



# Policies for Price Stability

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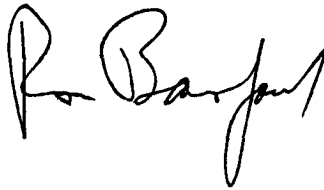
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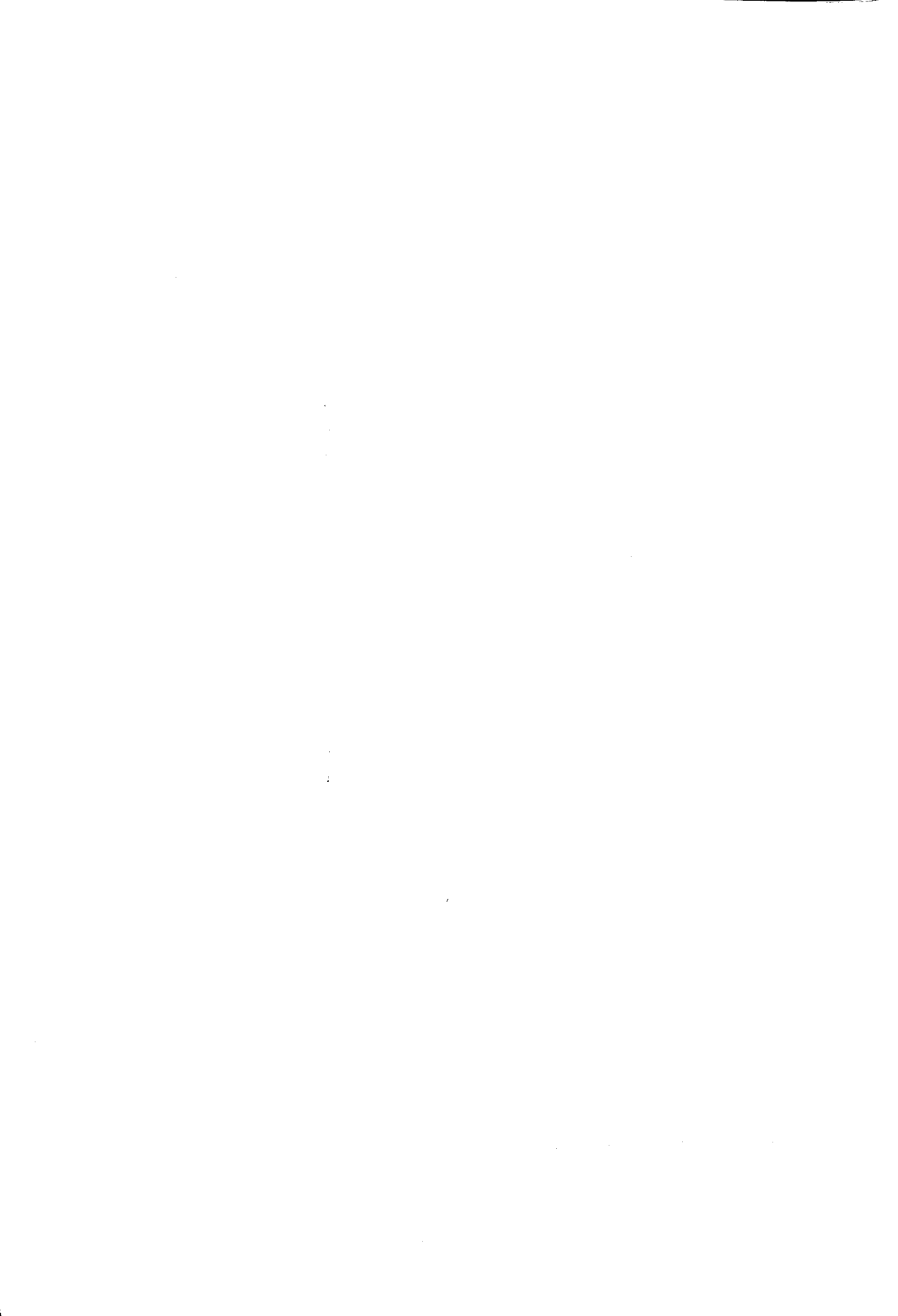
## FOREWORD

The purpose of this Paper is 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 our human and physical resources while, at the same time, maintaining acceptable price and cost behaviour. This Paper will serve as a basis for further consultations about this program with the various economic interest groups and the provincial governments.

A handwritten signature in black ink, appearing to read 'Ron Basford', with a stylized, cursive script.

RON BASFORD,  
*Minister of Consumer and Corporate Affairs*

OTTAWA, December 1968



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## INTRODUCTION

1. As Canadians, we face a new and difficult problem that vitally concerns our future economic well-being. While the more effective use of fiscal and monetary policy since the Second World War has prevented the depressions and spiralling inflations of the past, it is becoming increasingly evident that, with the existing tools of national economic policy, we cannot count on simultaneously maintaining the desirable level of employment and reasonable price stability. As Mr. Louis Rasminsky, Governor of the Bank of Canada, pointed out in an address in November, 1967, "our basic problem is how to cope with prosperity and add to high levels of output already attained." New initiatives must be taken to achieve our economic goals.

2. Government involvement in the economy is not a new or recent phenomenon. A structure of government able to protect individual and property rights, regulate the currency and ensure the enforcement of contracts was necessary for the development of our competitive, market-oriented economy. The transportation system on which the economic fact of Canada depends was built by government or with government assistance. Legislation governing such matters as foreign trade, combines, banking and the public provision of a high standard of health, education and transport services is essential for the elaborate system of production and exchange we have today. Since the depression of the 1930's, and more particularly since the Second World War, the Government of Canada has accepted responsibility for maintaining a high level of employment. Maintaining vigorous growth in the output of real goods and services is essential to meet that objective, particularly at a time when Canada's population and labour force are increasing rapidly.

