletin AI-11-P Revised, on May 10, 1977.

With the issue of technical bulletin AI-11-P Revised, most of the small companies, those below 500 and not listed on a stock exchange, were not required to file for dividends. This eliminated the very small companies and concentrated only on listed companies and those with more than 500 employees. Staff of the Prices and Profits Branch monitored the newspapers and financial papers for potential dividends being paid in excess of the Guidelines. Some dividends discovered through this process revealed situations where companies associated with other companies with more than 500 employees should have been reporting under the price and profit guidelines and were not. This served as a double check, and the few companies that were not reporting were required to do so.

By October, 1978, 380 recorded cases had come before the Board. Whereas companies had requested increases of almost \$700 million above the Guidelines, only \$282 million were permitted.

In summary, the guidelines for restraint of dividends served their purpose. Compliance with these guidelines was accomplished with only a small additional administrative burden for the Board and the companies involved.

Part Three: Technical Notes

1. Some Empirical Aspects of the Program Design

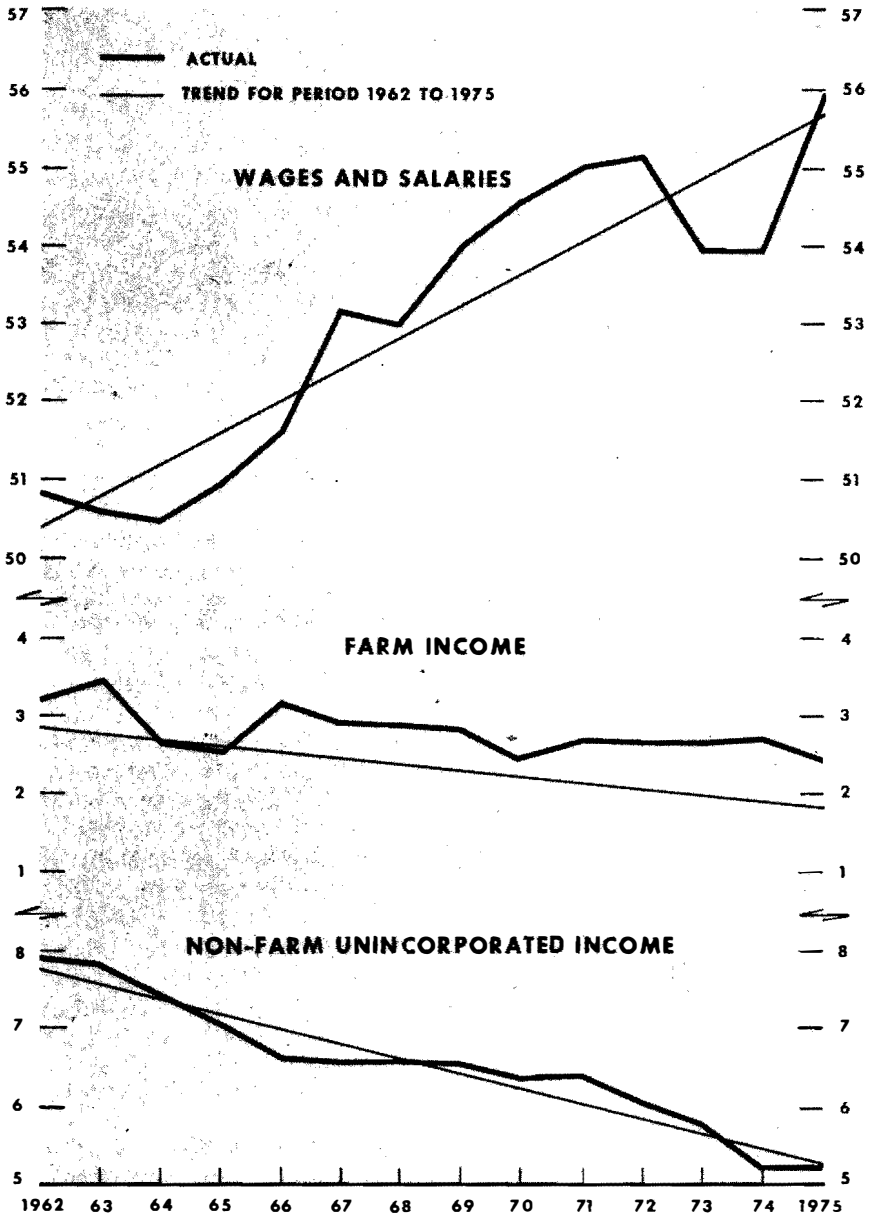
During the consensus discussions of spring 1975 between business, government, and labor described in chapter one, a small staff at the Department of Finance examined national income shares, particularly labor income (wages and salaries) and corporate profits, and the impact inflation was having on their historical shares and labor's real gains. The analysis led to a number of simulations of the major components of GNP and their share impacts using various price targets and various levels of productivity gains for labor. The reference period for the analysis was 1962-1974 and the simulation-forecast period was 1975-1978.

This analysis prepared the way for specific empirical proposals for discussion by the major participants in the exercise. Charts 2 and 3 show the movements and trends of GNP shares for wages and salaries, corporate profits, and other sectors for the reference period. Significant and cyclically related movements in shares over time can be seen. Labor's share is on a rising trend because of a shift out of non-paid employment, especially agriculture over time, and does not reflect any real shift over time from capital to labor. The share of profits exhibits a slight downward trend. This downward trend reflects a tendency to a higher ratio of debt financing, and not a downward trend in the share of capital in a broader sense. Most other major components of GNP (capital consumption allowances, net farm income, and non-farm unincorporated business income) exhibited a decline.

The consensus discussions did not expect to fundamentally alter these historical share patterns. However, it was noted that in 1974 corporate profits and farm income were above the longer-term trend while wages and salaries were below it.¹⁵ Consequently, in setting out means to reduce inflation it was recognized that the wage and salary position would have to be improved. The problem was to return to former positions in a less inflationary way than the economy would normally produce.

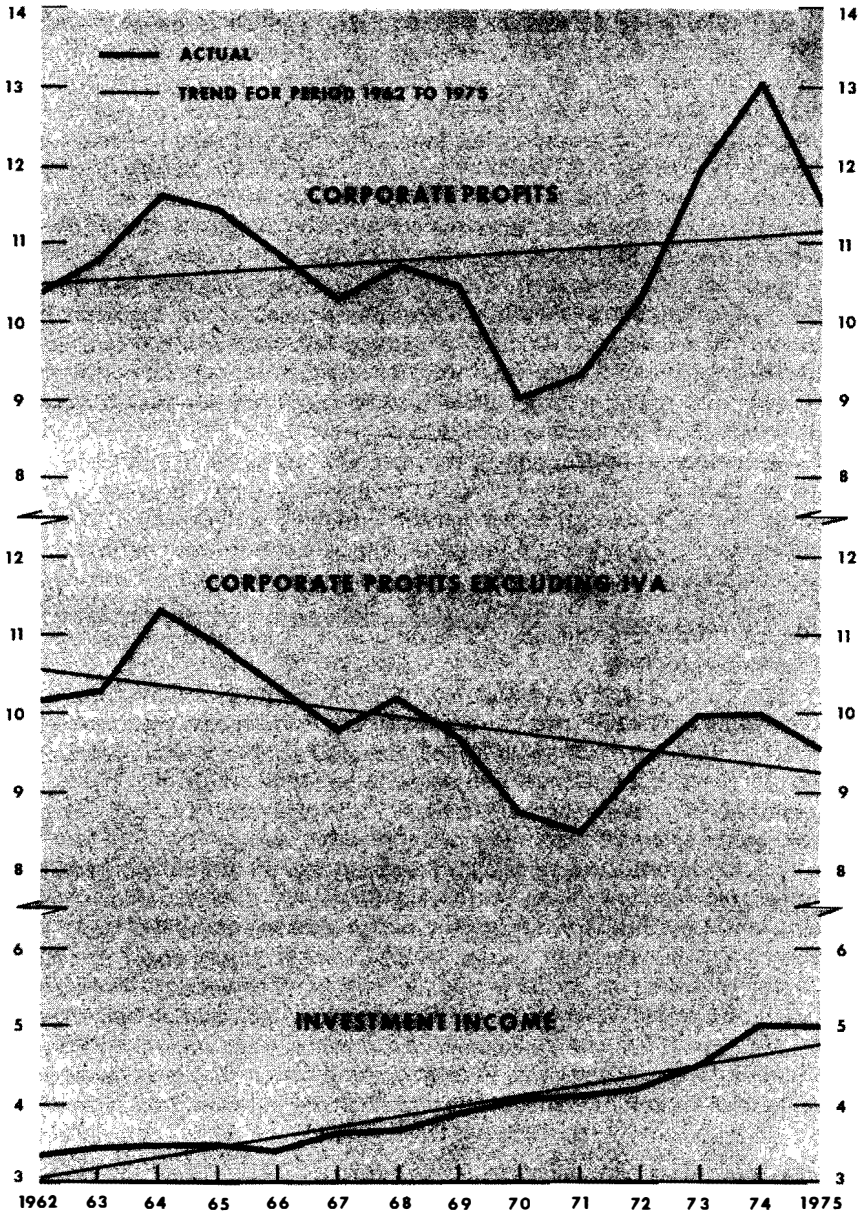
¹⁵ In terms of real income gains, wages and salaries had actually declined in 1973 and showed only a modest gain (less than 1 per cent) in 1974. It was recognized that a provision would be required in the Guidelines for compensation to provide for and control the rate of catch-up insofar as abrogation of existing labor settlements would not be considered.

CHART 2
INCOME SHARES OF GNP (A)



Source: Statistics Canada, National Income and Expenditure Accounts,
Reference Table 10.

CHART 3
INCOME SHARES OF GNP (B)



Source: Statistics Canada, National Income and Expenditure Accounts.
Reference Table 10.

Macroeconomic simulations by the same staff at the Department of Finance on price targets, price deviations, and productivity gains concluded that: (a) corporate profits would appear to benefit from a more modest price target while the share of wages and salaries would not be affected; (b) an actual price performance better than a given target rate would yield a gain for wages and salaries at the expense of corporate profit shares; (c) conversely, an actual price performance worse than a given target rate would yield an immediate loss for wages and salaries which could be restored in the following year; (d) wage and salary shares were particularly sensitive to productivity gains; and (e) the ability of wages and salaries and profits to displace other components of national income were significantly reduced under the consultation exercise assumptions of lower prices and modified labor settlements.

A point of some concern was that while the productivity gain in the reference period, 1962-1974, had been slightly greater than 2 per cent per annum, the trend value for 1975 suggested less than a 1 per cent gain. Nevertheless, the basic approach was to accept the longer-run productivity trends and select a target price for the first program year modestly below the rate of decline in prices then in evidence.

A number of projections on the economy suggested a mild recovery starting in mid-1975, largely due to a slow economic recovery in the United States. Real output per person employed was expected to grow slightly above 2 per cent, and real wages were to be confirmed to approximately this rate of increase. Any attempt to increase them faster was expected to result in either a lower share of profits, or a lower share of income to other component parts or sectors of national income not in the controls program.

The price target was estimated by feeding into the simulation cost increases already built into the economy, and certain assumptions about the price of imports and uncontrolled domestic sectors, especially oil and food. In general, an attempt was made to be fairly optimistic. The price target had a good chance of success if the program worked and the uncontrolled sectors did not take an unfavorable turn.

The basic profit restraint approach then was an attempt to translate this economic policy into a profit rule for firms. The two basic guidelines—unit cost and net margin—on a macroeconomic level gave the same result, that is, profit's share of GNP would nearly equal its trend value of 10.4 per cent in the period 1976-1978. (The average for profit's share in the period 1970-1974 was 11 per cent, 95 per cent of which gives 10.4 per cent.) The consequence of the income limitation rules (profits and labor compensation) was to restore the shares of national income in the controls period to those trend values observed in the reference period.

2. The Impact of the Unit Cost and Net Margin Rules

On a macroeconomic level, the unit cost and net margin rules gave the same result—profit's share of GNP would be about equal to its trend

share of 10.4 per cent in the period 1976-1978.¹⁶ This was accomplished in the unit cost rule by stating that a firm could keep its absolute dollar profit at the level it earned per unit of output in 1974. This profit per unit was maintained by allowing only price increases equal to allowable cost increases incurred in the controls period. In effect, this rule was a literal derivation of the general pricing principle stated in the White Paper. The net margin rule, chiefly designed for firms that could not allocate costs to individual products, was made equivalent to the unit cost rule on a macroeconomic level. This was done by deflating the average of profit's share of GNP in the 1970-1974 period to 95 per cent, which gave a share value of 10.4 per cent.

Although the two rules gave the same result over the 1976-1978 period, they did so in a different manner. According to the general principle of cost pass-through outlined in the White Paper, the implication for the unit cost rule was that, as cost increased, net margins would decline, a characteristic that many staff members sensed was not fully appreciated by firms subject to controls. A simple illustration of this implication is given in table 3 below.

TABLE 3
MARGIN IMPACT OF UNIT COST RULE*

| Item | Base Period | | Program Period | |
|---------------|-------------|----------|----------------|----------|
| | 1974 | 1974-76 | 1976-77 | 1977-78 |
| Gross Revenue | \$100.00 | \$109.00 | \$118.90 | \$129.79 |
| Total Cost | 90.00 | 99.00 | 108.90 | 119.79 |
| Profit | 10.00 | 10.00 | 10.00 | 10.00 |
| Profit Margin | 10.0% | 9.2% | 8.4% | 7.7% |

* Assume a constant volume of sales each year, gross revenue of \$100.00 in the base period, and cost increases of 10 per cent each year. Price increases reflect cost increases only (cost pass-through).

From this example it is clear that a net margin rule required a deflator if the principle of price restraint and equivalence of rules were to be achieved. The percentage profit deflator of the net margin rule, which *on the average* yields approximately the same results as the unit cost rule, depends critically on the base period chosen. Analysis indicated that for a 1970-1974 base period, on the average 95 per cent was the appropriate target net margin percentage for non-distributors controlled under the net margin rules (section 17 and 18) of the initial guidelines.

Early experience with the Guidelines indicated that the net margin rule was inappropriate for two groups of firms. For firms whose profit margins had tended to rise over time, the rule was unduly harsh and would in many cases have required large reductions in profit levels. On the other hand, for firms whose profit margins had tended to decline, the rule was not especially restraining and in many cases would have

¹⁶ See chart 2.

permitted large increases in profit margin levels and attendant price increases. Table 4 below illustrates these characteristics using the same assumptions as table 3.

TABLE 4
IMPACT OF NET MARGIN RULE*

| <i>Margin Experience</i> | <i>Base Period</i> | | | | | <i>1970-74 Average</i> | <i>Compliance Period</i> | | |
|--------------------------|--------------------|----|----|----|----|------------------------|--------------------------|---------|---------|
| | 1970 | 71 | 72 | 73 | 74 | | 1975-76 | 1976-77 | 1977-78 |
| Rising Margin | 6% | 7 | 8 | 9 | 10 | 8 | 7.6 | 7.6 | 7.6 |
| Declining Margin | 14% | 13 | 12 | 11 | 10 | 12 | 11.4 | 11.4 | 11.4 |
| Constant Margin | 10% | 10 | 10 | 10 | 10 | 10 | 9.5 | 9.5 | 9.5 |

* Assume a constant volume of sales each year, gross revenue of \$100.00 in 1974 and cost increases of 10 per cent each year of the compliance period. Price increases limited to maintenance of 95 per cent of average of 1970-1974 base period margins.

The net margin rule clearly calls for unique conditions for firms with rising and declining net margins in the first year of the compliance period. Further, it can be seen from table 3 why the rising margin firm would want to use the unit cost rule, and the declining margin firm would wish to stay on the net margin rule.

3. *The Impact of Base Periods*

Failure of the initial guidelines to provide any relief to a firm in a loss position or to low margin firms was the most common criticism made by the business community. The three main types of low base period problems identified were the rising margin firm, the low-base firm, and the low-base industry. While the loss position noted above was undeniably harsh, low-base firms which had margins well below their industry averages regarded the initial guidelines as equally unacceptable.

The low-base firm was characterized as one which experienced declining or negative profit margin years in its base period well below industry averages.

An important qualification was made between the low-base firm and a firm with a low base for one or more of its products or product lines. The Guidelines could provide an adequate margin for the firm as a whole, yet be quite restrictive for a few very profitable products or product lines. Conversely, the Guidelines could be quite restrictive for the firm as a whole by reason of its having only a few unprofitable products or product lines. The danger existed, therefore, that a firm might simply stop supplying such affected products or product lines.

It was also recognized that the restrictive aspect of the low base period problem could have an impact beyond the firm itself. In situations

where the low-base firm was an important element in the market, the effects of restraint could be felt by all the other firms in that market. If a major producer's margin, and therefore prices, were constrained to a level below the level required for its smaller competitors to survive, the effects could be devastating. Relief could only be given to smaller producers by giving it to the larger producer.

Three approaches to providing relief for low base periods were considered: (1) a more flexible choice of base, (2) a minimum rate of return, and (3) a minimum margin.

A more flexible choice of base could involve making the five years prior to the program the base period for all firms and establishing profit targets based on margins or unit profits in the best one, two, three, or four years. This approach was not without limitations, however. It could relieve a large number of firms and seriously lessen the degree of price restraint in the initial guidelines. Further, it might still not provide any relief for firms that had low or loss years throughout the base period. In addition, there were a number of practical considerations. It had been five months since the program began and the Board was only beginning to acquire the data necessary for assessing the acceptability of price changes. Any change in the Guidelines would postpone this assessment for at least three months. Further, a variable base period could compound the difficulty of rule selection already evident with the initial guidelines.