3. It has long been recognized that reasonable price stability is a necessary condition for sound economic growth. In its Fifth Annual Review, the Economic Council of Canada pointed out that the potentials for growth and development of the Canadian economy are rapidly increasing. "It is imperative, in the interests of all Canadians, that over the years ahead the actual performance of the economy should measure up well to these large potentials," the Council said. "But it is no less impera-



tive that reasonable price and cost stability should also be maintained—indeed sustained high performance is very unlikely to be attained without such stability,” the report declared.

4. The Government of Canada is well aware that, to maintain strong economic growth, the economy must remain competitive in international markets. To do so, Canada must contain the inflationary rise of prices at least as effectively as its major trading partners. There may be practical limits to the extent that we can hope for better cost and price performance here than in the United States but we must aim to do at least as well and hopefully better.

5. A rapid rise in costs and prices has a disruptive effect on many areas of our economy and it poses a serious threat to our ability to finance economic expansion. Our housing industry and many essential social services, for example, are largely financed by the issuance of bonds and debentures, the value of which is fixed in terms of money. In times of rapidly rising costs and prices, it becomes increasingly difficult to attract funds for such purposes except at very high rates of interest. Even if the rate of price increases were as low as  $1\frac{1}{2}$  per cent per annum, the effect would be to cut the real value of money in half within 45 to 50 years. But if the recent rate of price increases was maintained, the value of money would be halved within 18 to 20 years.

6. In addition to its disruptive effects on the economy as a whole, inflation causes major inequities. It creates serious difficulties for those who are living on pensions or other fixed incomes and for many others who do not have enough bargaining power to keep up with the rise in their living costs. But these are not the only people who suffer. Inflation also hits hard even at many who do have such bargaining power because of its effect in eroding over time the value of past and present savings invested in fixed forms, such as is the case with most pension plans and annuities.

7. In recent years there has been increasing awareness that policies to promote economic growth must do more than ensure the employment of our growing work force. National economic policy must also encourage more efficient use of our human and physical resources so that productivity will rise steadily. To the extent that our economic growth is accompanied by growth in the productivity of labour and capital—and only to this extent—the real income and the standard of living of the average Canadian can be increased. For this reason, the Govern-

ment of Canada in recent years has developed or expanded such important areas of policy as those dealing with improved manpower training, the increased mobility of labour and aid to industrial development and research. Trade policy is another important instrument which the Government is using to promote greater industrial efficiency and higher levels of productivity in Canada. The establishment of the Economic Council of Canada reflected the Government's concern to have the benefit of independent counsel in attaining a better overall economic performance and in developing policies over the longer term to promote more rapid and efficient growth consistent with the attainment of our other important economic and social goals.

8. An outstanding economic achievement over the post-war period has been the avoidance of any major depression of the type that marred the inter-war years. Credit for this achievement must be shared with the improved techniques of economic management among other industrialized countries. But, as our economic goals have become more clearly defined, our past shortcomings as well as our achievements have become more evident. In most of the first twelve years after the Second World War, the average level of employment was maintained at satisfactory levels and was accompanied by a good rate of national economic growth. But over much of this period prices increased too rapidly. Then during the late 1950's, better price performance was accompanied by a sharp rise in unemployment and a disappointing decline in the growth rate which persisted until the early 1960's. The sharp recovery in the growth rate which began in 1961 eventually reduced unemployment to more acceptable levels by 1965, but as the economy returned to near-capacity levels of operation for the first time since the mid-1950's, prices in many areas began to increase more rapidly. Over most of this period our balance of international payments remained viable, though at times, as during the second half of the 1950's, this involved a very large deficit on current account which had to be met by substantial net borrowing abroad. Since the devaluation of the Canadian dollar in 1962, however, our current account deficit and our dependence on capital imports have declined substantially.

9. The past three years have brought sharply into focus the critical problem of sustaining vigorous economic growth and a high rate of employment, while at the same time maintaining reasonable price stability. When it became apparent in the course of 1965 that demand was beginning to put pressure on the supply capacity of the economy, monetary and fiscal mechanisms were applied to restrain the growth in

demand. These conventional economic policy instruments not only succeeded in slowing demand, they did so without throwing the economy into a recession. From mid-1966 to the end of 1967, however, the economy grew at a rate that was well below its potential. The result of this slow growth was a gradual rise in unemployment from 3½ per cent in early 1966 to 4½ per cent by late 1967. Since the beginning of 1968, the pace has increased, though the further rise in unemployment to 5 per cent on a seasonally adjusted basis indicates that the economy has continued to run below its potential. Even so, and despite the existence of a significant unused industrial capacity for more than a year, prices and costs have continued to rise at rates that are far from satisfactory.

10. The conclusion drawn by the Government of Canada from our recent experience is that the present policy tools are not sufficient to resolve the very real conflict that exists at the present time between the objectives of maintaining high level employment and restoring the price stability that is necessary for sustained economic growth.

11. It may be that by applying the conventional monetary and fiscal levers with sufficient force, the inflation of the past three years could have been brought to a halt. But the immediate cost in terms of the level of unemployment and output foregone would certainly have been high.

12. When the economy is unable to run at a pace that matches its high potential, all of us are worse off. But those who suffer most are the Canadians without work who would otherwise be employed if the economy could operate closer to its potential and still maintain reasonable price stability. In cold statistical terms, the difference in the level of unemployment that exists when the economy is operating at its potential and running somewhat below it may not appear to be great. But the Government is very much aware that every one percentage point of the labour force which is unemployed represents some 80,000 Canadians who are suffering from the lack of a job. It is for this reason that the Government has concluded that it is of critical importance to seek new additional ways of maintaining reasonable price stability under conditions of high employment and strong economic growth.

13. In reaching this conclusion the Government has been mindful of the experience of other countries and of the advice of independent experts. The Government has noted the lessons to be drawn from other countries' experiences with prices and incomes policies, some of which have been far from encouraging. In this regard, the Government has

found particularly helpful some of the warnings voiced by the Economic Council of Canada in its careful analysis published two years ago which drew extensively on the experience of other countries. This analysis has been useful, not only in rejecting courses of action that have failed in other countries, but also in avoiding those courses which may have had a reasonable measure of success elsewhere but which could well fail in Canada's different institutional environment, with our different traditions and constitutional framework. Yet in coming to a conclusion the Government of Canada was also impressed with the reasoning presented in the most recent OECD Economic Survey of Canada. In this survey, published early in 1968, the OECD concluded its analysis of Canada's recent cost and price problems in the following words:

"Canada's price/wage performance in full employment conditions suggests that there is need for some sort of an 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."\*

## **THE PROBLEM OF RISING PRICES**

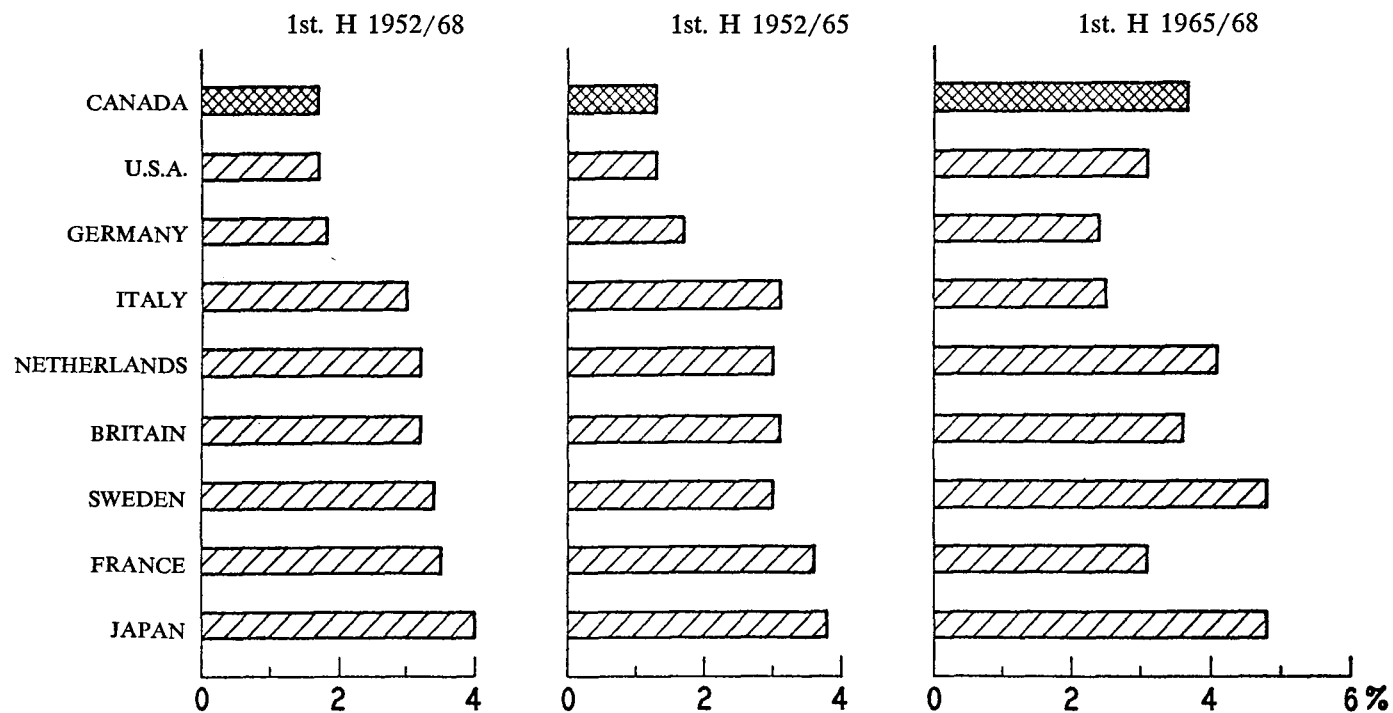
14. Over most of the post-war period Canada's price performance has been good by international standards. In the immediate post-war years it is true that prices increased appreciably when war-time price controls were being dismantled. Also, in 1950/51 prices increased sharply after the outbreak of the Korean War. Both these were somewhat exceptional periods of price behaviour and have little relevance to the problem of rising prices experienced in the past few years.

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\* "Economic Survey of Canada", page 20, published with the approval of the Economic and Development Review Committee, Organization for Economic Co-operation and Development, Paris, February 1968.

# INTERNATIONAL COMPARISON OF INCREASES IN CONSUMER PRICES

Average Annual Percentage Rates of Increase



15. It may therefore be more useful to focus attention on Canada's price performance from the beginning of 1952 to the present time. In the table below, our price performance over this sixteen-year period is compared with that of a number of other important industrial countries. It is also useful to divide this period between the first thirteen years, that is, from the first half of 1952 to the first half of 1965, and the more recent three-year period commencing in the first half of 1965.

TABLE I. CONSUMER PRICE INDEX—BY COUNTRIES

Average annual rates of increase

	<i>First Half*</i> 1952/68	<i>First Half</i> 1952/65	<i>First Half</i> 1965/68
	(percentage increase)		
U.S.A. ....	1.7	1.3	3.1
Canada ....	1.7	1.3	3.7
Germany ....	1.8	1.7	2.4
Italy ....	3.0	3.1	2.5
Netherlands ....	3.2	3.0	4.1
Britain ....	3.2	3.1	3.6
Sweden ....	3.4	3.0	4.8
France ....	3.5	3.6	3.1
Japan ....	4.0	3.8	4.8

\* Half-year periods are used because data for 1968 are available only to June 30, 1968.