The second alternative, using a minimum rate of return, was appealing as a concept. This approach would allow a firm to earn a specified rate of return before excess revenue was determined. Analysis of such a rule, using total assets, capital employed, and shareholder's equity as a base, suggested that the latter was the best basis as it gave the most uniform results. Nevertheless, there were two drawbacks to this approach. The first was setting the appropriate rate; the higher the rate the lesser the degree of price restraint. In some instances, entire industry sectors would effectively be exempted from price restraint even by a relatively low rate.

The second drawback was that application of such relief could only be applied to a firm or company as a whole since few, if any, could allocate assets or equity on a product or product line. It was noted that some future relief might have to be applied at a product or product-line level if that part of the business were to be maintained. As this was not an unusual situation, a minimum rate of return might possibly be of limited value.

The third alternative would permit a firm to earn some minimum profit margin before actual excess revenue was determined for a compliance period.¹⁷ The determination of the appropriate rate was difficult as

¹⁷ During the period of the Economic Stabilization Program in the United States, the Price Commission experienced similar difficulty devising a relieving rule. They used a capital turnover ratio along with a disguised return on equity with the understanding that it was only a partial solution as there was a cap at the 3 per cent profit margin level.

it had to strike a balance between adequate relief and desired price restraint. While it might be possible to have standard minimum return on capital, it was felt inappropriate to have a standard minimum margin for all firms, since average margins vary from industry to industry, reflecting different capital intensities, risk, and competitive conditions. The minimum profit margin rule had the advantage of being consistent with the target profit concept in the initial guideline and could be applied on a product or product-line basis, or modified to meet the requirements of individual cases.

While an initial recommendation was to apply the minimum profit margin concept on a case-by-case basis, the problem of classifying a firm in the appropriate industry sector to yield a satisfactory margin led by May, 1976, to reconsideration of the minimum rate of return.

The policy for low-base relief was made public in the draft guidelines highlighted in the May budget. It allowed a minimum target operating profit before tax of 8 per cent on a firm's average equity (or net assets) in a compliance period. Concern was expressed that making the 8 per cent figure public would suggest that this was the government's view of a suitable rate of return. The 8 per cent figure, however, was an arbitrary value representing approximately 50 per cent of the industry average for 1970-1974. This relief was to be applied only in compliance periods beginning after October 14, 1976, but in fact was made available for earlier compliance periods by the Board on a discretionary basis as outlined in an internal policy memorandum in late October, 1976 (no. 10-R). The memorandum also introduced an alternative to the 8 per cent rule, allowing firms to earn 50 per cent of the average return on sales in their industry. Relief was extended to the level of the product line by March, 1977 (no. 10-R-2), and made retroactive to earlier compliance periods.

Return on equity was generally a satisfactory approach to the low-base relief problem and could be applied in most instances. However, for chartered banks and other financial intermediaries, and to a lesser extent for property and casualty insurance firms, the Board felt that this approach did not provide adequate relief. Supplementary relief was to be available on a sectoral basis and was made public in a number of technical bulletins.

There were a few instances where the period 1970-1974 exhibited unusually low profit margins for all firms in an industry. The solution was to consider a 10-year base as being more representative of the industry's historical margin performance.

This represented one of the rare instances where the Board allowed a change in the base period from what was specified in the Guidelines. From the earliest days of the Board the usual approach was to have the firm determine its situation and submit its case for consideration. Should undue hardships or inequity be substantiated, the Board generally sought some form of relief that would not involve any alteration of the base period. Failing that, the 10-year base period was allowed.

4. Productivity Credit, Pricing Rules (the Draft Guidelines of June 11, 1976), and Investment Credits

THE PRODUCTIVITY CREDITS

The initial guidelines included a provision for deduction from apparent excess revenue for "unusual productivity gains." Unfortunately, no workable criteria were available to evaluate a growing number of claims in early 1976. The fact that it took until December, 1976, to establish a policy for productivity claims indicates the tremendous difficulty staff and Board had with this issue. The uncertainty surrounding the productivity issue contributed to growing criticism from the business community in the early months of the program.

In order to follow the development of the productivity policy, however, it is necessary to re-examine the concepts behind it. The intent was to control margins through the net margin or unit cost rule, and that margins should be allowed to rise as a result of legitimate increases in productivity.

To deal with the volume question, the principle adopted was that productivity gains resulting from volume increases should not be allowed as deductions by the program. In practice these gains were very difficult to separate from other gains and were in fact allowed.

The second question was whether productivity as defined by the program could be measured, and rules designed to allow a deduction from apparent excess revenue for productivity gains. Several obstacles stood in the way of implementing the definition of productivity that was adopted.

First of all, a way was needed to measure unit cost and decline in unit cost. This was done by firms reporting under the unit cost rule—they had what amounted to a volume measure—and was not a serious problem in the case of major products under the margin rules. The problem arose for product lines with many products, particularly if there were changes in product mix between the base period and the compliance period. As a result, the notion of imputed gross revenue was developed. This meant that compliance period quantities were measured at base period prices, that is, the amount of revenue that would have been earned in the compliance period if the prices in the base period had been in effect. The volume index for a product line became the actual gross revenue in the compliance period divided by the imputed gross revenue. This could be worked out in a simple equation that gave a conceptually correct volume index. In practice, however, it required firms to list all the products in the product line, and the quantity sold in the compliance period times the prices in existence in the prior period. (The prior period was simply the fiscal year immediately prior to the compliance period.)

A volume index was developed, although it was difficult to apply. Some firms had a large number of products in product lines, requiring a great deal of administrative work both for the firms and the Board. Additional problems arose where product lines had new products intro-

duced during a compliance period, or old ones dropped. Although ways were found to take care of these situations, they remained problematic.

A second obstacle to using the concept of productivity was that it required that costs be allocated by product or product line. The problem was that allocation of fixed costs to product lines was fairly arbitrary, and manipulation was possible.

A third problem was that the concept simply did not apply in some situations, custom-made products for example. There was really no product in a prior period with which to compare performance in the compliance period. For problems like this, where no conceptual solution existed, the Board decided that if a productivity gain couldn't be measured, it couldn't be allowed. Some firms offered to measure productivity by such means as the number of labor hours per dollar of gross revenue. Although a great deal of thought was given to these suggestions, it was concluded that they would inherently be difficult to monitor.

The fourth problem was how to net out factor price changes, since productivity was a fall in unit cost after factor price changes or their effect were removed. Although taking out these changes was purely mechanical, where there were a large number of products in a product line the accounting requirements of firms and the administrative burden of the Board would have been very large indeed. At the AIB, some had the view that most firms' cost accounting systems would permit them to do this kind of cost analysis. In other words, they believed that firms could tell you how much, on average, their factor costs had gone up. However, if one was prepared to accept this, it would have been difficult to disagree with firms once they had prepared the required calculations.

A fifth and general problem in implementing this kind of productivity measure was that it had to apply to many different types of businesses. In principle it should have applied to situations in which fees were charged for services as well as the normal sale of goods; in fact it really had to be interpreted very broadly to apply to any other than to a straightforward production process.

Although a conceptual solution was found to the question of what is productivity, at least for goods that could be measured in units and concrete numbers, the administrative problems were almost insuperable. This led to a search for practical ways for businesses and the Board to approximate the effect of the correct definition of productivity. The conclusion was that the compliance population was too diverse for a set of tight rules to capture real productivity gains and maintain the desired price restraint.

It is critical to note that the movement towards a single rule—the net margin approach—was predicated on the ability to measure productivity improvements to counter the disincentives inherent in a profit margin rule.

Despite the problems listed earlier, a comprehensive technical bulletin was issued which, in addition to three pricing rules, contained a productivity rule (AI-21-P-Draft, Pricing and Productivity Credits, June 11, 1976).

The productivity rule in the June, 1976, draft guidelines allowed a credit against excess revenue where a firm had managed decreases in non-material unit costs after adjusting (excluding) for the impact of volume increases. The credit was 25 per cent of the amount by which the rise in its unit costs is less than 6 per cent (a level somewhat below that expected for the economy as a whole), after adjusting for volume increase.

The main issue in the productivity rule was essentially the same as in the case of pricing rules. Given the problem of not being able to measure changes in unit cost, the productivity rule assumed that, on average, factor prices were to increase at a certain annual rate exclusive of fixed costs. The rate finally arrived at was 6 per cent. The background assumptions were that overhead costs would increase at an annual rate of 5 per cent, while labor and material costs increased at some rate between 8 per cent and 10 per cent.

On casual inspection, the 6 per cent factor in the productivity rule appeared to be niggardly. The number was based on average figures, however. Some firms with stable or declining material costs would find the figure to their benefit and thus take advantage of the rule, while others would not be able to do so. Thus an equity problem arose, as with other parts of the Guidelines.

THE PRICING CREDITS

The draft guidelines of June 11, 1976, also included a series of pricing rules, summarized below. Along with the double cap and the 85 per cent margin deflator, these rules were the subject of much criticism from the business community. The pricing rules raised a basic question: does one restrain prices, freeze them or just pass through unit material cost changes?

The first pricing rule in the draft guidelines was a price freeze. It stated that any supplier who froze prices and also had material costs less than 10 per cent of total average cost and did not experience a decline in the material costs would be free from excess revenue. The thinking behind this was not to force any supplier to reduce prices below those prevailing at October 13, 1975.

The second pricing rule came to be named the material cost pass-through rule. It said in effect that prices could not go up between one compliance period and another by more than the change in unit material costs. In other words, unit material costs could be passed through, but not other costs. The notion behind this was that material costs were not controllable, while other costs could be discretionary from the point of view of management. Clearly, there are some problems with this assumption, in particular for suppliers who are vertically integrated and have a good deal of control over costs of production. Despite these problems, however, the substance of the rule was that prices would go down only in circumstances in which material costs had fallen, and they were to be reduced by the same amount as the decline in unit material costs.

The third pricing rule was called the fee reduction rule. It applied to a different class of transactions, particularly those in which a fee was charged for service, e.g., real estate and insurance. The rule said that fees had to decline at a rate of one-third of a per cent per month. The notion behind this was that inflation would increase the base on which the fee was charged and therefore a reduction in price was called for.

INVESTMENT CREDITS

Publication of the draft guidelines drew strong criticism from the business community for being both tough and niggardly.

In fact, the reaction of the business community to the pricing and productivity rules was so strongly negative, and their complaints so directly related to the effects of the controls program on investment, that the idea of developing an investment credit was considered. To do this it was necessary to decide what was meant by investment, whether credit was being given simply for current investment, for current investment versus investment in a base period, or for net investment, i.e., gross or current investment minus depreciation of assets.

The difficulty in using current investment compared to a base period was that it penalized firms with good recent investment performance, for example, those who had just finished a major expansion program. With net investment, the difficulty arose in measuring depreciation, essentially a data problem and an accuracy problem.

The decision was made to base credits on investment in the current period with a few limitations on kinds that could qualify. Generally speaking, those allowed had to be productive, and could not include such items as purchases of land, office buildings, and the like.

The question of how much credit to give for a dollar's worth of investment was arbitrarily settled at 50 cents on the dollar. Analysis of a similar period suggested that for the majority of large firms under controls, investments were distributed between 100 and 300 per cent of profits. Therefore, to give an investment credit of 50 cents on the dollar, completely unconstrained, would result in tremendous increases in allowable margins for most firms for normal investment performance.

Therefore, for reasons of restraint, a limit was put on the investment credit so that it could only increase target margins from 85 to 93½ per cent of the base period margins. Technically, the investment credit was the lesser of a firm's qualified investments (50 per cent of approved capital outlays) and a 10 per cent improvement in a firm's target operating profit. It was to apply in the third compliance year of the program. Investments made after August 31, 1976, would qualify and the credit would apply to the non-distribution sector only.

As the credit was only brought in in the third compliance year, the Board was left with a number of unusual productivity cases from the first and second compliance periods.

The central dilemma—a trade-off between a rule that was easy to apply and one that was faithful to a true concept of productivity—was

only partially resolved. Discussions on the matter continued into December, 1976, before it was resolved. After the revised guidelines were announced in September, the position of the senior staff on unusual productivity gains changed significantly. Whereas before that date efforts had been made to devise a legitimate measure of productivity, subsequent discussions reflected greater concern over administrative aspects.

The final form of the credit required the same kind of calculations as did the short-lived productivity credit proposed in May, no doubt reflecting the sense that the loosening of the September guidelines should not be extended back to the initial compliance periods.

The substance and application of unusual productivity gains were outlined in an internal policy memorandum (no. 20-R). The claimed productivity improvement was to be directly related to an investment in fixed assets. Such investment was to be greater than the lesser of 10 per cent of total fixed assets at cost or \$1.5 million. The attendant cost-saving was to be at least a 10 per cent reduction in cost per unit after the effects of volume and factor price changes had been removed. Firms were then allowed to claim as a credit against apparent excess revenue the value of any cost saving achieved above a 2 per cent unit cost decline. These criteria seemed to satisfy the objectives as only a handful of firms were successful in obtaining this measure of relief.

A RETROSPECTIVE VIEW

As with the initial guidelines, the effort to measure productivity focused on development of rules that were applicable in nearly all situations and would allow consistent decisions. Due to measurement and accounting problems, however, this proved difficult.

Discussions with people involved in this issue during the Economic Stabilization Program in the United States suggested that their approach was more flexible and pragmatic. Near the end of Phase II of that program, the Bureau of Labor Statistics made estimates of past productivity changes by industry (at the three-digit Standard Industrial Classification level). These changes were used as minimum figures to determine productivity offsets to allowable profit increases. No matter that heroic assumptions would have to be made regarding the extrapolation of past productivity changes or the applicability of industry averages to an individual firm. This approach offered two important benefits. First, it would be difficult to dispute independent estimates of past productivity as opposed to current individual firm estimates. Second, where a firm was below the industry average, it could secure a margin improvement up to that average. Conversely, where a firm was above the average, it had to reduce its allowable cost price increase by an amount equal to this difference.

Although this approach was briefly considered by the Board, it was rejected for two reasons. First, the official statistics on industry productivity simply did not allow comparable industry disaggregation. Second, the variations in the structure of the reporting units (corporate, minimum

consolidation, total consolidation) was considered an obstacle to unilateral assignment of industry figures. Potential opposition by the companies was thought to be an additional argument against such a scheme. In sum, the arbitrary nature of the scheme was considered undesirable.

In retrospect, the flexible and pragmatic features of the U.S. program seem to produce a more fruitful approach to a complex issue. The Board experience graphically illustrates the difficulty of devising a detailed set of rules without imposing a great administrative burden on both the controls agency and the compliance population.

A slight paraphrasing of a statement by President William Howard Taft of the United States perhaps best describes the complex issue of productivity, if one simply substitutes "productivity" for "conservation": "There are a great many people in favor of productivity no matter what it means."¹⁸

One final point on flexibility can perhaps be made with respect to the Guidelines. Insofar as revisions to the Guidelines reflected unexpected deviations in economic performance as well as considerations of effectiveness and equity, greater flexibility might be achieved by not linking them to a point on a business cycle or a longer-term movement of the economy.

5. The Reinterpretation of Paragraph 95(1)(c)

Paragraph 95(1)(c) of the Guidelines required suppliers to control prices so that any increase in the price of a product was not "substantially inconsistent" with increases in costs associated with that product. The intent was to stop any cost shifting from one product to another to the detriment of the consumer. Technical bulletin AI-20-P, Pricing Guidelines, of November 5, 1976, and the specific guidelines to officers of the branch contained in policy memorandum 11 provided a general interpretation of the paragraph which held until late spring of 1977. At that time, the Board considered a reinterpretation which would disallow any price increase that exceeded related cost increases by more than 15 per cent.

The reinterpretation related incremental revenues estimated from a proposed price increase and associated costs in a compliance period with the price-cost relationship holding in the final quarter of the immediately preceding compliance period. This reinterpretation was revised in light of the volatile nature of quarterly margins (largely reflecting seasonality of sales) and the empirical observation that many firms would be held to a margin substantially less than what was allowed by the revised guidelines, or even the product-line cap in the proposed guidelines of May. Consequently, comparisons were to be made against the whole of the prior compliance period and the proposal was to be no more stringent than the earlier proposed product-line cap.

¹⁸ W. H. Taft, "The Subject of Conservation," *Outlook*, May 19, 1910, p. 57.

In the final interpretation of paragraph 95(1)(c), price increases were deemed not to be “substantially inconsistent” with cost increases if either (a) the resultant margin improvement for the product line did not exceed 15 per cent (25 per cent where the firm was operating at less than 80 per cent of target on an overall basis), or (b) the absolute dollar amount of revenue generated by the price increase on an annual basis did not exceed 115 per cent of the absolute increase in allowable costs measured in relation to the prior period. -

The allowance of a 25 per cent margin improvement for firms that were substantially below target, and the introduction of a third threshold dealing with firms earning less than 8 per cent on equity, were both in effect additional relieving provisions, limiting the Board’s invoking of paragraph 95(1)(c). Another minor variation provided that firms should not be forced to lose money on a product line by virtue of the Board’s administration.

The single most difficult aspect of the final interpretation of paragraph 95(1)(c) was the timing of the price increase within the supplier’s fiscal period. A product line which earned 10 per cent in the previous period, for example, could be permitted 11.5 per cent in the compliance period, but only if the price increases were implemented at the beginning of the period. If the product line continued to earn 10 per cent for the first six months and then the prices were adjusted, it would only be able to earn 10.75 per cent for the entire period: no “catch-up” was permitted. To do otherwise would have allowed astronomical price increases under the thresholds at the end of a fiscal period.