It will be seen in Table I that over the whole sixteen-year period only two countries, the United States and Germany, have maintained as good an average record as Canada. Whereas these three countries experienced an average annual increase in consumer prices of about 1½ per cent, the other six countries included in the comparison had average increases ranging from 3 to 4 per cent per annum.

16. However, the record for the sub-periods shows clearly that the good long-term performance in both Canada and the United States, relative to other countries, was due to the small price increases experienced over the first thirteen years when the consumer price index in both countries rose by only 1.3 per cent per annum, while the index of all goods and services measured in the Gross National Product (GNP) increased at an annual average rate of just under 2 per cent. Given the problems of price measurement and the nature of our economy, the performance in this period was probably as close to true stability of prices as we can reasonably expect to achieve.

17. Unfortunately, it cannot be said that our record over this period demonstrates the ability of the Canadian economy to maintain a satisfactory price performance at very high levels of employment. Over the whole period from early 1952 to early 1965, the unemployment rate in Canada averaged exactly 5 per cent. This average level is certainly higher than the great majority of Canadians would regard as a satisfactory norm for economic policy and it is 2 per cent higher than the target towards which the Economic Council of Canada urged that policy be directed. Moreover, during this thirteen-year period of reasonable average price stability, the one occasion when prices rose significantly was in the period when unemployment fell below 4 per cent during the 1955/57 investment boom. The deterioration in the price performance which occurred at that time was relatively short-lived, but that was a result of the subsequent recession of 1957/58, when unemployment rose to a seasonally adjusted rate of  $7\frac{1}{2}$  per cent. Thereafter, until the mid-1960's, price performance was satisfactory; but once unemployment began to fall to a more acceptable level, and the resources of the economy became more fully utilized, there was a marked acceleration in price changes.

18. As shown in the right-hand column of Table I, prices in Canada over the three years from the first half of 1965 to the first half of 1968 rose at an annual rate almost three times as fast as they had over the preceding thirteen years. Moreover, Canada's price performance in this period, relative to the United States and several other countries such as Germany, Italy and France, was decidedly less favourable than over the preceding period.

19. A more detailed comparison of the behaviour of Canadian prices over the recent three-year period and the preceding thirteen-year period is highly illuminating. Perhaps the most striking feature of the comparisons in Table II is the extent to which all major categories of consumer goods and services, and most of the other major groups of goods and services measured in the GNP, have contributed to the acceleration in price changes which has taken place since the beginning of 1965. Of course, even in a period of relative price stability, such as during the period from 1952 to 1964, price behaviour differs considerably between particular categories of goods and services. For example, most kinds of services tend to show more persistent price increases than goods, since in services the normal rise in costs is often not matched by productivity gains. Nevertheless, the fact that prices of virtually all categories of goods and services have been rising in recent years at

TABLE II. PRICES  
Average Annual % Increases

	<i>Weights</i>	<i>First Half 1952/65</i>	<i>First Half 1965/68</i>
<i>Consumer Price Index</i> .....	100.0	1.3	3.7
Food .....	26.7	1.0	3.7
All Other .....	73.3	1.4	3.7
Durables .....	12.3	-0.3	1.7
Non-Durables .....	31.2	0.7	3.5
Shelter .....	17.9	2.1	4.4
Rents .....	8.8	1.5	2.8
Home Ownership .....	9.1	2.7	5.5
Services ex. Shelter .....	12.7	3.5	5.0
Health Care Services .....	3.4	3.8	4.4
Household Operation			
Services .....	2.1	1.9	2.9
Local Transportation .....	1.3	4.3	8.3
<i>GNP Price Index</i> .....		1.9	3.9
Personal Expenditure .....		1.3	3.5
Government Expenditure .....		3.5	5.6
Residential Construction .....		2.8	6.4
Non-Residential Construction .....		2.9	5.0
Machinery and Equipment .....		2.8	-0.3
Exports .....		0.9	2.4
Imports .....		1.5	2.1

appreciably faster rates is evidence of a distinct inflationary bias in the economy since early 1965. The one notable exception in the above table—the price index for machinery and equipment—reflects the removal of the 11 per cent Federal Government sales tax during 1967.

20. One further point to be noted from Table II is the fact that the index of imported goods and services shows one of the smallest rates of increase during the past three years. It is generally agreed that any marked increase in import prices can exert strong upward leverage on domestic price levels, as they did in the period of inflation following the outbreak of the Korean War in 1950. Clearly, this has not been a significant factor in the excessive rate of price increase which has occurred in Canada during the past three or four years.

21. A particularly disturbing aspect of recent price behaviour in Canada has been the unusual persistence of excessive price increases since demand pressure subsided after mid-1966. This is illustrated in the following table.



TABLE III. ANNUAL RATES OF PRICE INCREASE 1964-1968  
Year to year changes

	1964/65	4th Quarter 1965/66	1966/67	Average Oct.-Nov. 1967/68
Consumer Price Index—Total	2.9	3.9	3.8	4.2
—Food	4.3	5.2	2.1	3.2
—Other	2.4	3.5	4.4	4.6
GNP Price Index	3.2	4.7	3.5	3.4*

\* 2Q/67 to 2Q/68

22. It is clear from Table III that as far as prices of goods and services measured in the consumer price index are concerned, the rate of increase over the most recent twelve-month period available has been more rapid than in the earlier periods. It is true that food prices increased faster in the 1965/1966 period, but non-food items in the index have risen by  $4\frac{1}{2}$  per cent over the latest twelve months or three times faster than their annual average rate of increase of about  $1\frac{1}{2}$  per cent between 1952 and 1965. The GNP price index does show a somewhat slower rate of advance over the most recent twelve-month period available than occurred during 1966. But even here, the evidence of slackening in the pace of price increase needs to be qualified. Over the two most recent quarters (i.e., the first half of 1968), the increase in this measure was equivalent to an annual rate of 3.6 per cent compared to a rate equivalent to 3.2 per cent per annum over the two preceding quarters. In other words, while the GNP price measure has recently been rising more slowly than in the period of strongest demand pressure in 1966, there is no clear evidence to suggest that the slowing down has continued since the end of last year. In fact, given the current strength of most economic indicators, there is a distinct possibility that new pressures may be put on costs and prices in the period ahead.

23. The current rates of increase in the two most comprehensive measures of prices in our economy are a particular cause for concern when two other important considerations are taken into account. First, more than two years have now elapsed since excessive demand pressures in our economy were checked. This should have provided time, allowing for lags in the system, for most of the original price and cost pressures set off in 1965/66 to have worked themselves out. Secondly, during the most recent twelve-month period of continued price increase, unemployment has been in the neighbourhood of 5 per cent on a seasonally adjusted basis. While various studies of the so-called

"trade-off" between unemployment and prices in Canada have suggested that inflationary risks become high whenever unemployment falls much below 4 per cent, as it did in the latter part of 1965 and much of 1966, rates of price increases as high as those occurring over the past year are much above what might have been expected, in the light of past experience, at the present level of unemployment.

24. To sum up, we are confronted today with an inflationary problem in our economy that is pervasive and appears to have built up a momentum of its own that threatens our longer-run economic well-being just as much as the sharper but generally short-lived inflationary bursts of the past. Because it has been a less dramatic inflationary problem than those of the past, there is a danger that it may become accepted by many Canadians as an unavoidable price to pay for further economic progress. This would be an imprudent and short-sighted view to take.

## **THE CAUSES OF RISING PRICES**

25. What are the underlying reasons for our recent unsatisfactory price behaviour? To what extent do generally accepted theories about the price mechanism provide a useful guide for national economic policy in the kind of situation which confronts all Canadians at the present time? We have to recognize that our present state of knowledge of many aspects of the problem is insufficient to provide conclusive answers. We lack adequate statistical data and sufficient empirical research in the areas of price and income determination in Canada. Thus we are confronted today with explanations that are contradictory and differ with the approach or the particular economic interests of those undertaking the analysis or offering their policy prescriptions. Some tend to put most of the blame on excessive wage demands or high levels of government expenditure; others point to excessive rates of profits, rising rents, interest rates and other costs. Accordingly the Government has concluded that there is a real need for more objective research by qualified experts in the field.

26. Although these uncertainties exist, it should be pointed out that there is a considerable measure of agreement among experts on a number of the common causes of inflation and on the policies that are appro-

priate in dealing with them. In order to isolate the areas of uncertainty, there follows a brief and simplified analysis of "conventional" price theory in an economy such as ours.

27. Prices of individual commodities in a competitive, market-based economy are constantly changing. Such changes are the signals by which consumers tell producers how much of which goods and services are required. Frequently, increased demand for a particular good will raise its price but then the higher revenues which result will encourage more production until supply and demand are once again in balance. Since this balance is achieved at a price just sufficient to attract human and physical resources from the production of other things, these changes do not of themselves imply a rising price level. In a period of over-all price stability some prices may increase over time. But others will fall, either because of declining demand or because rapid increases in productivity allow demand to be met with lower prices. This is the broad principle underlying the operation of the price mechanism in our economy.

28. In an economy with a significant margin of unused resources, in the form of unemployed labour or unused plant and equipment, inflation should not develop. Inflation in its classic form—often called "demand/pull inflation"—occurs when the increase in total demand arising from money incomes exceeds the growth in the real production of goods and services in the economy. Hence the traditional definition of inflation as a situation of "too much money chasing too few goods." This is the type of inflationary situation which the conventional policy tools of monetary and fiscal policy are suited to handle. In theory, with good management of total demand in the economy through these instruments it should be possible to prevent a situation developing where demand presses too hard on the physical limits of the economy.

29. As a practical matter, of course, there are some serious difficulties. In the first place, conventional policy instruments work with certain time lags, and if demand rises more rapidly than expected—perhaps due, as in 1965, to some external development such as the Viet Nam war—excessive demand pressure may have developed before policy actions succeed in applying the brakes. This occurred in both the Canadian and U.S. economies in the latter part of 1965 and early 1966. But this is not the only problem.

30. A second practical problem that renders demand management more difficult is the uncertainty about the precise upper limits at which the economy can be permitted to operate relative to its capacity, before serious demand pressures and inflationary price increases develop. In Canada in the mid-1960's there had been no experience for almost a decade as to how the economy would respond to a level of unemployment of less than 4 per cent. Early post-war experience suggested inflationary tendencies could develop as the level approached 3 per cent. But, in the event, serious inflationary pressures developed without the average level of unemployment falling below  $3\frac{1}{2}$  per cent. This experience suggests that structural unemployment\* may be a more serious problem in our economy than many had hoped. Structural unemployment is bound to exist in any technologically advanced economy and especially in Canada with its vast size and regional diversity. The lack of necessary skills, or reluctance to move to a new environment, make it difficult for the unemployed to transfer quickly from industries or areas where demand is deficient to those where pressure on resources exists. The problem is not, of course, confined to labour. Similar factors tend to impede the transfer of unused capital facilities. Therefore, when the economy is operating close to its limits, considerable cost and price pressures may develop in particular industrial sectors or areas before labour with the necessary skills is attracted, or needed capital facilities are installed, to meet rising demand.