6. Consolidation and Monitoring

The Board allowed firms associated within the meaning of section 256 of the Income Tax Act or related through management, ownership, or financial affairs to consolidate their financial data for reporting purposes.¹⁹ The objective was to allow an associated group of companies for reporting purposes to present adjusted operating profits which reflected actual business activities not distorted by corporate structure, which could vary considerably from one group of related companies to another. This policy of consolidation, however, contained several issues which were the subject of a review in the summer of 1976. One of these centered on the degree of price restraint inherent in the policy.

From the time of the introduction of the “double cap” in April to the review of the consolidation policy, there was discussion regarding the implications for price restraint of placing the margin test or cap at different levels. Generally, the higher the cap or margin limitation is placed, the lower the target or allowable profit margin will be. This

¹⁹ The latter inclusion caused a number of problems for staff in identifying companies subject to the mandatory requirements of the Guidelines. See 7, Exemptions.

follows from the proposition that where firms have a choice of a base period and the objective of making the maximum target margins, they will prefer to place a cap at the lowest possible level in order to make the most of the choices available. The degree of price restraint is a function not only of the size of the target margins, but also of the extent to which the firm has different profit behavior in different parts of its business.

Where a firm requires large offsets in one part of its business to secure its target margin, a lower level of the cap will produce a greater degree of price restraint. It also follows that the more variable the profit profile for a firm, the more it would prefer the cap placed at a higher level. Consequently, one could conclude, a priori, the degree of price restraint if a firm is capped at a high or low level. It depends upon the nature and historical pattern of the firm's business.

This led to the conclusion by many that with arbitrary placement of the cap, either high or low, the impacts must be random among firms. Board discussion generally favored capping at the lowest level—much the same principle as under the initial guidelines, although cast under different circumstances.

The degree of restraint necessary for the program under the amended guidelines yielded a margin deflator of 85 per cent of base period margins. The deflator was again tested in view of the discussions on the question of consolidation. A variety of data sources were used to simulate the effect on the degree of restraint of different levels of consolidation. Although there was no a priori reason for it, all of the analyses gave approximately the same result, that is, the deflator should be between 83 and 85 per cent in order to make it equivalent to 95 per cent of the 1970-1974 period under the initial guidelines, providing all firms were treated the same. This analysis was particularly important as it allowed the staff to recommend a general consolidation policy of requiring firms to continue reporting on corporate structures developed for the initial guidelines.

This recommendation also satisfied administrative considerations, particularly time and budget demands. It only remained to approve a somewhat lengthy draft technical bulletin (AI-30-P, November 5, 1976) on reporting requirements under the amended guidelines that was to reflect the firm stance of the Board on consolidation policy. This part of the transition to the amended guidelines presented few problems in implementation.

7. Exemptions

Any supplier in Canada who employed 500 or more persons, or suppliers in the construction industry who employed 20 or more persons, were subject to the reporting provisions of the Anti-Inflation Act. Subsection 3(4) of the Act defined the number of persons employed by a supplier as including persons employed by corporations associated with the supplier

within the meaning of section 256 of the Income Tax Act or by reason of the inter-relationship of management, ownership, or financial affairs of the supplier and the corporation.

In some cases, however, this brought under mandatory enforcement many suppliers whose compliance would have had little effect in curbing inflation in Canada, would have added considerably to the burden of administering the Guidelines, and was contrary to the intention of subsection 3(4). These cases included situations where suppliers did not form part of a common enterprise carried on by the associated group; in many instances suppliers carried on radically different businesses and were separately managed.

Subsection 3(4) did, however, give the minister of finance the power to grant exemptions from its application. Although discretion to grant exemptions rested with the minister, certain criteria were established by the Board for making recommendations regarding applications for exemptions.

As a general rule, suppliers were not initially exempted if at any time during their last fiscal year ending prior to October 14, 1975, they employed more than 19 persons, or had gross revenue from operations in excess of \$500,000. For those who employed fewer than 20 persons and whose gross revenue for the year was less than \$500,000, the criteria for determining exemptions from the association rule were twofold: whether the supplier was associated by virtue of section 256 of the Income Tax Act or by virtue of the interrelationship of management, ownership, or financial affairs. Suppliers associated with other suppliers under the first criterion who met the employment and gross revenue requirements would generally be granted exemptions if none of their products or services competed with or were similar to those of any other associated suppliers, if their management was substantially independent of that of any other associated suppliers, and if no significant commercial or financial relationship existed between them and any associated suppliers.

Suppliers associated with other suppliers under the second criterion who met the employment and gross revenue requirements would generally be granted an exemption if their management was substantially independent of that of any other supplier, and if the terms of their financial and commercial transactions with other suppliers were consistent with those between unrelated parties.

Applications for exemptions were either forwarded to the attention of the minister of finance or directly to the Anti-Inflation Board. In either case they were sent to the Technical Information Unit of the Prices and Profits Branch of the Board where they were processed. Applications were reviewed by both the Compensation and the Prices and Profits branches where recommendations were made regarding each application. The Technical Information Unit assimilated the data into a single concise report outlining the recommendations made by both branches. The case was then forwarded to the Prices and Profits Case Review Committee which had authority for making a recommendation.

By the end of the first year of the program, 172 requests for exemptions were received. Of these, 64 were granted and 108 refused. By the end of the second year a total of 469 requests had been received, with a total of 280 granted and 189 refused.

The increase in exemptions resulted from a change in the exemption criteria in early March, 1977 (internal policy memorandum no. 33). Prior to that time the general rule was that any firm that employed 20 or more persons, or had gross revenue from operations in excess of \$500,000, would not be granted an exemption. This rule was changed so that any firm with fewer than 500 employees was eligible for exemption providing that it was an associated supplier (within the meaning of section 256 of the Income Tax Act), dealt at "arm's length" with other members of the associated group, none of the supplier's products competed with or complemented those of an associated member, management was substantially independent, and no significant commercial or financial arrangements existed between the supplier and other associated suppliers. Where suppliers were associated but not under the meaning of the Income Tax Act, eligibility required that management be substantially independent and that all commercial and financial transactions between a supplier and an associated supplier be consistent with such terms as might exist between unrelated parties.

CHAPTER V

The Legislative Record

Following the announcement of the anti-inflation program on October 13, 1975, notice of Bill C-73, "an act to provide for the restraint of profit margins, prices, dividends and compensation in Canada," was given in the House of Commons on October 14, 1975. The bill was introduced on October 15, passed on December 3, and given royal assent on December 15, 1975.

Application

The Anti-Inflation Act delineated the part of the population subject to mandatory control: "(i) public sector suppliers of commodities or services, (ii) private sector suppliers of commodities or services who employ five hundred or more persons in Canada, (iii) suppliers of services prescribed by the regulations to be professional services, (iv) persons carrying on business in the construction industry who employ twenty or more persons in Canada. . . . (v) private sector suppliers of commodities or services who are from time to time declared by order of the Governor in Council. . . to be of strategic importance to the containment and reduction of inflation in Canada," employees of all the above, and public sector employees (subsection 3(2)). "Public sector" was specifically defined and the private sector was defined as anything that was not the public sector. Although the provincial public sectors were exempted from the Act, the federal government could enter into agreements with the provinces to have their public sectors covered by the Act.

The provinces had two options: (1) under subsection 4(3) of the Anti-Inflation Act, to enter into an agreement which provided coverage for the provincial public sector with controls to be administered by the federal Anti-Inflation Board, or (2) under subsection 4(4) to sign an agreement which provided for a province's own equivalent of the Anti-Inflation Board to ensure compliance with the Guidelines by its public sector.

The provinces, of course, have the constitutional authority at any time to establish an equivalent to the anti-inflation program to handle matters within their legislative competence. As it turned out all provinces except Saskatchewan, which independently implemented its own program, signed an agreement with the federal government. Saskatchewan

established the Public Sector Price and Compensation Board with its own guidelines. Of the nine provinces that signed an agreement, only Quebec chose to establish its own inflation control commission.

The Anti-Inflation Act provided that, where a statutory regulatory body existed which established or approved prices or profit margins, that regulatory body must apply the Guidelines, modified to the extent the regulatory body deemed appropriate. In these circumstances, the Anti-Inflation Board was precluded from performing the functions given to it in the Act with respect to price or profit margins.

The provision regarding regulatory bodies was a difficult one to interpret. In some cases, increases in rates need only be filed; in the absence of any action on the part of a regulatory body, they come into effect after a certain time. The question arose whether this constituted "approval" under the terms of the Act. Section 4.1 required that the statutory body did in fact approve or establish prices or profit margins, not simply that it had the legal authority to do so. Did this mean that the body must have acted in the case of the specific supplier? that it must have acted in a majority of cases? or was it enough to have acted once? These questions were resolved on a pragmatic basis.

Duties and Powers

The duties of the Board were set out in section 12 of the Act:

- (a) to monitor changes in prices, profits, compensation, and dividends;
- (b) to identify contraventions of the Guidelines either in fact or in spirit;
- (c) to identify the causes of actual and proposed changes in prices, profits, compensation, and dividends and to endeavor through consultations with the parties concerned to modify such changes in order to bring them within the Guidelines;
- (d) where voluntary compliance could not be achieved and where, in the opinion of the Board, contravention of the Guidelines was not justified, to refer the matter to the Administrator for consideration; and
- (e) to promote public understanding of the problems of inflation, to publicize and discuss the options available to governments to deal with inflation, and to emphasize the need for all groups to join in the battle against inflation.

Section 13 gave the Board the power to require suppliers subject to mandatory control to file information. Suppliers who failed to file the required information were subject to penalties imposed either by the Administrator or by summary conviction (section 21; subsection 44(5)).

The position of the Administrator was described in section 15 of the Anti-Inflation Act. The Administrator had the power to issue legally binding orders. Acting only when cases were referred to him by the Anti-Inflation Board or by cabinet, the Administrator was required to conduct an investigation to determine whether the Guidelines had been

contravened. When the Administrator determined that there had been a contravention, he could make any of the following orders under section 20 of the Act:

- (a) where excess revenue had been derived in the course of doing business, the Administrator could order the company to pay back the money to those who had obtained it, to rebate it to future customers, or if these were impractical, to pay the money to the Receiver General of Canada;
- (b) where a person had paid or credited compensation or dividends in excess of the Guidelines, to order the person to cease doing so and if the Administrator deemed it appropriate, to order payment of the excess amount to the Receiver General of Canada;
- (c) where persons had received compensation or dividends in excess of the Guidelines, to prohibit the persons from accepting any further compensation or dividends and, if the Administrator deemed it appropriate, to require the person to pay the excess amounts to the Receiver General of Canada; and
- (d) where there had been a knowing contravention of the Guidelines, to order payment of a penalty equal to 25 per cent of the excess revenue or the excess paid or credited.

The division of authority provided for in the Anti-Inflation Act is unique for administrative bodies in Canada. The Anti-Inflation Board had no binding powers except to require the filing of information, and its function was to act as persuader to help achieve “voluntary” compliance. The Administrator became involved only when this persuasion failed and a legally binding order was believed necessary.

The duties of the Board were designed to give it maximum flexibility and discretion. The Guidelines established the framework within which parties subject to mandatory control could operate without interference. If the Guidelines were contravened, the Board was to identify such contraventions but was not required to take any action. The Board could decide that the contravention was justified in the circumstances, that the contravention in total was not justified but that a portion of the excess was justified, or that the Guidelines should be adhered to rigidly. Because the Board was not by law required to act, no legal action could be taken to force it to act in a particular case.¹

As a practical means of performing its duties, the Board established a system of recommending to parties involved in a contravention of the Guidelines the amount which, if earned or paid, would not result in a reference to the Administrator. Although the Board was not required to explain its recommendations, it chose in most cases to give a reason if it recommended an amount above the Guidelines. It also felt constrained by its previous recommendations, although there was no need for this given the virtually limitless discretion allowed the Board within the legislation.

¹ Except as provided in sub-paragraph 12(1)(d.1).

The Anti-Inflation Board was restricted in the information it could disclose about its recommendations. Section 14 of the Act stated that any information obtained by the Anti-Inflation Board that was "in its nature confidential" was privileged and that it was an offence to disclose such information except under specified circumstances. Since collective agreements in all provinces are public documents, the Board could publish its recommendations for unionized groups. However, the Board could not release detailed information about executive compensation, other non-union compensation or any prices and profits cases. This caused some public misunderstanding of the Board's operation. Many believed that the Board was only dealing with union compensation and not with other matters, particularly prices and profits. On the other hand, the Board may have been more effective on the prices and profits side because of the reluctance of companies to have confidential information released. As long as a company complied with the Board's recommendations, there was no disclosure. However, the information became public if the matter went to the Administrator, since a report had to be tabled in the House of Commons giving details of the case.

Although the recommendations of the AIB were not binding, they were accepted in the great majority of cases. In most cases it was probably understood that there was little to be gained by a reference to the Administrator. While the Board had virtually unlimited discretion to allow amounts above the Guidelines, the Administrator had no discretionary power; his orders had to be made within the limits set by the Guidelines. Only in cases where section 44 of the Guidelines applied could the Administrator be somewhat subjective. This section stated that an additional amount consistent with the objectives of the Act could be paid to a group that had an "old" contract or a historical relationship with another group. In cases where the Board had used its discretion to recommend more than would have been allowed by the Guidelines and the parties nevertheless chose to request a reference, the Administrator, if his investigation confirmed the facts submitted to the AIB, had to order payments of amounts lower than the Board would have been prepared to accept.

The fact that, while the Board did not make binding decisions, most people acted as if they were binding, caused complications in labor relations. The federal and the various provincial labor relations boards were faced with making determinations on the effect of these non-binding opinions given by the Board but acted upon by the parties to the collective agreements.

The question of whether there could be a legal strike to oppose a Board recommendation also arose. Although it is difficult to say an opinion could have a legal effect on a collective agreement, the labor relations boards were faced with the reality that if they forced an employer to pay the amounts required in the collective agreement, the employer could become liable for a penalty imposed by the Administrator for a "knowing contravention." All labor boards faced with the problem

chose not to require employers to pay in excess of the Guidelines in the absence of an AIB recommendation in favor of an above-guidelines settlement.² Most labor relations boards also chose, largely on practical grounds, to find that a collective agreement providing for increases in excess of the Guidelines was rendered null and void by a Board recommendation that the amounts be reduced. Once the collective agreements were rendered null and void, the parties were required to return to collective bargaining. All labor relations acts require that bargaining be done in good faith. Indications were that, in this context, good faith would mean bargaining within the limits of the AIB's recommendation, although this point was never decided.³

Reference to the Administrator could be made only where there was a contravention of the Guidelines and, generally speaking, where that contravention resulted in excess revenue being paid. If a party disagreed with the Board's method of calculation or with one of the Board's interpretations of a section, there was no way the question could be settled by the Administrator unless there was a contravention of the Guidelines, excess revenue or excess compensation resulted, and the matter was referred to him. This posed some difficulties for companies planning for subsequent years. They had either to accept the Board's position or risk excess revenue if their position was not accepted. As a result of this uncertainty, and the fact that this was a temporary program, most companies chose to accept the Board's position even though they may not have been satisfied that it was correct.

Because there was no forum for deciding disputes between the Board and parties it was dealing with except where there was a contravention or a failure to file required information, the only option for suppliers who felt the Board had improperly considered them subject to mandatory control was to refuse to file information. The Administrator was then informed of the failure to file required information and the supplier would make the case that he was not subject to mandatory control to the Administrator. If the supplier was not in fact subject to mandatory control, the Administrator had no jurisdiction in the case.

Section 24 and section 30 of the Anti-Inflation Act provided for a further appeal procedure. A party subject to an order of the Administrator could

- (a) petition cabinet, who, within 30 days of receipt of the order, could revoke the order of the Administrator or instruct the Administrator to vary his order in a manner prescribed by cabinet; or

² See *Joint Council of Newspaper Unions and Pacific Press*, in *1976 Canadian Labor Relations Board Reports*, Vol. 2, p. 342.

³ Perhaps the most lucid decision in this context was that of Paul Weiler, chairman of the B.C. Labor Relations Board, in *Board of School Trustees of School District No. 39 and CUPE Local 407*, reported in *1977 Canadian Labor Relations Board Reports*, Vol. 2, pp. 201-211.

- (b) within 60 days of the date of the Administrator's order, appeal to the Anti-Inflation Appeal Tribunal.

No rules were set out for cabinet to deal with the petition and it could intervene in a case of its own volition. Cabinet never acted on a petition and it is unlikely that it would have intervened except in the most exceptional circumstances.

In the case of an appeal, the Appeal Tribunal was to conduct a hearing at which both the appellant and the Administrator would have an opportunity to present evidence. The onus was on the appellant to satisfy the Tribunal that the appeal should be allowed. The Appeal Tribunal could dispose of an appeal by

- (a) dismissing it; or
- (b) allowing it and
 - (i) vacating the order appealed against,
 - (ii) varying the order appealed against, or
 - (iii) referring the matter back to the Administrator for reconsideration and variation of the order.⁴

Decisions of the Anti-Inflation Appeal Tribunal could be reviewed by the Federal Court of Appeal under section 28 of the Federal Court Act. These reviews were limited to errors in law, capricious findings of fact, or denial of natural justice.

During the term of the anti-inflation program, various amendments to the Anti-Inflation Act were required. The amendments in Bill C-89 became effective May 20, 1976. Further amendments were contained in Bill C-18 which was given royal assent on April 20, 1978.

The Bill C-89 amendments dealt primarily with technical defects or additions. There was, however, one major change which affected the program from then on. The Anti-Inflation Board and the cabinet originally had a "monopoly" on referral of a case to the Administrator. The May 20 amendments contained a provision that allowed parties subject to a Board recommendation to require the Board to make a reference to the Administrator. As a result, there were many more references to the Administrator than originally anticipated, most of them at the request of the parties involved.

Near the end of the program, amendments were introduced to clear the way for decontrol. These included provisions to deem collective agreements amended consistent with a recommendation of the Anti-Inflation Board (or, if a reference had been made, consistent with an order of the Administrator), and to render null and void various clauses in collective agreements which provided for immediate increases on the termination of controls. Other amendments remedied technical defects and provided for continuation of the powers and duties of the Board, the Administrator, and the Appeal Tribunal after December 31, 1978, for matters relating to the control period.

⁴ Anti-Inflation Act, section 30(2).

The decontrol process started April 14, 1978, and the Act terminated December 31, 1978. Thus, many suppliers and employee groups exited from mandatory controls in the middle of a fiscal period or guideline year. The transition to an unregulated situation would have been more orderly if all controlled fiscal periods and all guideline years had finished while still under controls. Furthermore, if the decontrol process had started earlier or if the Act had been extended to April 13, 1979, there would have been no need for many of the "notwithstanding the expiry of this Act" clauses.

Guidelines

The Anti-Inflation Guidelines were established by regulation which set out control programs for prices and profits, professionals, dividends, and compensation. Later, specific rules were introduced for banks and financial institutions, and substantially new guidelines (the part 7 guidelines) were brought in for prices and profits control. Various changes were made in the Guidelines throughout the program as the need arose.

Constitutional Challenge

After the Anti-Inflation Act was introduced, it soon became clear that it would be challenged. Indeed, the constitutional challenge was raised as early as January, 1976, by the Renfrew Teachers, who challenged the validity of both the Ontario agreement and the Act itself. The government referred the matter of the constitutionality of the Act to the Supreme Court of Canada for an opinion. The question whether the Ontario-federal agreement was valid was referred at the same time.

By a majority of seven to two, the Supreme Court found that the Anti-Inflation Act was "valid legislation for the peace, order, and good government of Canada and does not, in the circumstances under which it was enacted and having regard to its temporary character, invade provincial legislative jurisdiction." The majority of the court felt that the federal government had perceived an economic crisis and that this "emergency" allowed it to enter what was usually provincial jurisdiction under the "peace, order, and good government" provision of the British North America Act. The dissenting members took the position that, in order to take such action, Parliament must specifically declare that an emergency exists, and that the court should not imply it. Four members of the majority believed that the legislation could be justified on a broader basis that "national emergency," and were prepared to support the legislation on the basis that it dealt with a subject of "serious national concern."

The Supreme Court held in a unanimous decision that the Ontario-federal agreement was invalid. The Ontario government by order-in-

council had transferred control over the wages and salaries of its public employees to the federal Anti-Inflation Board. The court held that such interference with the rights of citizens, which in effect changed provincial law, must be approved by the legislature. Ontario remedied the situation by passing retroactive legislation.

A similar question came up later as to the validity of the Manitoba-federal agreement. The Supreme Court, this time in a five to four split, again held that the agreement was invalid. Manitoba also passed retroactive legislation.

Parliamentary Debates

The motion for third reading and passing of Bill C-73 was adopted by a vote of 111 to 96 on December 1, 1975.

Clause 46(6) of the bill, which was added in the course of the third reading, created a stir in the Senate because it did not provide for the usual Senate approval of an early expiration of the Act. The Senate motion to approve the bill was agreed to and passed only after the minister of finance gave assurance that he would introduce an amendment to correct the anomaly.

In the late spring and early summer of 1977, the government consulted the provinces and representatives of labor and business in an effort to obtain consensus on a method of decontrol and a firm commitment to practice restraint once controls were removed.

With the exception of Saskatchewan, which had its own board to deal with areas of provincial jurisdiction, and Quebec, which had opted out of the anti-inflation program for areas within its provincial jurisdiction shortly after the November, 1976, election, the provinces generally favored continuing the program for most of 1977. British Columbia wanted the government to keep the program until expiry of the legislation in 1978. Although both business and labor favored removal of controls, the government was unsuccessful in obtaining a firm commitment for future restraint.

On June 16, 1977, following presentation of a petition signed by the required 50 members of the House, a motion was introduced by the Progressive Conservative party to end controls on June 30, 1977. The party blamed the program for the slump in the economy and the high unemployment rate. It suggested that the government monitor wage and price developments and reserve the right to reimpose controls temporarily in the future in the event the marketplace was not working well.

The government defended continuation of the program on the basis that, because of the continuing upward pressure on costs and prices of domestically-produced goods and services, the need for controls still existed. It also expressed the fear that ending the program with the prospect of reintroduction of controls, as proposed by the opposition, could produce anticipatory wage and price increases.

The motion to end controls on June 30, 1977, was defeated by a vote of 102 to 80 on June 21, 1977.

Another concern of the government, explained at the time of the motion to end controls, was the legal status of unamended collective agreements once controls were removed. Many of these agreements had been reached at rates of increase substantially higher than the Guidelines. Some had been rolled back by recommendation of the Anti-Inflation Board, others had been reduced by order of the Administrator. However, because many of the contracts had not been rewritten to reflect these rulings, they still provided for the rates originally negotiated. The minister of finance therefore proposed amendments to the Act to deem the agreements amended in line with the Anti-Inflation Board recommendation or order of the Administrator.

On October 20, 1977, the minister of finance announced in the House of Commons that a phasing out of controls would begin on April 14, 1978, and that an agency would be established to monitor wage and price developments after that date.

Anti-Inflation Board Legislation References

Thirtieth Parliament—First Session
September 30, 1974 to October 12, 1976

Anti-Inflation Bill C-73

HOUSE OF COMMONS

| | <i>Hansard Pages</i> | <i>Date</i> |
|-----------------------|----------------------|------------------|
| <i>First Reading</i> | 8264 | October 16, 1975 |
| <i>Second Reading</i> | 8306 - 8326 | October 20, 1975 |
| | 8349 - 8380 | " 20 " |
| | 8400 - 8433 | " 21 " |
| | 8453 - 8470 | " 22 " |
| | 8483 - 8494 | " 23 " |
| | 8500 - 8512 | " 23 " |
| | 8586 - 8587 | " 27 " |

Bill Referred to the Standing Committee on Finance, Trade and Economic Affairs

Minutes of Proceedings and Evidence

| <i>Issue No.</i> | <i>Date</i> |
|------------------|------------------|
| 62 | October 30, 1975 |
| 63 | " 31 " |
| 64 | November 3, 1975 |
| 65 | " 5 " |
| 66 | " 6 " |
| 67 | " 7 " |
| 68 | " 13 " |
| 69 | " 17 " |
| 70 | " 18 " |
| 71 | " 19 " |
| 72 | " 20 " |
| 73 | " 21 " |

Committee Reported Back to the House of Commons

| <i>Hansard Pages</i> | <i>Date</i> |
|----------------------|-------------------|
| 9416 - 9450 | November 25, 1975 |
| 9510 - 9513 | " 27 " |

| | <i>Hansard Pages</i> | <i>Date</i> |
|----------------------|----------------------|------------------|
| <i>Third Reading</i> | 9584 - 9617 | December 1, 1975 |
| | 9640 - 9668 | " 2 " |
| | 9686 - 9690 | " 3 " |

SENATE

| | <i>Debates Pages</i> | <i>Date</i> |
|-----------------------|----------------------|------------------|
| <i>First Reading</i> | 1500 - 1501 | December 3, 1975 |
| <i>Second Reading</i> | 1503 - 1513 | December 4, 1975 |
| | 1524 - 1537 | " 8 " |
| | 1538 - 1545 | " 8 " |
| | 1550 - 1564 | " 9 " |

Bill Referred to Senate Standing Committee on Banking, Trade, and Commerce

| <i>Issue No.</i> | <i>Date</i> |
|------------------|------------------|
| 71 | December 9, 1975 |

Bill Referred Back to the Senate

| | <i>Debates Pages</i> | <i>Date</i> |
|----------------------|----------------------|-------------------|
| | 1573 | December 10, 1975 |
| | 1573 - 1581 | " 10 " |
| <i>Third Reading</i> | 1581 - 1587 | December 10, 1975 |
| <i>Royal Assent</i> | 1617 | December 15, 1975 |

Amendments to the Anti-Inflation Act—Bill C-89

HOUSE OF COMMONS

| | <i>Hansard Pages</i> | <i>Date</i> |
|-----------------------|----------------------|----------------|
| <i>First Reading</i> | 11706 | March 11, 1976 |
| <i>Second Reading</i> | 11912 - 11918 | March 18, 1976 |
| | 11924 - 11937 | " 18 " |
| | 12006 - 12017 | " 22 " |
| | 12024 - 12037 | " 22 " |
| | 12187 - 12204 | " 26 " |
| | 12226 - 12233 | " 29 " |

Bill Referred to Standing Committee on Finance, Trade, and Economic Affairs

Minutes of Proceedings and Evidence

| <i>Issue No.</i> | <i>Date</i> |
|------------------|---------------|
| 97 | April 8, 1976 |
| 98 | " 12 " |
| 99 | " 13 " |

Committee Reported Back to the House of Commons

| | <i>Hansard Pages</i> | <i>Date</i> |
|----------------------|----------------------|----------------|
| | 12920 - 12926 | April 27, 1976 |
| | 12930 - 12943 | " 27 " |
| | 12961 - 12979 | " 28 " |
| | 12995 - 13003 | " 29 " |
| <i>Third Reading</i> | 13003 - 13004 | April 29, 1976 |

SENATE

| | <i>Debates Pages</i> | <i>Date</i> |
|-----------------------|----------------------|-------------|
| <i>First Reading</i> | 2076 | May 4, 1976 |
| <i>Second Reading</i> | 2098 | May 6, 1976 |
| | 2104 - 2106 | " 11 " |
| | 2111 - 2115 | " 12 " |
| | 2123 - 2124 | " 13 " |
| | 2133 - 2139 | " 18 " |

Bill Referred to Senate Standing Committee on Banking, Trade, and Commerce

| | <i>Issue No.</i> | <i>Date</i> |
|--|------------------|--------------|
| | 86 | May 19, 1976 |

| | <i>Debates Pages</i> | <i>Date</i> |
|----------------------|----------------------|--------------|
| <i>Third Reading</i> | 2150 - 2151 | May 20, 1976 |
| <i>Royal Assent</i> | 2152 | May 20, 1976 |

Thirtieth Parliament—Second Session
October 12, 1976 to October 17, 1977

*Resolution: AIB Act to Expire June 30, 1977,
Under Section 46(6)*

| | <i>Hansard Pages</i> | <i>Date</i> |
|---------------|----------------------|---------------|
| <i>Debate</i> | 6745 - 6757 | June 16, 1977 |
| | 6766 - 6780 | " 16 " |
| | 6806 - 6821 | " 17 " |
| | 6855 - 6870 | " 20 " |
| | 6874 - 6886 | " 20 " |
| | 6940 - 6953 | " 21 " |
| | 6953 - 6954 | " 21 " |

Resolution was defeated by House of Commons vote.

Thirtieth Parliament—Third Session
October 12, 1977 to October 11, 1978

Amendment to Anti-Inflation Act and Guidelines—Bill C-18

HOUSE OF COMMONS

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| 8 | February 7, 1978 |
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| 10 | " 21 " |
| 15 | March 16, 1978 |

Committee Reported Bill Back to the House March 17, 1978

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SENATE

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CHAPTER VI

Communications

There were three distinct stages in the communications effort of the Anti-Inflation Board. The effort began in October, 1975, as a somewhat rushed attempt to inform a client audience, the “regulated” public, how to comply with the new economic controls. After about a year, the main thrust was given to explaining the program to the general public and garnering and maintaining support for it. Finally, especially from mid-1977 to early 1978, the AIB sought to educate the general public about the causes and dangers of inflation and exhort individuals to combat inflation through their own buying and spending behavior.

The Beginning

The possibility that wage and price controls would be imposed had been discussed in the media for some time before they were actually announced. Many commentators correctly surmised that economic restraint was the topic for discussion when the prime minister met with the provincial premiers in Ottawa on Thanksgiving Day, 1975. Nevertheless, the prime minister’s nationally-televised statement that evening came as a surprise, if only because the government had vigorously resisted the idea of controls in the 1974 election campaign.

The announcement was dramatic, and indicated that the government would move quickly to deal with the economic crisis. This sense of urgency and mission characterized the controls program for several months and undoubtedly contributed to the widespread public support that flowed to the fledgling AIB.

At the outset, creating public confidence in the Board was not difficult. Opinion polls indicated that most Canadians wanted strong government action to contain inflation; creation of the Anti-Inflation Board to administer guidelines restraining prices and incomes appeared to meet that requirement.¹ The appointments on October 14 of Jean-Luc Pepin, former minister of industry, trade, and commerce, as chairman and Beryl Plumpton, the popular chairman of the Food Prices Review

¹ A Gallup poll taken one week before controls were imposed indicated that 70 per cent of the population felt controls were justified; of those, only 21 per cent favored voluntary controls. Fifty-four per cent wanted compulsory action on wages and 70 per cent favored compulsory action on prices.

Board, as vice-chairman, were strong indications that the government intended the Board to be vigorous, tough-minded, and highly visible. Another factor contributing to the Board's early acceptance was an extraordinary round of speaking engagements by the prime minister and his cabinet. Each day between October 14 and Christmas, as many as 10 ministers delivered speeches in support of the anti-inflation program.

The decision to impose controls was taken quickly. Although there was little time to devise a detailed communications strategy, considerable effort had been made to prepare material, recruit staff, and devise tactics for handling the immediate situation. Two top government writers were summoned to the Finance Department to draft and redraft a White Paper outlining the government's four-part attack on inflation, and to prepare a brochure and a press summary of the highlights.

A great deal of unavoidable confusion marked the early days of the Board, unavoidable because the AIB had been created with a clear mission but with only a broad outline of how to achieve it. While the confusion and uncertainty persisted for two months, until the Anti-Inflation Act was enacted and detailed guidelines were published and distributed in December, the Board's difficulties were far less serious than they would have been without public support.

The first problem was to satisfy an immediate and overwhelming demand for information about how the program would work. This was a formidable task. On October 14, 1975, the AIB was created with full powers under the emergency provisions of the Inquiries Act. At that point, however, and for two months thereafter, the Board had neither an established set of guidelines nor any other document giving details of how it would administer the restraint program. The communicators had only the government's bill (still to be debated in Parliament), the White Paper, and the text of the prime minister's announcement to guide them.

Companies and unions whose employees or members were likely to be subject to the mandatory provisions of the Anti-Inflation Act had the most pressing need to know about the program. Within this group, companies and unions in the midst of contract negotiations, or companies on the point of establishing new prices, had to know as soon as possible whether they were subject to the rules and, if so, how to proceed.

Other groups with a significant "need to know" included the media, politicians and public servants in Ottawa and provincial and municipal administrations, and, of course, the general public.

To assist in this initial communications task, officers from the 28 District Taxation offices across Canada were brought to Ottawa and briefed. By October 15, they had returned to their desks to answer basic questions and to route more complex inquiries to Ottawa.² At the same

² Revenue Canada's District Taxation offices made an important contribution to this early communications effort. By December, 1975, the offices had distributed 195,000 copies of the Department of Finance brochure on the program and had handled a large volume of inquiries about the evolving guidelines.

time, the Anti-Inflation Secretariat seconded information officers for a number of government departments to handle media requests, and to establish a technical inquiries group to provide more detailed information.³ The complaints and inquiries section of the Food Prices Review Board was also brought in to deal with questions from the public.

The demand for information soon flooded these quick-response facilities. In addition to meeting the demands of their particular clienteles, media relations officers and public inquiries staff were soon pressed into service on the technical inquiries front, answering calls from the “regulated” public and referring them only when very detailed or specific responses were required.⁴

Soon after the program was launched, the private sector helped to ease the communications burden. Large chartered accountancy firms, after gleaning information from the Act, the White Paper, and experts in Ottawa, published brochures for their clients. The business press did an excellent job of reporting on both the mechanics of the program and its implications, while several publishing houses put together collections of information about controls, advising subscribers of all changes and interpretations issued by the government and the Board.⁵

The Early Weeks (October 31 to December 31, 1975)

At the outset, the AIB had substantial support from the business community,⁶ the media,⁷ local and provincial governments, and the public at large. However, an increasingly widely held conviction that the AIB was tough on wages and less tough, if not “soft,” on prices quickly emerged as a problem that was to plague the Board throughout its life. The persistent opposition of organized labor leadership to the whole idea of controls added considerably to this problem.

³ The clerk of the Privy Council had urged all government departments and agencies to co-operate in the effort to launch the Anti-Inflation Board by releasing people to the Secretariat. The result was that a battery of experienced public servants were relieved of their regular duties and instructed to report to the new agency within the space of a day or even an hour.

⁴ The public inquiries staff retained this role throughout the program. For all intents and purposes, they replaced the technical inquiries group when it disbanded at the end of 1975.

⁵ CCH Canada, Butterworth and Company, and Richard DeBoo.

⁶ By the end of the program, 51 employees from private industry had worked with the AIB, through the Public Service Alliance of Canada Executive Interchange Program.