31. Because of such structural problems it will always be difficult to be sure at precisely what level of resource-use inflationary symptoms will begin to emerge in the Canadian economy. At the same time, for obvious reasons, national economic policy must seek to maintain the lowest level of unemployment at which the economy can operate efficiently and without developing inflationary tendencies. Thus, even with the best possible management of over-all demand through the use of our fiscal and monetary tools, there will always be some risk of running the system too close to the limits for short periods of time.

32. A third factor which complicates the management of demand is that of "bottleneck" problems. Such situations can arise because of the way demand for certain types of goods or services may run far ahead of the growth in total demand. In 1965, for example, serious

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\* Structural unemployment has been defined by the Economic Council of Canada as "long-duration unemployment arising from structural changes in the character of the demand for labour, coupled with the failure of the labour supply to adjust swiftly to these changes."

bottleneck problems arose in the construction industry in various parts of the country because of the rapid growth in demands from private industry and from the various levels of government. The result was that inflationary increases developed in both labour costs and prices in the construction industry well in advance of the more general inflationary symptoms which emerged later on. To the extent that the public sector contributes to this kind of situation, it may be possible to alleviate it by more co-ordinated planning among the various levels of government. But some bottlenecks of this type are difficult to avoid in a period of vigorous economic growth such as that during the mid-1960's. Bottleneck problems may also arise where supply is limited by natural or other factors that impede additional production in the short-term. For example, again in 1965, a serious shortage of various types of live-stock, relative to rising demand, contributed to the early, sharp advance in food prices. Such bottleneck problems can arise even in periods of less rapid economic advance but their impact tends to be more pervasive and disruptive when they occur at a time of generally high activity in the economy. But at any time, bottlenecks tend to affect other parts of the economy and they accentuate the problems of dealing with more general inflationary tendencies as these begin to emerge.

33. The preceding analysis has dealt with the kind of inflationary problem which began to emerge in 1965 and continued during 1966. It provides some insights into the way the problem arose. It suggests that initially, the difficulty was essentially one of overly rapid growth in demand as the economy's output approached capacity, magnified by certain structural and bottleneck problems that were not fully recognized until after the event. But the foregoing analysis provides no satisfactory answers to why inflationary tendencies have persisted since 1966. The conventional weapons of fiscal and monetary policy had dampened excess demand by the middle of that year. But, even though the original cause of the problem was removed, the inflationary pattern of rapidly rising costs and prices has continued. Why has this been so?

34. It is true that despite a general easing of demand pressures, supply shortages of manpower and other resources have persisted in particular sectors of the economy and have continued to exert upward pressures on the price level. Policies to deal more effectively with these problems, such as programs to improve the level of skills and the allocation of manpower, have been developed in recent years, though their maximum benefit may not be realized for some time.

35. A more important part of the explanation of why inflation has persisted since 1966 is the absence of basic counter-forces which have traditionally checked inflation in the past. In the recent economic history of most countries, inflationary tendencies have usually been checked in one of two ways—internally, as a result of a business recession or, externally, by increasing difficulty in international competition. It is a fact to be welcomed that neither of these harsh, corrective processes has developed since 1966. Canada has succeeded in avoiding a business recession for almost eight years since the economic recovery began in 1961. At the same time, despite increases in costs and prices since 1966, our underlying balance of payments position has remained strong and our trade surplus in 1968 appears to have been the largest in recent years. The continuing strength of our balance of payments may, in part, be due to the essentially strong competitive position in which Canada was placed after the Canadian dollar was devalued in 1962. It also undoubtedly reflects the recent problems of our principal trading partners, especially the United States, in coping with their own inflation. We should not take comfort from this. The heavy strains on the U.S. economy are undoubtedly making it more difficult for Canada to achieve better price performance. At the same time we cannot count on our principal trading partners continuing to do as badly in relation to their own price goals as they have been doing recently. On the contrary, they are even now making strenuous efforts to deal with their problems of inflation.

36. The Government is aware of some important factors which have contributed to the persistence of inflation since 1966. It recognizes that many areas of our economy are not subject to the simple mechanism of price competition that operates in a theoretical model of the market economy. In public services, for example, most charges to the public have to be set on the basis of costs rather than by market forces. The same is true of private utilities which have a natural monopoly position. Moreover in fields where there is some degree of market competition the effectiveness with which all the various economic interest groups exercise their market power makes it more difficult to restore price stability once inflationary expectations have become established. These groups include powerful businessmen, strong trade unions and farm organizations, highly organized professional associations, and many less organized groups of professionals and skilled artisans. The Government also recognizes that past experience is not a complete guide to the understand-

ing of recent price behaviour in the Canadian economy. Conditions are changing so rapidly, both domestically and internationally, and so many new factors are at work, that problems and possible solutions are cast in a new light.

37. These difficulties should not, however, serve as an excuse for inaction. We must avoid taking a fatalistic attitude toward the present inflationary problem. The Government of Canada is determined to develop new ways in which inflation can be checked without awaiting the harsh remedies which economic forces, given time, will otherwise administer.

### **POLICIES TO STABILIZE PRICES**

38. We have seen that under conditions of high employment and buoyant economic growth, upward pressures on the level of prices will develop. Moreover, prices have continued to advance strongly even though, since mid-1966, a measure of slack has appeared in the economy. The problem confronting Canada is how to restore and maintain price stability without sacrificing economic growth and employment and without inhibiting basic freedoms.

39. The Government has available to it a range of policy instruments developed over the years. Some of these are designed specifically to promote price stability; others, although aimed primarily at other objectives, may assist indirectly in holding the price level down. Some measures are applied against excess demand. Others are used to relieve supply bottlenecks, thus reducing costs, raising productivity, and contributing to lower prices.