⁷ According to the Anti-Inflation Secretariat's broad analysis of editorial comment during the period October 14 to October 31, roughly 75 per cent of the newspapers logged were either favorable or neutral to the program. Thirty-two of 127 editorials were critical. Among the most common criticisms were (a) the program would not work unless the government set an example of spending restraint; (b) wage and price controls had not worked elsewhere and there was no reason to expect they would work in Canada; and (c) the program should have been launched with a freeze on wage and price increases.

Spokesmen for organized labor lost no time denouncing the restraints. Their argument was that the burden of the fight against inflation would be borne "on the backs of workers," as well as the poor, and those on fixed incomes, who were the victims rather than the causes of inflation. In a news conference held 10 days after the announcement of the program, the president of the more than two-million-member Canadian Labor Congress (CLC) called on the prime minister to withdraw the legislation. A week later, after a meeting between cabinet ministers and union officials, the CLC announced that it would raise \$500,000 to fight controls through a direct appeal to the public.⁸

The Board had anticipated the opposition of organized labor, although the strength of union reaction may have been underestimated. The importance of union support was a prominent theme in many early speeches by Board members and senior staff. However, when polls began to show emerging support for the restraints among the rank and file, if not among union leadership, the Board broadened its theme to a more general appeal for the continued support of all Canadians.⁹

In his first official act as chairman, two days after his appointment, Mr. Pepin attempted to counter labor's arguments by publicly demonstrating the Board's commitment to control prices. In a letter to 1,500 of the largest firms in Canada, the chairman asked for their "assistance and co-operation" in complying with the restraints, and cautioned them to retain all records of price levels in effect on October 14.¹⁰ He also indicated that prenotification of price increases would be required from some companies. The chairman's letter was published as a news release and distributed to the media.

A news release issued after the AIB's first formal meeting (October 28-30, 1975) emphasized that the Board's first priority was "to establish without delay the process of monitoring price and profit developments. . . . In particular. . . the Board will immediately be asking about 100 of the largest firms in the country to identify their main product lines as a basis for an efficient system of price monitoring."¹¹ A week later, on November 7, 1975, the Board published the text of a letter sent to 178 firms, requesting this product-line information. At the same time, it announced that the food price monitoring system developed by the Food Prices Review Board would be continued by the AIB and extended to include other non-food consumer goods.

⁸ The CLC subsequently ran a series of quarter-page newspaper advertisements using the slogan "Why Me?"

⁹ An opinion poll taken by the government in November, 1975, indicated that only 56 per cent of union households opposed the program and 8 per cent had no opinion. Sixty-six per cent of non-union households supported the program.

¹⁰ The letter was a minor embarrassment because the list of companies contained many errors. A subsequent press release admitted the mistake before it became a cause célèbre in the media. See news release 75-01, October 17, 1975.

¹¹ News release 75-05, October 30, 1975.

Many of the Board's early public actions were a result of the need to be, and to appear to be, firm in the application of the rules restraining prices and profit margins. Because of the nature of these rules, it was clear that in the short run there would be no dramatic deceleration in rates of increase. However, by demonstrating its commitment to be vigilant in administering the Guidelines, the Board hoped to dampen public expectations of continued high rates of inflation over the longer term.

Three further actions were taken on the price side before the end of 1975. On December 15, the Board announced a system of price prenotification applying to 117 companies, representing \$28 billion in annual sales.¹² These companies were also asked to postpone any increases in the Canadian selling prices of their products until publication of the prices and profits guidelines. On December 19, companies subject to controls on a mandatory basis were told publicly that they would have to move quickly to eliminate "excess revenue," and on December 29 the Board instructed 19 major oil firms to submit prior notification of intended price increases.¹³

The Board's efforts to convince the public of the effectiveness of its prices and profits regime were complicated by a number of factors. Initially the majority of companies subject to controls chose to comply with the rules.¹⁴

As a result, there was little occasion for publicity about AIB price "rollbacks." There was immediate and very visible rollback activity on the compensation side, however, since many employee groups had continued to negotiate for substantial wage increases which were found to exceed the first-year guidelines. Because the Board's decisions in these cases were made public, organized labor's accusation that the Anti-Inflation Board controlled wages but not prices gained increasing plausibility.

The Board faced the related difficulty of producing concrete evidence of an effective and vigorous scheme to restrain prices. Devising a mechanism to control prices and profits proved to be considerably more difficult than controlling compensation. Indeed, the Board was already making decisions on compensation cases while it was still deciding how to restrain prices.

¹² The number of firms required to prenotify the Board of price increases was raised to 274 (\$60 billion annual sales) in May, 1976, and to 298 (\$170 billion) on February 8, 1977, when the reporting requirements were tightened. On December 9, 1976, the Board reported that "virtually all" proposed price increases were within the Guidelines. Of 1,150 applications, the Board intervened in only 18.

¹³ See news releases 75-11, November 21, 1975; 75-18, December 15, 1975; and 75-22, December 19, 1975.

¹⁴ In a speech in Toronto early in 1976, Mr. Pepin described this as the "hesitation waltz" period, where companies, uncertain of the regulations, decided to hold their prices rather than risk inadvertent non-compliance.

The system that emerged was complicated and difficult to communicate to the general public. In outline, it was designed to restrain prices by limiting profit margins (see chapter four). As a result, the final test of a company's compliance with the rules—and thus the possibility of establishing and making public any “excess revenue”—occurred only at its fiscal year-end. It was thus several months before the Board could demonstrate that its prices and profits regime was in operation.¹⁵

The publicizing of price actions was further limited by the Board's responsibility, enshrined in the Act, to maintain the confidentiality of information submitted by companies subject to mandatory reporting. Disclosure policy (i.e., a policy on the amount of information that could be released about prices and profits cases) was long a matter of controversy among Board members and staff. In general, the Communications Branch pressed for greater freedom to publicize the Board's activities in this area. On the advice of the Board's lawyers, what emerged was a public statement that “the AIB will disclose the names of firms involved in rulings and relevant facts which help to clarify the rulings, provided that *such disclosure does not infringe on the confidentiality of information provided by the firms to the Board*” (emphasis supplied).¹⁶

This position drew sharp criticism from the media and did little to advance the Board's efforts to demonstrate the effectiveness of its price restraint regime. For example, it meant that several decisions reducing dividend payments, which might have helped to build public confidence in the Board, were not immediately announced.¹⁷ Another implication was that the Board had to seek a company's consent before releasing specific information to the media.

Nailing Down the Program (December, 1975 to March, 1976)

For several months after the Board was created, the major information effort had been to communicate the “how to” message to the “must do” audience, that is, to ensure that those who had to comply with the law were told how to do so, and to provide them with the necessary forms, guidelines, technical bulletins, and instructions. While this was not the

¹⁵ The first excess revenue case was not publicized until April, 1976. It involved acceptance of a compliance plan proposed by Canada Starch Company to dispose of \$6,000 of excess revenue, gained in the period October 1, 1975, to December 31, 1975, through price reductions—rather small beer from a communications point of view and treated as such by the media.

¹⁶ News release, 75-17, December 15, 1975.

¹⁷ The first announcement of dividend restrictions came on March 12, 1976. At the same time, a clarification of disclosure policy was announced: “The Board's policy is to make public any formal decisions to intervene in corporation decisions on dividend payments. . . [however] any decision to intervene would not be announced publicly by the Board until the corporation had publicly declared its dividend.” Press release, 76-38, March 12, 1976.

sole communications activity, it consumed a large amount of the energies of the Communications Branch.¹⁸

After the Act was given royal assent on December 15 and the Guidelines were released on December 18, 20,000 kits containing these items and explanatory materials were distributed to companies and labor unions affected by the Act, and to major trade, business, and professional associations, provincial governments, and members of Parliament. The kits were also distributed to the media at a briefing session on Parliament Hill. Copies were sent to the 28 District Taxation offices, AIB regional offices, and the AIB distribution centre in Ottawa for further distribution.

In December, a series of technical seminars was held in Ottawa to acquaint a number of public servants with the program. This was followed by a series of 29 one-day seminars in cities across Canada in January. These sessions reached more than 4,200 people, including representatives of 184 of the top 200 firms in Canada, and 104 of the 117 firms then subject to price prenotification. Four more seminars were held in February to brief provincial and municipal officials.

Although these briefing seminars were generally well received by the participants, they were perhaps not as effective as they might have been had they begun sooner. In any event, the Board decided that the seminar was not the most efficient way to disseminate information about the program and a proposed second round was canceled. Instead, the AIB supported privately-held seminars by selectively providing experts and by preparing an audio-visual presentation explaining the Guidelines.

In an attempt to communicate an outline of the program to the widest possible general audience, the Board also purchased full-page advertisements in 110 daily newspapers during December, 1975. This decision proved to be controversial both as to the expense and the choice of the advertising agency. In February, 1976, a further series of advertisements was published to advise the "regulated" public that AIB reporting forms were available and to advise them of the preliminary reporting schedule.

For the first three months of 1976, the AIB continued to be preoccupied with establishing the machinery of controls. Procedures for oil price monitoring were made public on December 30, 1975, followed about a month later by announcement of the general system of monitoring prices, profits, dividends, and compensation. Guidelines for chartered banks and other financial institutions were released on February 20, and in April the Board announced rules covering life insurance companies and professionals.

¹⁸ A major publicity project was undertaken during this early period in co-operation with the Department of Finance and the Department of Health and Welfare. "A Message from the Prime Minister" describing the seriousness of inflation was enclosed with family allowance and old age security cheques in December, 1975, and reached a total of 5.1 million households.

All these early announcements required distribution of news releases and frequently arrangement of news conferences and background briefing sessions for members of the Ottawa-based media. Almost all the announcements received wide media coverage.

Modification and refinement of the controls machinery continued throughout the spring and summer of 1976. Problems with the prices and profits guidelines led to a decision to revise them in consultation with the business community. In May, a draft of the proposed revisions was mailed to the 3,454 companies subject to mandatory compliance,¹⁹ as well as to 2,500 other interested companies and business associations.²⁰ In the same month, the Board increased the number of companies under its prenotification regime to 274.

The Tough Grind (April to August, 1976)

After a period of grace, public support for the anti-inflation program slipped from 62 per cent in November, 1975, to 54 per cent in March, 1976, to a bare 50 per cent in July, 1976.²¹ A national opinion poll indicated that the decline was broadly-based and general: it was evident in all regions of the country, among all age groups, both sexes, and at all income levels. As suggested earlier, the overriding factor in the decline was a widely-held conviction that the Board was neither willing nor able to restrain prices. When the program was introduced, the public expected prices noticeably to stabilize and was disappointed when they continued to rise. A reduction in the average rate of price increase was not enough to overcome public skepticism.²²

Early in 1976 the consumer price index, published each month by Statistics Canada, had emerged as the AIB's "scorecard," to the extent that when the CPI increased by 0.8 per cent from April to May, 1976, the media blamed the Board. The chairman replied in a news release that the program could not be judged on the basis of "month-to-month fluctuations" in food prices, which had been chiefly responsible for the

¹⁹ In July, a full-page advertisement appeared in a number of Canadian dailies. It was an "open letter" from Paul Paré, president of Imasco Ltd., to the minister of finance. In his letter Mr. Paré described his corporation's effort to "make common cause" with the anti-inflation program, but with the proposed changes he predicted decreased productivity and postponed investment. It was the start of a difficult time for AIB Communications.

²⁰ The AIB received more than 500 briefs from the business sector, most of them reacting negatively to the proposed changes. Reaction was particularly strong to the proposal to reduce some firms' allowable margin of profit from 95 per cent of that earned in a base period to 85 per cent.

²¹ *Price and Income Restraints: A National Study of Reaction*, Goldfarb Consultants Limited, November, 1976, p. 10.

²² The annual rate of inflation, measured by the consumer price index (per cent change from the same month a year previously), declined from 9.6 per cent in January, 1976, to 6.8 per cent in July, largely because of decreases in food prices. However, the inflation rate of non-food commodities was declining at the same time.

increase. Mr. Pepin also pointed out that the public should not be dismayed by continued increases in some prices:

The AIB has tried to persuade the public not to expect an abrupt end to all price increases, but rather to anticipate a gradual winding down in the rate of inflation. It is hoped that the public will realize that the success of the wage and price controls should be judged by the moderation of the inflation rate.²³

At this stage the Board, particularly the Communications Branch, was aware of the need to prevent further erosion of public support. As a result, the communications effort shifted its focus from the mechanics of controls to the more general question of why such a program was needed. A concerted effort was made to convince the public that the Board was applying the rules firmly, equitably, and with encouraging results. To communicate these messages and to restore flagging public support, the Board consciously took advantage of opportunities afforded by its high public profile.

Although communications strategy at this point dictated an even greater effort to demonstrate the efficacy of the price restraint regime, there were serious tactical difficulties. To a public looking for visible results, the Board could show only slim pickings. Between April and August, it was able to announce only seven pricing actions, four of which arose out of the prenotification system.²⁴

Although there were few price rollbacks to publicize, high priority was placed on providing the public with specific information on the price monitoring system. A summary of statistics on compliance forms received and processed, dividends, price prenotifications, and excess revenue cases was published regularly.

The Board also sought to restore public support through projects designed to engage the general public in the program and to inform it about the causes and consequences of inflation. One such project involved preparation and broad distribution of a booklet entitled *A Guide to Your*

²³ News release 76-108, June 15, 1976.

²⁴ *April 8, 1976.* The AIB intervened in a proposed 1.5 cents per gallon price increase requested by Imperial Oil, reducing it to one cent. This represented about \$22.5 million in revenue for the last three quarters of 1976. (News release 76-58, April 8, 1976.) The AIB later called for cutbacks in proposed increases by Gulf Oil Canada, Texaco Canada, and BP Canada, accepting about one-third less than was proposed.

April 13, 1976. Announcement of intervention in four dividend applications; neither the companies nor the amounts were made public.

April 14, 1976. First compliance plan accepted from Canada Starch Company to eliminate \$6,000 in excess revenue.

April 15, 1976. Noranda Mines agreed to AIB request to withdraw proposed increase in copper prices.

May 13, 1976. Travelers Insurance Company, Toronto, and Hertz Canada agreed to reduce proposed price increases.

July 29, 1976. The AIB announced acceptance of 40 excess revenue compliance plans totalling \$22,018,000. The companies involved were not identified.

August 27, 1976. Monarch Fine Foods agreed to dispose of \$82,000 in excess revenue earned in the company's first compliance period ending December 31, 1975.

Personal Fight Against Inflation in May, 1976. The booklet encouraged Canadians to be “inflation fighters” by bringing unreasonable or unjustified price increases to the attention of the appropriate provincial, federal, or regulatory authorities listed in the booklet. This publication was advertised in daily newspapers on May 18.

A related project was the limited distribution of the so-called consumer price monitoring forms. The forms were designed to provide consumers with a systematic way to investigate and report rate or price increases. Buyers were asked to question store managers and manufacturers about price increases and, if they remained unsatisfied, to describe the price change on the form and mail it to the AIB.

In the early summer of 1976, the monitoring forms were test-marketed in three cities with the voluntary assistance of the Consumers’ Association of Canada.²⁵ Unfortunately, the system was apparently too complex and time-consuming to inspire wide public participation. Response to the project was very poor, with the Board receiving fewer than 200 returns. An effort to distribute the forms through newspaper advertisements²⁶ proved equally unsuccessful and the program was dropped.

An innovative communications project undertaken early in 1976 was the creation of a Division of Corporate Relations within the Communications Branch. Two consultants were hired for five months to meet with senior management in corporations subject to mandatory compliance. Company managers were urged to use their corporate communication networks, which linked them with employees, shareholders, and customers, to publicize their support of restraint and their efforts to comply with the spirit of the program. While the Board’s initiative produced some results, including several private-sector advertisements announcing “anti-inflation” sales and promotions, it would no doubt have been more effective without the growing corporate frustration at the complexities and proposed changes in the prices and profits program.²⁷

By this time, summaries of compensation decisions, statistics on public complaints and inquiries received by the AIB, a report on the food price monitoring program, and a bulletin for weekly newspapers called “Consumer Information” were being released by the Communications Branch on a regular basis. “Consumer Information” became an important means of communication with the general public. It was distributed in “repro proof” form so that editors could strip articles directly into their makeup, and it was widely carried by weekly papers.

Specially prepared electronic news releases were issued regularly to broadcast news services and to regional and local stations. The chairman,

²⁵ The forms were made available in selected supermarkets, government offices, and financial institutions in Winnipeg, London, Ontario, and Quebec City.

²⁶ In the *Halifax Chronicle Herald* and the *Edmonton Journal*, July 14 and 15, 1976.

²⁷ This frustration reached its peak at the annual meeting of the Canadian Chambers of Commerce in Montreal in the fall of 1976.

Board members, and senior AIB staff held frequent background briefings for the media. A loose-leaf backgrounder service, "The Media Reference File," was continuously updated and distributed to about 200 key media people across the country.

Apart from these media programs, an inquiries and complaints organization was established to deal directly with members of the public by telephone or mail. This group had helped to respond to the enormous volume of questions received in the program's early months. Its function steadily broadened, however, to include public concerns extending from the technical inquiries of professionals or businessmen concerning the Act or Guidelines, to the most general questions or complaints ("Why are prices still rising when we have price controls?") from the public at large.²⁸ The inquiries and complaints staff served as the Board's window on the world, responding directly to comments and questions from the public and communicating them to the Board and senior staff.²⁹ By the end of the program, Ottawa and regional offices had responded directly to nearly 100,000 inquiries and complaints from the public.

Speaking engagements played a major role in the Board's communications effort from the start, particularly in mid-1976, and the Speakers Bureau was established in the Communications Branch to direct this activity. To extend the Board's speaking schedule and ease the burden on Board members and senior AIB staff, eight special advisers (prominent businessmen who took an interest in the program and who were located in all regions of the country) were made a part of the communications program in March, 1976. These special advisers immediately gave the Speakers Bureau a national base.

During the spring and summer of 1976, the speakers carried the message that the program was beginning to achieve encouraging results. A full-scale media program was often associated with speaking engagements. Board members would meet with representatives of the local media, appear on public affairs and hotline radio programs, and make themselves available for interviews. By the end of the second year of AIB operations, 850 public speeches had been given in about 250 communities.

The resignation of the vice-chairman, Beryl Plumptre, on June 1, 1976, was a loss of considerable proportions for the Anti-Inflation Board. Mrs. Plumptre's great personal credibility with the public had been a valuable asset, particularly during the difficult period in mid-1976 when

²⁸ In addition to the inquiries staff in Ottawa, regional offices were established in Halifax, Quebec City, Montreal, Toronto, Winnipeg, and Vancouver to serve as a base for the five regional commissioners.

²⁹ A bi-monthly statistical summary of inquiries and complaints, noting trends in both the volume and the nature of questions from the public, was distributed to the Board and senior staff. It was a useful gauge of the public mood on certain issues—notably, government and regulatory pricing policies, and the escalation of rates in the insurance industry—and aided the development of both communications policy and monitoring strategy.

the Board was fighting hard to overcome an increasing tide of public disenchantment. Her comments and speeches invariably received wide media coverage. Although her departure was initially seen as the abandonment of a sinking ship, at a news conference on June 11 she scotched these rumors, stating that she was leaving for personal reasons and not as a result of a policy disagreement with the chairman or dissatisfaction with the operations of the Board.³⁰

The “tough grind” between April and August, 1976, ended rather ingloriously for the AIB. A Gallup poll revealed that only 23 per cent of Canadians had noted signs of success in the battle against inflation, while 69 per cent could see no progress whatsoever. About the same time, on August 12, the Canadian Labor Congress announced plans to organize a national day of protest against the controls on October 14, the first anniversary of the program.

The First Year Ends (September to October, 1976)

The fall of 1976 was a period of intense communications activity for the AIB, keeping the Board in the forefront of news coverage and editorial comment as its first year came to an end. To begin with, the federal government undertook an advertising blitz to convince Canadians that the program was working—that it was biting on prices and fair to wage-earners. At the same time, the Board’s Communications Branch launched a coordinated public relations campaign. It arranged appearances for Board members and senior staff on nationally-televised public affairs programs; arranged speaking engagements; encouraged radio, newspaper, and magazine interviews and generally sought every opportunity to communicate.

To counter these positive messages about the effects of the anti-inflation program, the New Democratic Party launched a nationwide campaign to “expose” controls by demonstrating that, while wages were strictly controlled, profits were free to rise without restraint. Meanwhile, the government announced controversial revisions to the guidelines governing prices and profits, and the CLC organized its national day of protest, when workers were to demonstrate unified opposition to the restraints.

In early October, the Canada Labor Relations Board ruled that a rollback by the AIB had invalidated a collective agreement between the Cyprus-Anvil Company and about 500 of its employees at the Cyprus-Anvil mine in Faro, Yukon Territory. The Board was concerned that this decision would result in a series of similar cases, which would hamstring the program.

³⁰S. June Menzies, an economist and prominent consumer advocate from Winnipeg, replaced Mrs. Plumtre on September 8.

About this time, disclosure policy re-emerged as a controversial topic, following General Foods' announcement of price reductions to eliminate excess revenue.³¹

To underscore the potential advantages for the Board of adopting a more liberal disclosure policy, the *Calgary Herald* on August 28 had argued that the General Foods rollback "helps destroy labor's claims of a lonely martyrdom and gives the Anti-Inflation Board a much needed boost in credibility."

On August 30, the *Ottawa Journal* criticized the Board's policy of withholding the names of companies with excess revenue as "a stumbling block to public appreciation of the anti-inflation program."

Ultimately, on October 27, the Board announced a policy of fuller disclosure and, with the express agreement of the firms involved, released the names of 96 firms that had filed compliance plans eliminating \$9 million in excess revenue.³² This was the first in a series of such reports which appeared until the end of the program. At the same time, the Board published a list of 12 companies which had rolled back or rescinded proposed price increases as a result of the price prenotification regime.³³

The AIB collaborated closely with the Finance Department in preparing the advertising campaign referred to above. The campaign consisted of seven advertisements in all 107 daily newspapers in Canada, two advertisements in more than 900 weekly newspapers, two in 88 ethnic publications, and a five-week series of 60-second spots on 220 radio stations. Anti-inflation leaflets were prepared as inserts for mailing with 5.1 million family allowance and social security cheques in September.³⁴ The main theme of the advertising was that the Board's price restraint system was tough and effective. Said one ad:

...Most businesses are co-operating with the anti-inflation program. They want to see inflation beaten as much as anyone. So, in a year of controls, you haven't seen many price rollbacks. There are instead price "holdbacks."

Although media reaction to the campaign was negative, it was equally critical of the New Democratic Party's campaign and the CLC's day of protest. The national NDP leader argued that corporate profit increases were proof of the program's bias against the worker, whose wages were strictly controlled. In a series of speeches, he berated the media and took the trust companies, chartered banks, and utilities companies to task for what he described as unfair profit-taking. The companies themselves hit

³¹ General Foods published an advertisement in daily newspapers August 24, 1976, announcing that it would eliminate \$1.4 million in excess revenue through price reductions on five product lines.

³² News release 76-207, October 27, 1976.

³³ News release 76-209, October 27, 1976.

³⁴ The funds for this program, \$1.4 million, were obtained by a corresponding reduction in the information budgets of other government departments. Thus there was no net increase in government spending on advertising.

back with charges that the statistics cited were inaccurate or misleading. In a comment typical of the media's reaction to the NDP campaign, one columnist accused the party leader of "intellectual dishonesty...the one-time political science whiz now is dealing in statistical illusions, carefully encouraged misconceptions, and fiery calls to headlong prejudice."³⁵

From a communications point of view, the September announcement of revised guidelines governing prices and profits was little short of disastrous. As noted earlier, in chapter four, the Board had decided to revise the original guidelines. In May, 1976, draft revisions were distributed to the business community for comment, and final revisions were made in the light of nearly 500 submissions from business. When the minister of finance announced the revised guidelines on September 7, business reaction was decidedly negative; the Canadian Chamber of Commerce officially withdrew its support from the program.³⁶

Despite the obviously hostile reception in the business community, however, the new rules were attacked by organized labor as a sellout to business. Media reaction was ambivalent but generally supported labor's view. Many commentators compared the new guidelines with the draft proposals released in May rather than with the originals announced in December, 1975. They concluded that the program now provided less, rather than more, restraint on prices and profit margins. Others attacked the revisions as compounding and extending the complications and uncertainty that had plagued the anti-inflation program from the beginning.

As this chronicle of events suggests, the Board had to contend with its share of critical lumps during the fall of 1976. There were compensating aspects of the AIB's notoriety in this period, however, not the least of which was its virtually boundless opportunity to communicate with the public via the media. The first anniversary of controls on October 14, 1976, was the occasion for many summary review articles in daily newspapers, most of them centering on whether the controls were working, how long they would (or should) remain in force, and what would replace them when the program ended. Television coverage was also heavy; all the Canadian networks produced special programs on the AIB in prime time. During this period, the media analysis unit of the Communications Branch circulated between 20 and 50 newspaper clippings on the program each day.

Turning the Corner (November, 1976 to January, 1977)

After the CLC's national day of protest, the Board entered a period of relative calm. Organized labor became somewhat less vocal in its opposition to controls; business settled back into a sullen acceptance of the new rules; and other events, notably the election of the Parti Québécois in

³⁵ Jack McArthur, the Toronto *Star*, September 9, 1976.

³⁶ The new guidelines were adopted by order-in-council on October 21, 1976.

Quebec and rising levels of unemployment, tended to draw the spotlight away from the anti-inflation program. At this stage, the focus of media attention shifted from whether controls were good or bad, effective or ineffective, to the mechanics of decontrol and the government's preparations for the post-controls period.

In late 1976, the consumer price index showed continued improvement, price restraint became more apparent, and public opinion began to shift in the Board's favor. A survey in November indicated that 56 per cent of Canadians now supported the program, compared with the low of 50 per cent recorded in July, 1976. Public support had increased most notably in Quebec (up 10 percentage points from July); among those 55 years of age and older (up 14 points); and among those earning \$20,000 or more (up 10 points). Even among union households, support had increased from 47 per cent to 53 per cent during this period.

With the dissemination of the new prices and profits guidelines and the distribution of new and revised technical bulletins in November, 1976, the task of communicating the "how to" of the program to the "must know" audience was almost finished.³⁷ At this stage, the Communications Branch increased the effort to broaden its audience, extend its use of the media, and change the nature of its message. The emphasis shifted towards development of a broader public understanding of the causes, nature, and dangers of inflation, and the need for a substantial and lasting change in the climate of expectations before controls could be safely removed.

The new orientation of the Board's communications effort led to creation of a radio and TV bureau to organize appearances on talk shows. In the winter of 1976-1977, Board members and officials responded directly to the public on radio hotline shows across the country, via conference telephone hookup at the AIB's Ottawa offices, and in studios across the country.

Another continuing communications project was the weekly news-sheet "Consumer Information," distributed to consumer affairs editors and broadcasters. Radio tapes featuring the chairman or vice-chairman were provided every other week in conjunction with major stories in the bulletin.

To counter suggestions from many quarters that the AIB had done its job and the government should begin to get out of controls, the Board stressed another basic message during this period: "Keep controls on until the job is done."

The Home Stretch (February, 1977 to April, 1978)

By early 1977, the communications program had matured. The Anti-Inflation Board had become an accepted—if frequently criticized—part

³⁷ The final task of this kind was to communicate the rules governing phased decontrol, announced by the minister of finance on October 20, 1977.

of the national scene; there was no longer a need to show that it was on the job. Communications staff diverted their energies from explaining and defending the program to explaining the inflationary process and the roles and responsibilities of the major players: government, business, labor, and the general public.

In February, 1977, the Board released one of its first and most successful educational publications, "The Inflation Debator," a booklet outlining the origins and nature of inflation and reviewing the AIB's role in coping with it. "The Debator" was widely circulated among high school students and was made available to high school teachers in parcels with background material on the program.³⁸ It is one measure of the success of this publication that the Board received requests for nearly 500,000 copies in English and 120,000 in French.

On May 1, 1977, Jean-Luc Pepin resigned as chairman and was replaced by Harold Renouf, who had represented the Maritime provinces on the Board since its inception. Mr. Renouf was a well-known chartered accountant in Halifax and had taken part in several government studies, including the royal commission on price structures in the gasoline and diesel industry.

Mr. Renouf's appointment coincided with renewed acceleration in the rate of inflation.³⁹ In a news conference, the new chairman cautioned: "We haven't reached the degree of stability in the rate of inflation or in the inflationary psychology to terminate the program immediately At this moment, the job is not done as far as the Board is concerned."

The replacement of the effervescent Mr. Pepin with a quiet chartered accountant led to media speculation that the government had deliberately lowered the Board's profile as a prelude to an early termination of the program. However, the prime minister personally discounted this interpretation when he announced Mr. Renouf's appointment, as did the new chairman. In a speech to the Federation of Canadian Municipalities on May 17, Mr. Renouf said:

I wish to stress that there will be no major changes in the philosophy of the AIB. Having been closely involved in the decisions of the Board since its early days, I feel our main responsibility is still to run the controls program to the very best of our ability and to further subdue inflationary expectations....The style may change, of course, because I am not Mr. Pepin, but the substance will not. For those who like descriptive phrases, it is 'business as usual' at the AIB.

³⁸ "The Debator" classroom package included, besides 40 copies of the booklet, a covering letter from the director general of communications; the Canadian Labor Congress' Manifesto for Canada (May, 1976); "Inflation and the AIB" (Canadian Foundation for Economic Education, August, 1976); the text of the prime minister's October 13, 1975, address announcing the anti-inflation program; a federal government discussion paper on the economy, "The Way Ahead" (October, 1976); the White Paper "Attack on Inflation" (October, 1975); a glossary of AIB terms; and the Board's pamphlet "A Guide To Your Personal Fight Against Inflation."

³⁹ Higher food prices had pushed the consumer price index to an annual rate of 7.4 per cent in March, 1977, up from a low of 5.6 per cent in November, 1976.

For the Board's communicators, business was indeed much as usual through most of 1977, as the branch carried a full slate of projects and publications.⁴⁰ The Board continued to pursue its efforts to promote public understanding of the inflationary process and in July it released a second major educational publication, "Kick the Inflation Habit."

The booklet was a lively, exhortatory publication which provided background on the historical evolution of money and the causes of inflation. It urged consumers to explore the reasons for price changes, to handle credit wisely, to shop carefully, and to avoid waste. Reaction of the media and general public was largely favorable and the demand for copies was substantial.⁴¹

Another educational project carried out during the summer of 1977 consisted of a series of advertisements placed in public transit vehicles in major Canadian cities. Based on the theme "Think About It," the ads contained such messages as "Inflation steals jobs"; "Smart shopping fights inflation"; and "Be a credit to your card, use it wisely." Another major theme in both transit advertisements and publications was "There is no free lunch."

About the same time, the AIB launched an extensive public service radio and television campaign, with the approval of the Canadian Radio-Television and Telecommunications Commission and the support of the Canadian Association of Broadcasters and the networks. Before the campaign, the Board undertook a three-week blitz of paid radio advertising, chiefly as a means of encouraging radio stations to make use of the public service clips. This project proved an effective and inexpensive means of increasing public awareness of the dangers of inflation.

Another public education project which came to fruition later in 1977 was entitled "Conversations on Economic Change." A workbook was produced by the Board to help the Canadian Association of Home Economists arrange informal public discussions on the inflationary process and what could be done to combat it.

By the fall of 1977, speculation and concern about the method and timing of decontrol began to build, following an unsuccessful attempt by the federal government to get agreement from labor and business for voluntary restraint if controls began to be lifted in October, 1977.

The public concern most frequently expressed was for an end to uncertainty about decontrol timing and method. A September speech by Harold Renouf in Newfoundland, followed by an appearance on the popular CTV public affairs show "Question Period," indicated that he favored gradual decontrol starting within six months. Mr. Renouf's message about the trend in the underlying rate of inflation was also given prominence in news and editorial coverage. Understanding by the public of the need to look beyond the simple CPI monthly figures to the trend

⁴⁰ On June 13, 1977, the AIB held a press conference in Toronto where it announced the addition of 44 food processing firms to the price prenotification list, as well as an effort to get companies to disclose more information on excess revenue.

⁴¹ 165,770 copies of the booklet in French and English were eventually distributed.

appears to have started about this time. More and more commentators picked this up as the program neared its end.

Although the Canadian Chamber of Commerce called for early removal of controls about this time, their message was somewhat muted because of lack of support from their members. Meanwhile, there was evidence of growing public support for the controls program, along with apprehension about the consequences of ending it, and some support for this view among business and the media.

The October 20, 1977, announcement of the details of the decontrol process by the minister of finance was treated as important news by both newswriters and editorial writers. There was a wide range of views (too soon, too late, and so on), but most agreed that an end to speculation was welcome.

The simultaneous announcement by the minister that the compensation guideline for the third year would be 6 per cent was taken rather passively, although some adverse comment was heard. Some editorial writers and columnists took advantage of that announcement to comment on the need for Canadians to take a modest decline in real income to make up for past excesses.

By January, 1978, the Communications Branch reported to the Board that while the AIB continued to enjoy a high degree of public support, the media and the public at large were somewhat confused about the imminent decontrol process and the Board's responsibility in the decontrol period.⁴² A modest campaign to correct this was proposed and agreed on.

Once decontrol plans were announced, speculation died down and public interest in the controls program began to wane. This trend persisted into the spring of 1978 when a brief round of renewed interest was aroused by the actual start of the decontrol process on April 14.

The Board in the meantime had reassessed its communications plans and decided that, although a lower activity level could be expected, those still required to comply would be assisted in obtaining all necessary information.⁴³ Speeches tended to become more technical (reminiscent of the early days of the AIB) and required more time for specialist staff than from Board members or senior executives.

The slowdown and reorganization of the Communications Branch was based on the assumption that some sort of monitoring agency would be set up by the time decontrol began and that it would assume the AIB's public information and educational programs. Some adjustments to plans and programs were necessary when it became apparent that the new agency would not be in operation before the fall of 1978.

⁴² In the fall of 1977 the Board had prepared advertising supplements for *Saturday Night* and *l'Actualité* which outlined the intended method of decontrol. At that time, however, neither the timing of the process nor its technical details had been announced by the minister of finance, so the message was incomplete.

⁴³ A secondary concern was to avoid the appearance of a "lame duck" organization. It was decided that Board decisions should continue to be released to the public from time to time.

An important decision by the Board in early 1978 was to sponsor another high school educational program of the kind conducted in 1976-1977. Arrangements were made to develop a series of articles on basic economics and to provide them in classroom kits to interested secondary school teachers.