40. On the demand side, the rate of growth in Federal Government spending on goods and services has been sharply reduced. Efforts have also been made to restrain other forms of federal expenditure, although the needs of provincial governments and the requirements of social security programs limit the degree of reduction possible. Parliament has played its part by authorizing increases in taxes, unpopular as these are, in order to dampen excess demand. Despite large government borrowing requirements and other factors, monetary policy has played a major role in restraining the growth of demand. Interest rates have risen to very high levels.

41. Many efforts have been made to improve the efficiency of the supply side of the market. Manpower programs—for the training, placement, counselling, and movement of workers—have contributed significantly to raising the productivity of Canadian workers and to changing the structure of labour supply to match changes in the structure of demand for manpower. The Economic Council of Canada, acting on a Government request, is concluding a special study to consider what kind of Combines policy will best contribute to greater efficiency and lower prices. Industrial development programs and research incentives designed to raise productivity are being implemented. In its procurement policies the Government of Canada has reorganized and centralized its operations to bring to bear the fullest measure of competition for supply contracts. Such policies and programs can contribute importantly to price stability through lower-cost production.

42. Canada's trade policy is being aimed at progressively extending the benefits to be realized from international specialization. The Kennedy Round of trade negotiations, and other measures in this area such as the Canada-U.S. automotive agreement, are making it possible for many industries to become more competitive at home and abroad. Over time this should help in a very important way to achieve better price performance both by checking cost increases and through increasing exposure to competition.

43. Measures to restrain inflation have been applied by provincial administrations as well as by the Federal Government. Other major efforts have been made through annual meetings between Ministers of Finance and Provincial Treasurers to achieve a greater degree of coordination among the fiscal programs of the federal and provincial governments. These efforts are expected to lead to action for the relief of bottlenecks and the improvement of efficiency in industries such as construction, education, health services, and transportation, where government decisions affect a substantial segment of the market.

44. The growing importance of wage and salary bargaining in the public sector as a factor in the movement of costs and prices has commanded the attention of many governments. These settlements are important both in themselves and in the standards they may set for bargaining demands in the private sector. One of the duties of the special Task Force on Labour Relations established by the Government was to consider how these matters may be dealt with fairly and efficiently.



45. The efficient operation of the price mechanism in our economy depends upon well-informed consumers and upon the power of such consumers to make their preferences felt in the market place. To assist the consumer in this regard Parliament created the Department of Consumer and Corporate Affairs. By helping the consumer to play an informed role in the product market this Department should have a moderating influence on the movement of prices.

46. Thus, through a wide spectrum of policies and programs the Government has worked for a more stable price performance. It will continue to develop and refine these instruments and coordinate them more effectively to achieve an integrated approach to the problem of inflation. It is endeavouring especially to improve the use of the traditional monetary and fiscal tools, particularly with regard to enabling the Government to put this machinery more swiftly into operation as conditions require it and to reduce the time lags which have been an impediment to effective fiscal and monetary policy in the past.

47. The Government is hopeful that the new measures it is now proposing will provide better insight into the operations of the economy which will make it possible to employ the existing instruments of economic policy more effectively. But it is also hopeful that these measures will help to promote a greater awareness and understanding of the problem and to suggest new means of achieving reasonable price stability and a high level of employment and economic growth.

### **A SEARCH FOR NEW METHODS**

48. The Government's awareness of the need to seek out new methods for restraining prices was one of the factors which led it, in 1965, to request the Economic Council of Canada to undertake a special study. The Council was asked to examine the interrelationships between movements in prices, costs, productivity and incomes, the problem of reconciling price stability with other economic goals, and the policies and experience of other countries in this regard.

49. The Council's report stressed the basic importance of monetary, fiscal, and commercial policies in influencing aggregate demand and maintaining a desirable balance between employment and price stability. It emphasized as well the need for complementary programs designed to increase the supply of goods and services both generally and in regard to particular pressure points. The Council also examined the concept of incomes policy as an approach to price restraint, based on the experience of other countries with such policies and their relevance for Canadian conditions. A formal incomes policy, the Council noted, had three main components: "a set of general guidelines for incomes and prices in the whole economy, a means of making these guidelines relevant for individual price and wage decisions, and a means of inducing conformance with the guidelines". After careful consideration the Council recommended against this approach for Canada, concluding that it would not be an effective way of "bringing about an improved reconciliation of high employment and reasonable price stability in Canada under normal peacetime conditions". The foundation of price stabilization policy, in the Council's view, should be the basic monetary, fiscal, commercial, and supply adjustment policies already available or in the course of being developed.

50. On the other hand, while the Council advised against a formal incomes policy it did conclude that "much more basic economic research needs to be done on problems relating to prices, costs, incomes and productivity in the Canadian economy . . ." and went on to propose that "In the interests of better public education and information regarding current economic developments, including those in the field of prices, costs, and incomes, steps should be taken to establish an independent institute of economic research."

51. The proposals that follow take into account the arguments against attempting a formal incomes policy in Canada at this time. In designing new approaches to price stability the emphasis will be placed on finding out more about the causes and consequences of inflation, on discovering how inflation can be avoided, and educating economic interest groups, governments and the general public in these matters.

52. There are lessons, however, to be learned from the experience of other countries with incomes policies of the formal type. In particular, this experience has shown the critical importance of having

broad acceptance of voluntary restraint. If an incomes policy—formal or informal—is to work, then *all* interest groups in the economy must be governed by the same principles. Because wage and salary income is the largest single component in the total national income, restraint in pay incomes is obviously of fundamental importance. But all forms of non-wage and non-salary income—including profits, rents, interest, professional fees and unincorporated business income—exert their own upward pressure on the general price level. For these reasons, and on the vital grounds of equity in income distribution, restraint in these kinds of income claims is as indispensable as wage restraint to an effective program of restoring price stability. As the Canadian Labour Congress has said in *Labour Costs in Canada*,\* “A genuine incomes policy should consider the returns of all factors of production . . .” “Organized labour would resist any incomes policy which, either by design or interpretation, placed heavy responsibilities on labour for exercising wage restraint while allowing other forms of income to find their own level. On the other hand, labour would certainly give consideration to, and be prepared to discuss with other groups, an incomes policy or set of guidelines which took the returns of all factors of production into consideration.”