Winding Up the Program

The final action of the Communications Branch was to complete an extensive publications program. Early in the history of the AIB it was decided that the mandate of the Board to communicate must include research into the cause, nature, and effect of inflation and related phenomena.⁴⁴

Under the aegis of the Economic Research Branch, a program of research studies to be carried out by Board staff and persons under contract was launched in early 1976. This resulted in the publication of 12 AIB studies in both official languages, and completion of a further two AIB studies in background paper format. All were produced in the final months of the Board's existence.

The Board had entered the publications field with three annual reports and the results of a special inquiry on profit margins in the food processing and retailing industry, as well as the more or less routine communications and education publications mentioned earlier. A final report and the massive *Chronicles of the AIB* rounded out the publications schedule.

This last-minute effort changed the nature of the Communications Branch and brought in additional specialists (editors, translators, publications managers, and so on) to bring off a heavy publications effort in a very short time.

The work of the Communications Branch of the AIB officially ended at the end of the 1978-1979 fiscal year when the remaining small publications group and advisory staff was attached to the office of the executive director.

Notes

1. Provincial Liaison

Among the Board's first lines of communication were its links with the provincial governments. All of the provinces except Saskatchewan signed formal agreements with the federal government extending the application of the Guidelines to areas within provincial jurisdiction.⁴⁵

⁴⁴ Anti-Inflation Act, Section 12(1)(e).

Major policy issues or politically sensitive matters relating to the provinces were dealt with through contacts between the Board's chairman or senior staff (executive director and associate executive director) and provincial premiers, cabinet ministers, or senior government officials. Routine business (including the formidable task of keeping the provinces briefed on developments in the program, changes in the Guidelines or Board policy, and key decisions affecting the provincial public sectors) was handled by a provincial coordinator in the Communications Branch in contact with her counterparts (designated "anti-inflation coordinators") in the provincial governments.

In addition to her regular briefing and provincial liaison functions, the coordinator organized three major Board and federal government visits to the provincial capitals. The first of these, which involved the chairman, vice-chairman, and senior AIB staff, took place in the late fall of 1976. Its purpose was to report to the provinces on the Board's first year of operations, in particular as they affected the provincial sectors.

The second round of provincial visits involved both the Anti-Inflation Board and representatives from the Departments of Finance and Labor and Treasury Board. The tour (a "blitz" of 10 capitals in five days) took place in February, 1977. At this point, planning for the decontrol and post-control periods was well under way, and a series of preliminary proposals for these periods was presented for discussion with the provinces.

The final round of consultations with the provinces was carried out in late July, 1977. In most respects, including the cast of characters and the agenda for discussion (decontrol and post-control issues), it was a repeat of the February visits. At this stage, however, greater emphasis was given to more fully elaborated proposals for the post-control period, as well as to the province's preferences for the timing of decontrol.

2. Handling the Media

At the start, the Board was dubious about the reliability of the media to carry its important and complex message. This was a factor in its decision to appeal directly to the "must know" audiences through paid advertising. On the advice of the Communications Branch, the Board avoided media contact other than formal communiqués of case and policy decisions, and a limited number of "set piece" speeches.

By mid-1976, the Communications Branch had reversed its strategy. It was urging complete co-operation with the media by actively seeking

⁴⁵ With the exception of Quebec and Saskatchewan, which had established their own provincial counterparts to the AIB (the former with and the latter without a formal agreement with the federal government), all the provinces had signed anti-inflation agreements empowering the Board to administer the Guidelines within their public sectors.

media exposure, including radio hotline appearances where Board members and officials could expect a rough time.⁴⁶ This more positive approach formed the basis of the Board's established media policy.

This media policy included full announcement of all Board decisions; frequent technical and background briefings for selected media representatives; and programs for specialists such as columnists, consumer affairs editors, and broadcasters. Serious misrepresentations of the program were usually handled by letters to the editor, frequently from the chairman or a senior AIB official. On occasion, a particularly widespread misconception was met by issuing a correcting news release.

Disclosure policy was a subject of controversy in the media throughout the first two-thirds of the Board's existence. The policy eventually embraced six points: (1) all formal decisions to intervene in a compensation plan or a prenotification of price increases would be reported to the media by the AIB; (2) the Board would not necessarily report every decision *not* to intervene; (3) Board decisions would not necessarily be announced immediately⁴⁷; (4) decisions on dividends would be announced only after the company had declared the dividend; (5) interventions in dividends proposed by companies in the process of reorganization would not be announced; and (6) informal advice to unions and firms would not be made public.

On June 29, 1976, the Board announced that it would discontinue its practice of issuing a press release on each individual compensation decision. Instead, it began issuing bi-monthly statistical summaries, showing the number of cases coming in over and under compensation guidelines.

⁴⁶ The Communications Branch acknowledged that the Board members themselves formed the most effective team of "communicators" and urged them to take on a heavy load of speaking and media engagements, particularly from mid-1976 to fall 1977.

⁴⁷ This was a matter of simple courtesy; the Board would advise the parties involved before making a public announcement.

CHAPTER VII

Decontrol

Planning for decontrol began slightly more than a year after controls were introduced. Although the options for decontrol were identified quickly and an approach agreed upon, the timing of the process was less readily decided. A number of views were held as to the conditions favorable for its initiation.

Although decontrol policy would eventually include fiscal and monetary policies, suitable monitoring arrangements, and other policy instruments, the initial focus of the staff was on the technical aspects of the nature and timing of decontrol.

Economic Considerations

A fundamental concern in designing any system of decontrol is the likelihood of a price "bulge" when controls are removed. This bulge may be large enough to negate the gains achieved by controls. One decontrol strategy is simply to exit from controls before demand increases begin to outstrip capacity increases and place upward pressures on prices.

Although the so-called wage-price bulge reflects the inevitable distortions resulting from controls, these distortions can be minimized during controls through enlightened application of the regulations, and fiscal and monetary policies consistent with program objectives. Furthermore, an orderly decontrol process over an appropriate period of time can minimize the extent of such a bulge.

A second concern was the nature of the decontrol process itself. It was especially important given the variety of incomes controlled, the mechanisms for controlling them, and associated characteristics of the economy.

Planning for decontrol began with a review by AIB staff of the economic forecasts for 1977-1978. The view generally held among the staff was that unemployment would remain at or above 7.5 per cent and consumer price increases would be in the 6 to 6.5 per cent range.¹ An analysis of labor's bargaining calendar and of Board data indicated that

¹ The initial assessment of the depreciation of the Canadian dollar was to assume a range of 97-98 cents U.S.

the average guideline for the last quarter of 1976 and the first two quarters of 1977 was likely to be marginally less than 7.5 per cent. In effect, the forecast—high unemployment, reduced inflation, little change in the level of profits and substantially lower profit share of GNP, slower growth of government spending and monetary growth—suggested that there was sufficient slack in the economy to accommodate decontrol.

The increasing number of so-called “AIB clauses” in labor agreements, providing for above-guideline settlements once the Board ceased to exist, caused some concern, and seemed to mitigate against complete withdrawal of controls at a single time.²

A more general concern was that if the economy developed as forecast, particularly with regard to sluggish growth and rising unemployment, there would be strong pressure from groups subject to compliance to withdraw from the program as early as possible in the belief that the program was having a depressing effect.

The Options

There were three main alternatives for decontrol: decontrol on a single day (called the “lights out” approach), sectoral decontrol (initially viewed with favor, it became less attractive upon closer examination), and phased decontrol (the approach preferred by AIB staff). Behind all the alternatives was the assumption that a “successor agency” would be established to review wage and price developments in the post-control period.

At the outset of discussions, two dates were suggested for commencement of decontrol, October 14, 1977, and January 15, 1978. Each date had advantages and disadvantages regardless of the decontrol process selected. Furthermore, each date offered advantages of timing and approach to the compensation or to the prices and profits regime; a balance had to be struck between the two.

DECONTROL ON A SINGLE DAY

The intent of decontrol on a single day was simply to announce that controls would cease on a given date. Beyond that date neither prices nor incomes would be subject to the mandatory requirements of the Guidelines.

This approach was largely predicated on the already-noted favorable inflation forecast both domestically and internationally for 1977-1978, and on the perception that the controls had not caused serious price or compensation distortions. This view of the situation therefore suggested that the problems of a wage/price bulge faced by other countries upon removal of controls would not occur in Canada because of the expected

² This problem eventually led to an amendment in the legislation, binding parties to the full terms of an agreement approved by the Board for the guideline year of that agreement.

favorable economic environment. However, there was some concern that the economic situation in 1977-1978 might not turn out as favorably as was expected at the time of the decontrol deliberations in late 1976. Therefore the decontrol-on-a-single-day option was rejected.

A SECTORAL APPROACH

The sectoral approach, as the name suggests, would remove compensation and prices and profits controls on a sectoral basis (preferably on a 3-digit Standard Industrial Classification basis, but at least on a 2-digit group level). The notion behind this approach was that the impact of controls had varied from sector to sector and that their withdrawal should be planned in a way that would minimize any wage-price bulge. In other words, sectors which had felt the least impact would be withdrawn first, while those experiencing the greatest impact (that is, the greatest potential price distortions) would gradually be released from the program. This approach recognizes the possibility of a bulge and seeks only to spread it out over a longer period of time.

Two problems arose with the sectoral approach: how to define a sector in relation to reporting units, and how to resolve differences in sectors on the compensation and prices and profits sides of the program. There were lesser problems associated with methods of phasing out the program and the duration of the decontrol phase. The task of identifying the sectors to be released would be complicated by the need to match reporting-unit structures with product markets. A further complication was the diversification of product markets in the larger firms on which the controls program concentrated.

There is a paradox in this approach. While early decontrol of certain sectors is sought to avoid price distortions, these are the very sectors on which the controls are having an impact. It would be difficult, therefore, to make a case for maintaining controls in sectors where there was no real impact and removing them where they are needed most.

The more the sectoral approach was examined the less attractive it became. Technical problems with methods and timing of release added to a growing disinclination toward this approach.

A PHASED APPROACH

The idea behind a phased approach was to avoid concentrations of wage bargaining and price changes. Initially it involved phasing out of controls by size of firm or by a variable time schedule.

Level III firms (those with annual sales of less than \$25 million) would be released first, and the remainder by specifying higher sales threshold values over time. As Level III firms accounted for approximately 75 per cent of the reporting units and only 30 per cent of the gross revenue subject to compliance, this approach would offer a noticeable reduction in the Board's administrative burden and in the number of

firms involved in controls, yet retain significant control during the decontrol period. The nature of the phased approach suggested that it could begin toward the end of 1977, preferably on October 14, 1977.

On the compensation side, the timing for phasing out the Guidelines would be determined by the termination dates of collective agreements reached, and unilateral compensation plans implemented, during the life of the anti-inflation program. Withdrawal of the Guidelines was to be closely coordinated with the removal of restraints on prices and profits, and preferably would take place before prices and profits restraints were removed. Special approaches were considered for the public sector and those parts of the private sector where prices were regulated.

It was recognized that all available measures would have to be used to ensure that there would be no widespread reopening of wage agreements. The Board was to consider modifying the Guidelines so as not to disrupt "existing association bargaining" with its stabilizing influence on industrial relations.

In effect, the phased approach was related to a group's entry into the program. Once an exit date was announced, no new compensation agreements would be ruled on. For agreements concluded before that date, the first year would be subject to the Guidelines. In other words, the groups that were "first in" would be "first out." On the prices and profits side, firms whose fiscal years included the exit date would remain subject to controls until the end of their fiscal year. Firms with excess revenue would remain subject to controls until the Board was satisfied the revenue had been satisfactorily dissipated.

Planning and Consultation

By mid-December, 1976, the Board had come to a number of conclusions regarding decontrol strategy. They were summarized in an AIB discussion paper prepared for senior staff of the ministry of finance: (a) the government had no intention and no public commitment to withdraw from the program before October, 1977; (b) 1977 would be the year to plan for and consult on decontrol; (c) the third program year would be the year for decontrol and the government would likely announce its plans before October, 1977; (d) the Board's preference was for a phased approach; (e) the program was likely to be terminated by the expiry date of the Act, December, 1978.

The Board's preference for phased decontrol was favorably received by the government and detailed planning on both the compensation and prices and profits regimes began. However, the Board's preferred date of October 14, 1977, for the start of decontrol did not receive approval.

Consultations were carried out at a number of levels during the spring and summer of 1977. On October 20, 1977, the minister of finance announced that a phased removal of anti-inflation controls would begin on April 14, 1978.

Decontrol of Compensation Guidelines

The objective of phased decontrol for compensation was to avoid the disruptive effects of a concentration of collective bargaining. As mentioned earlier, a growing number of collective agreements were including "AIB clauses," requiring the parties to re-open negotiations or implement agreed-upon increases in excess of the Guidelines when the Act expired. If a large number of such agreements were under way at the same time, it was felt, a few excessive settlements could have a "snowballing" effect.

For the part of the labor force whose compensation was determined unilaterally by the employer, generally at the beginning of the calendar year, excessive increases and pressures resulting from salary compression would soon be reflected. Since public sector wages and salaries were largely determined by reference to the private sector, excessive settlements there would likely be transmitted to all levels of government.

The proposal, therefore, was for controls on compensation of groups of employees to be phased out over a period of one year. Compensation plans which followed those terminating before a specified date would be subject to the compensation guidelines for a further period of one year from the termination date. For example, if the starting date of the phasing-out process was to be October 14, 1977, all employee groups would have emerged from controls by October 14, 1978. The timing of decontrol for compensation plans reflected concern that all groups emerge from controls before the expiration of the Act.

A limited number of long-term agreements which were subject to the Guidelines and which did not expire until after October 14, 1977, presented a special problem. Such agreements would not expire until after many groups had emerged from controls; without a special provision to reopen such agreements, the employees covered by these agreements would appear to have been penalized.

One of the less desirable aspects of the phasing out process was that groups of employees in the same firm could emerge from controls at different times. This was particularly evident for those whose compensation was determined unilaterally, generally at the beginning of the calendar year, in contrast to those under a collective bargaining agreement.

Early announcement of the nature and timing of compensation decontrol would eliminate the uncertainty which could become a serious impediment to collective bargaining by mid-1977. If it was made known that the Guidelines would apply to the agreements which replaced those terminating prior to a specified date, the incentive to prolong negotiations—in hopes that the agreement ultimately reached would not be subject to control—would be eliminated.

It was recognized that the number of one-year agreements would be likely to increase after decontrol was announced. This was regarded as an unfortunate but unavoidable aspect of the evolution of the collective bargaining process.

Decontrol of Prices and Profits Guidelines

The strategy for decontrol of prices and profits guidelines was to combine relative ease of administration with minimum changes to the Act or Guidelines and broad equitability with the decontrol of compensation.

The overall strategy of decontrol was built upon recognition of a "successor agency" to the AIB, voluntary guidelines, and continued monitoring of individual price and profit developments during the phasing-out period.

It was recognized that the phasing-out approach would not yield the desired degree of inter-company equitability. A 12 month phasing-out period would allow firms to exit at different times (the compensation regime would also exhibit this feature). A number of proposals were put forward in the event this proved to be a serious problem.

The mechanism for decontrol of the price and profit guidelines was simply the completion by a firm of the compliance period (fiscal year) which included the decontrol date. An important exception to this approach was the retention of any firm with excess revenue under the Guidelines until it had dissipated such revenue to the satisfaction of the Board. As a practical matter this could mean that a firm would remain subject to the Guidelines for anywhere between six and 12 months beyond its fiscal year end.

Therefore, compliance with the Guidelines in the last compliance period was a condition of decontrol and was felt to be a strong incentive to a firm to ensure compliance.

There were two views on the announcement of decontrol. One view favored announcing the nature and timing of decontrol early in the year, in March, 1977, to allow the Board to plan an orderly exit from the program and focus on consultation for the post-controls period. Further, there was concern that rigid pursuit of compliance might even add to the potential size of a price bulge.

The other view was for announcement at or near the actual exit date. This view was based on the belief that, once the announcement was made, firms would spend a great deal of time arranging their affairs to demonstrate technical compliance, and that enforcement, particularly in difficult cases, would be perceived as being unfair during the release of firms from the program.

After some consideration, the decision was made to make an early announcement that the program would continue at least until October, 1977, and expire on or near its statutory limit of December 31, 1978. With October, 1977, as the start date of phased decontrol, approximately 70 per cent of firms would begin to exit as of December 31, 1977, while the rest would be evenly distributed over the first nine months of 1978.³

³ This simply reflected the distribution of the fiscal year-ends of the firms subject to mandatory enforcement of the Guidelines.

All Level I and II firms (those designated for price prenotification and those with annual revenue in excess of \$25 million) would be required, for monitoring purposes, to continue to report after their third compliance periods in 1978. Level III firms, those with annual revenue less than \$25 million, would be fully released from all aspects of the program including reporting requirements, except firms with excess revenue at the end of their third compliance period.

Consultation

Before the meeting of finance ministers in early February, 1977, the federal minister of finance had publicly committed the government to a period of consultation on decontrol and post-control issues.

At the finance ministers' meeting all aspects of decontrol including timing were reviewed with no strong preferences indicated. Later in the month, the views of each of the provinces on decontrol were solicited. There was general agreement on the phased approach but no clear consensus on timing.

In early April the minister of finance announced the government's intention to hold a tripartite conference with business and labor to discuss post-control arrangements later in the month. The prospect of tripartism, or of some voluntary arrangements, had been raised earlier in the budget of March 31.

In early May another meeting of finance ministers confirmed the view that some sort of monitoring agency should be set up for the period after decontrol. Later in May, the government published a Green Paper entitled "Agenda for Co-operation." Alternative methods of decontrol were examined, again without reference to a particular starting date. The paper noted the government's wish to form a multipartite forum to provide a final opportunity for discussion of decontrol and post-control before the timing of decontrol was decided upon. The forum would extend the tripartism mentioned above to farmers, fishermen, consumers, professionals, co-operatives, and others.

Formal and informal discussions between business, labor, and government were carried out over the summer. In mid-August, leaders of organized labor announced they were rejecting the government's conditions for an early end to controls. By the end of August, the Board's preferred date of October 14, 1977, for the start of decontrol seemed unlikely.

On October 20, 1977, the minister of finance announced that phased decontrol would begin on April 14, 1978, that the Act would expire on December 31, 1978, and that no one would be subject to controls *after that date* (emphasis supplied). However, enabling amendments were to be made to secure compliance with Board recommendations in cases dated before the formal expiry of controls.

The most striking amendment was a change in the arithmetic guideline on the compensation side. For guideline years beginning after October 13, 1977, the guideline was 6 per cent plus or minus an experience adjustment factor of up to 2 per cent. In effect, the basic protection factor and the national productivity factor were dropped as determinants of the arithmetic guideline for the third and final program year.⁴ Employee groups with guideline years starting on or after April 14, 1978, were no longer subject to controls.

On the prices and profits side, companies would be removed from controls upon their fiscal year-ends after April 13, 1978, but no later than December 31, 1978. The major exception to this rule was for companies with fiscal years ending after December 31, 1977, and before April 14, 1978. If they were designated as Level III, they would exit from controls upon their fiscal year-end. Companies designated as Level I or II would continue quarterly reporting up to their last fiscal quarter prior to January 1, 1979. Where excess revenue existed at the end of this period, companies were to dispose of it either through customer rebates or direct pricing action as quickly as possible.

For those subject to the professionals regime, the Guidelines were to remain in force until their fiscal year-ends in 1978.

Dividend payments were controlled for a further 12-month period ending October 13, 1978. Increases on dividend payments were limited to 6 per cent above the allowable limit of the preceding 12 months.

In summary, then, the process of decontrol was broadly equivalent for compensation and price and profit guidelines. Further, exiting from controls was somewhat similar to entering controls, particularly for the price and profit guidelines. The principle of removing compensation guidelines in advance of price and profit guidelines was also achieved (32 per cent of employees would emerge from controls before the final quarter, compared with 25 per cent of the companies).⁵

Implementation

Prices and Profits Mechanisms

The prices and profits decontrol mechanisms closely followed the outline announced by the finance minister on October 20, 1977. The principal mechanism was an amendment to the Guidelines which redefined compliance period as "a fiscal period of a supplier commencing after January 1,

⁴ Although there was apprehension that this amendment might cause an adverse reaction from organized labor, this reaction did not materialize. Further, the reduction was held to be consistent with the real income gains of labor during the program and the prospects of prices and real growth in the final year.

⁵ There were a number of technical problems associated with the announcement of decontrol on October 20, 1977. For details of these problems, see technical bulletins AI-31-C, December 30, 1977, and AI-36-P, AI-37-P, December 30, 1977.

1978, the first three months, the first six months, the first nine months of that period or the complete fiscal period, whichever ends nearest to but before January 1, 1979.” The amended definition meant, for example, that suppliers with fiscal year-ends from October through December would not have a compliance period that commenced after January 1, 1978, and would thus exit from controls with their 1978 year-ends. Suppliers with year-ends from April through September would have a three-month or six-month final compliance period, and those with year-ends from January through March would have a nine-month final compliance period.

The amendment to the Guidelines terminated their application on or before December 31, 1978, but did not reflect the decontrol date of April 14, 1978. This aspect of decontrol was implemented on an administrative basis. On December 30, 1977, the Board issued technical bulletin AI-36-P which provided details of the decontrol process. Suppliers were told that for purposes of reporting to the Board the final compliance period would be the fiscal period ending in 1978 with the following exception: large suppliers (Levels I and II) with fiscal year-ends after December 31, 1977, and before April 14, 1978, would have to file reports covering their final compliance periods of six or nine months, whichever ended nearest to but before January 1, 1979.

These decontrol mechanisms had the curious effect of leaving some suppliers in an uncertain position. From a legal point of view, a supplier with a fiscal year-end on June 30, 1978, for example, was technically subject to mandatory compliance until December 31, although he had the Board’s assurance that compliance would not be measured during this final six months. Judging from the lack of inquiries on this point, however, suppliers and their legal advisers were not troubled by this uncertainty.

Section 3 of the Act suggested that there was a relationship between employees subject to compensation controls and employers subject to prices and profit controls. If prices and profits guidelines had been amended to remove suppliers from the program early in 1978, compensation controls for the employees of those suppliers may have ceased to operate. There was an obvious advantage, therefore, in using an administrative vehicle to implement the April 14 decontrol date, keeping each supplier theoretically subject to mandatory compliance with the prices and profits guidelines until his last fiscal quarter ending in 1978.

Dividend controls were simply allowed to lapse. There was no definition of a “fourth compliance period” or a “dividend factor” for such a period; hence no controls were in effect after October 13, 1978.

Decontrol of professional fees and incomes was not exactly as outlined by the finance minister on October 20, 1977. Many firms had late winter or spring fiscal year-ends; analysis revealed that if all firms exited from controls at the close of their 1978 fiscal periods, professional practitioners would generally be free of control earlier than workers under compensation controls.

It was decided to inject the April 14 decontrol date into the plans and treat professional firms much like the Level I and II suppliers in the prices and profits regime: those with fiscal year-ends before April 14 would have a final compliance period of less than 12 months, ending December 31, 1978. In this way, the Board could defend the phasing out of controls by showing that in general terms compensation controls were lifted first, followed by professionals controls and prices and profits controls.

Two changes in the part 2 guidelines provided the mechanism for decontrol of professionals. A new section, 31.1 read: "This part does not apply to compliance periods commencing on or after April 14, 1978." This provision alone would have resulted in final compliance periods extending into 1979.

Consequently, the definition of "compliance period" was adjusted so that the final compliance period ended no later than December 31, 1978.

SHORT FINAL COMPLIANCE PERIODS

Measurement of compliance in a short final compliance period was seen as a potential problem both for professional firms and for general suppliers subject to the prices and profits controls. Regarding the latter group, the final period was generally nine months; since these suppliers were already subject to quarterly reporting, no difficulty was anticipated in completion of final AIB-22 reports. However, since many suppliers show seasonal patterns in profitability, measurement of a nine-month compliance period against a 12-month base period might have proved inequitable.

The solution proposed was to change the rules by introducing a seasonality adjustment to the target net margin per cent as follows:

$$TNM\%^s = TNM\% \times \frac{NM\%^{9P}}{NM\%^P}$$

where $TNM\%^s$ = seasonally adjusted target net margin per cent to be applied in final nine-month compliance period

$TNM\%$ = target net margin per cent per regulations

$NM\%^{9P}$ = the actual net margin per cent realized for the corresponding nine-month period in the preceding year

$NM\%^P$ = the actual net margin per cent realized for the whole of the preceding year

This approach would have required the adjustment to be enshrined in the Guidelines, since its effect might have been to reduce a supplier's target in certain circumstances. However, because there was a reluctance to introduce any apparent tightening of the program as part of the decontrol process, it was decided to make the adjustment optional. As a result, it would only be used where it would benefit the supplier by increasing his target. The seasonal adjustment could therefore be introduced on an

administrative basis, and it was included in decontrol technical bulletin AI-36-P.

In the professionals regime, the "stub" period ending December 31, 1978, might be 9, 10, or 11 months long. The main problem anticipated was determination of revenue and cost figures for such a period. The pertinent technical bulletin (AI-37-P) provided that where the only financial reports of a firm were customarily prepared on an annual basis, the Board would accept a reasonable allocation of income to the stub period.

There had developed among AIB staff a general feeling that the Board should be able to terminate its operations by mid-1979. In the Prices and Profits Branch, the target date of June 30, 1979, caused concern, particularly with respect to suppliers who earned excess revenue in their final compliance periods. A supplier with a December 31, 1978, year-end might not file his last AIB-22 report until its due date, March 31, 1979. The report would be assessed during April and, if the supplier were in an excess revenue position, only two months would remain to negotiate a compliance plan and see it carried out.

Staff were encouraged to monitor interim reports filed during 1978 closely and impress on suppliers the advantage of avoiding final period excess revenue. A survey of the industry divisions indicated that perhaps 5 to 10 per cent of suppliers would be in an excess revenue position for 1978. Various compliance plan options were examined, particularly the low-base relief policy which would require, for a December year-end supplier, a price freeze at 1975 levels until September 30, 1979. Although monitoring such a compliance plan would present some problems, the Board agreed to make no change in this policy for the final compliance period. If a supplier elected this type of compliance plan, his case would presumably require full publicity and his own customers would be in a position to monitor his price freeze.

Final period excess revenue was a concern in the area of property and casualty insurance as well, where virtually the entire industry had trouble staying within the Guidelines. In many cases, suppliers had excess revenue in three consecutive years. Despite their efforts to eliminate it, they kept earning more. Nevertheless, price control during the program had been very effective, prompting the Board to adopt a flexible approach to compliance plans for the final period. Suppliers in the industry were to eliminate cumulative excess revenue either by (a) freezing rates on all non-commercial lines until 1980, or (b) giving premium discounts or immediate rebates.

It was recognized that option (a) would be attractive to suppliers with large amounts of excess revenue, and in some cases would not really result in its dissipation. However, the Board was attracted by the advantage of maintaining some control on rates for a full year after expiration of the program.

ADMINISTRATIVE CHANGES

In December, 1977, the Prices and Profits Branch appointed a task force to plan the administrative requirements of the decontrol process. At this time, most suppliers had not filed their first year-end compliance reports under the part 7 guidelines. As a result, initial estimates of manpower requirements were rather inaccurate. The recommendations were to be reviewed after the peak processing period of May to August, 1978.

In May, 1978, the task force reconvened and made wholesale changes in its previous recommendations. The 1977 year-end reports were being processed at a much faster rate than anticipated; a revised estimate of manpower requirements was drawn up and a new branch organization proposed and adopted. As well, the task force recommended that staff be surveyed during June to determine how many would prefer to seek early relocation and how many would prefer to stay with the branch. This recommendation was accepted, and enough staff members selected early relocation to allow manpower to be reduced appropriately.

PRICE PRENOTIFICATION

Although it was anticipated that price prenotifications would diminish as the final date approached, this did not happen. As late as October and November, 1978, suppliers were still arguing the justification for last-minute price increases. The staff could not explain this phenomenon, since suppliers were free to adjust prices without interference if they waited until January. Two answers were suggested: suppliers wanted AIB approval to defend price increases that would take effect in the post-controls period, and suppliers did not believe that the program would be terminated as announced.⁶

When the prenotifications actually began to *increase* dramatically, the staff asked the Board to consider an immediate termination of the prenotification system, fearing that suppliers intended to misuse the system as described above. Before a decision was made, however, the intake dropped to normal levels and the matter was not pursued.

Decontrol of Compensation Mechanisms

The compensation decontrol plan called for groups to emerge from controls on a phased basis, beginning April 14, 1978, and ending December 31, 1978. The date on which a group came out of controls depended on the starting date of the group's final guideline year, defined as the 365

⁶ Such skepticism might have been justified. The U.S. had recently announced a new "voluntary" controls program; a new federal budget was scheduled for late November, 1978; recent polls indicated that government popularity was slipping and that most Canadians (58 per cent) favored a controls program; and a federal election was expected in the first half of 1979.

days beginning on or after April 14, 1977, and ending before April 14, 1978.

A group with a final guideline year starting on or before January 1, 1978, remained subject to the Guidelines for the duration of that final year. A group with a guideline year starting after January 1, 1978, but before April 14, 1978, remained subject to the Guidelines only for the period between the start of the guideline year and December 31, 1978, and not for the full final guideline year. Groups with a guideline year starting on or after April 14, 1978, were no longer subject to controls. This approach to decontrol required a number of changes in the Guidelines.

A new section (S.67.2) stated that the Guidelines no longer applied to groups with a guideline year starting on or after April 14, 1978. Another new subsection (44(3)) was added, to the effect that a group still under controls could not claim a historical relationship with a group that had emerged from controls. A third, more complicated, amendment involved a new section (38.2) and dealt with the problem of how increases in compensation were to be calculated in situations where the final guideline year extended past December 31, 1978. This meant that the Guidelines applied to a period of less than a full year. The problem was resolved by the device of stating in the Guidelines that in such circumstances the terms and conditions of the compensation plan in effect on December 31, 1978, were to be assumed to be in effect on the last day of the final guideline year. The April 14, 1978, start of the phasing out required some other minor changes in wording in the Guidelines to delete references to "annual" rates of increase, because of the problem of guideline years extending past the December 31, 1978, expiry date of controls.

CASE PROCESSING

The start of decontrol produced problems for case processing in two main areas: multi-year contracts partly in and partly out of controls; and compensation plans beginning between January 2, 1978, and April 13, 1978.

Some multi-year contracts with compensation increases effective post 1978 had been dealt with by the AIB in 1977, but these naturally became more numerous in early 1978. Consequently, the Board began to consider the negotiated increase after the end of the program in determining whether an increase slightly in excess of the Guidelines during controls might be warranted. However, similar considerations were also given earlier during the program when multi-year contracts were considered. In these cases, if one year of a three-year contract was in excess of the Guidelines and the other two years within the Guidelines, a minor amount above the Guidelines of up to 2 per cent might be allowed.

The second problem involved contracts and compensation plans commencing between January 2, 1978, and April 13, 1978. Although the

period under control lasted only until December 31, 1978, employers were required to file for the full year, as a guideline year was defined as a period of 365 days. This did not usually cause a problem but in a few cases the contract or compensation plan called for increases after December 31, 1978. In these cases a second AIB-2 form was submitted, indicating the increases up to December 31, 1978.

BRANCH RE-ORGANIZATION

The phased approach to decontrol required that the Compensation Branch continue to be staffed with a sufficient number of people, and that they be as competent as those who had been with the branch in the past. In other words, planned and controlled reduction of staff was essential.

As of April 14, 1978, the Compensation Branch was composed of the seven Industry Contact Divisions, the Administration and Audit Division, and the Policy and Compensation Analysis Division, under the direction of the director general.

After reviewing the work load for the first six months of 1977 and the projected work load for the decontrol period, a task force established to recommend a plan of action for the future made its proposals for a new organizational structure.

The new structure saw creation of three divisions in place of the seven Industry Contact Divisions: Public Sector, Regulated Industries, and Non-Regulated Industries. The Administration and Audit Division and Policy and Compensation Analysis Division remained unchanged.

This new structure could, if necessary, retract to the organization alignment established in the earliest stages of the Anti-Inflation Board: two divisions, one administering the Guidelines for private sector employers, the other for public sector employers. The reorganization was approved in August, 1978, with an implementation date of October 1, 1978.

BRANCH STAFF LEVELS

At the beginning of decontrol, Compensation Branch employed 240 people. As of mid-December, 1978, the staff had diminished to 183.

For the Compensation Branch to carry on effectively until the Board's work was concluded, a few people had to be hired on contract or on a term basis in June, 1978. This was done only when no one could be found within the AIB to fill positions.

MONITORING POST-CONTROL INCREASES

Before the start of decontrol, the prime minister asked the Economic Council of Canada to take on certain responsibilities for analysing wage and price developments in the two years following the lifting of controls.

The chairman of the Economic Council, Dr. Sylvia Ostry, agreed to this request and in June, 1978, announced that a special group, the Centre for the Study of Inflation and Productivity (CSIP), would be established as a distinct entity within the Economic Council to carry out this task.

While options for the creation of the centre were being considered in early April, 1978, the AIB was asked to monitor wage increases received by groups that had emerged from controls until CSIP could recruit staff and go into operation. The AIB immediately had to face the difficulty of reconciling its continuing role as a "controller" with its new role as a "monitor" or "reporter" of wage increases. Employers were not required to report increases for groups to which the controls no longer applied, and the AIB was most reluctant to take any action that might be interpreted as an attempt to "stay in business" after decontrol, especially since even if the AIB obtained information on post-control increases it had no power to take action on them.

The AIB, therefore, chose to restrict its monitoring activity to analysing the kinds of wage increase data that were publicly available and would be available to CSIP when it went into full operation in the fall of 1978. The information on post-control wage increases used by the AIB was drawn from monthly reports by Labor Canada of settlements reached by major bargaining units, that is, units of 500 or more employees. Information on these settlements was received and post-control increases were analysed monthly by Compensation Branch staff. Regular reports on the trend in post-control settlements were given to Board members and officials of other agencies. By late 1978, CSIP was able to undertake and publish detailed analyses of post-control wage settlements, and the AIB's activity in this area was reduced to a brief monthly internal report to Board members.

On March 2, 1979, the government created a new agency to monitor prices, profits, compensation, and costs. This organization, which replaced CSIP, was called the National Commission on Inflation (NCI). It was established by order-in-council, and was given investigative powers under the Inquiries Act. The government believed that the more aggressive approach of the NCI, involving powers under the Inquiries Act, was not compatible with CSIP's role within the Economic Council of Canada.

The NCI was given a term ending June 30, 1980. Monitoring was to be carried out by a relatively small staff of no more than 100 people. With the announcement of the new commission and the closing of CSIP, some staff from that agency and from the Anti-Inflation Board moved to the NCI. The chairman of the NCI was Harold Renouf, who was also chairman of the Anti-Inflation Board.

The government elected on May 22, 1979, reviewed the policy regarding the NCI and announced the termination of its mandate on July 25, 1979.