53. Another lesson to be learned from experience with formal incomes policies in other countries is that while it is desirable to keep the rate of growth of money incomes from exceeding productivity growth in the economy as a whole, it is neither possible nor desirable to lay down specific guide-lines about the *shares* of national income going to different economic groups. This, in fact, requires distinctly different policy approaches in such areas as taxation, welfare, regional development and others.

54. Still another lesson is to avoid creating unrealistic expectations about what can be accomplished by any policy aimed at price restraint. In a democratic country no mere institution can ensure price stability simply by the fact of its establishment. Ultimately the effectiveness of the following proposals will depend upon the co-operation and sense of responsibility of Canadian citizens, and their awareness of their own long-term self-interest.

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\* Canadian Labour Congress, Feb. 1966, p. 20 and p. 22.

## A NEW APPROACH

55. As the foregoing discussion has made clear, the achievement and maintenance of price stability at high levels of employment and under conditions of rapid economic growth is a major challenge for Canadian economic policy. Moreover, in the past two years it has proved difficult to hold the price level down even though unemployment has risen significantly and demand pressures have eased. Over the years, many policy instruments have been developed for the containment of price movements and these have been employed as the need arose. They have not, however, always been fully successful and this is particularly true of the recent period. Therefore, the search for new methods continues.

56. Price stability policy involves the work of many government departments and agencies. Their activities are coordinated by the Cabinet Committee on Economic Policy and Programs. The Government now proposes the creation of two new bodies to focus continuing attention on the problem of rising prices:

- (a) A new independent public body, to be known as the Price and Incomes Commission; and
- (b) A new joint Senate-Commons committee to be known as the Standing Parliamentary Committee on Price Stability, Incomes, and Employment.

57. Within the Government itself the Cabinet Committee on Economic Policy and Programs will continue to keep the problem of inflation under constant review and seek to marshal the varied instruments of public policy in a consistent and coordinated way. It relates the objective of price stability to other major economic goals—such as full employment, economic growth, economic equity and a viable balance of international payments—and makes recommendations on priorities relating to these goals. These are responsibilities to which the Committee is already committed and for which it was designed. It is essential that the price stability question be considered in its total economic context and by a body which can bring about policy decisions.

58. Although the Cabinet Committee on Economic Policy and Programs will continue to concern itself with price stability, and to pursue this objective together with the other major economic goals, our recent experience has demonstrated that this area of policy requires more specialized treatment. For a variety of reasons, some of which have

been examined in the foregoing sections of this Paper, price movements have not fully responded to the more traditional instruments of policy. Our understanding of the process of inflationary price behaviour is not complete and there is much controversy on the issue in public debate. Consideration of cost and price developments should not take place only in crisis situations, such as in a period of rapidly rising prices or during major collective bargaining negotiations, and remedial action should not be developed only in the context of preparing the Budget. In order to acquire greater insight into the causes, processes and consequences of price change, the study of price movements and the development of solutions should be removed from any crisis atmosphere. It is necessary to carry out *continuous* analysis of price behaviour and to develop an approach to price and income problems outside of the traditional framework of government decision-making, although government, of course, will bear a heavy responsibility for adopting and carrying out new policy.

59. For these reasons, the Government will establish the Price and Incomes Commission. It will be charged with the responsibility for conducting studies of price and income developments in Canada, and for producing regular reports on its findings. The purpose of the Commission will be to *discover* the facts, *analyze* the causes, processes and consequences of inflation, and to *inform* both the public and the Government on how price stability may be achieved. It will not play the role of policeman. It will not intervene in the particular price and income decisions of individual persons, business firms, or trade unions. It will be empowered, however, to undertake research and enquiries and issue periodic public reports on current trends and prospects for prices, costs, incomes and productivity for the economy as a whole; to make similar studies and reports on various broad sectors and industries; and to engage in related investigations of other broad issues which may have a bearing on cost and price movements. The Commission will need to maintain close communication and consultation with economic groups for the purpose of obtaining information and ideas on prices and incomes, will provide information and education for the general public, and will make policy recommendations for the achievement of greater price stability. To carry out this broad and difficult role, the Commission will be given adequate powers of enquiry. It will be provided with the necessary budget and an expert staff. It will also be authorized to

engage consultants, and to arrange for the conduct of research by the universities and other bodies as it finds appropriate. Its hearings and discussions will be in private but its reports will be public.

60. Thirdly, as a further measure of ensuring a wider public understanding and participation in a voluntary program of responsible price and income behaviour, the Government will propose the early establishment of a Standing Parliamentary Committee on Price Stability, Incomes, and Employment. What is envisaged is a Joint Committee of the Senate and the House of Commons. It would receive the reports of the Commission for review and discussion and would make recommendations.

61. Parliament has a number of occasions to review Government policies and decisions in economic matters. For example, the budget and supply debates, and debates on tax measures and departmental estimates provide for full examination of Government policies and an opportunity for the forces of public opinion to be brought to bear on them. Specialized standing committees help to make these reviews more effective. Similar opportunities for parliamentary review of conditions and developments in the private sector are less frequent. The Committee here proposed will, in the course of studying the reports of the Commission, provide a forum for public hearings and reviews of trends in the private sector and major price and income developments.

62. The new approach to price stability thus rests on three bodies whose functions, though different, are related and complementary. The concepts of Cabinet Committees and Parliamentary Committees are relatively familiar but the proposed Price and Incomes Commission is an innovation. The following sections describe its proposed functions and terms of reference.

63. It is particularly important to stress that the Commission will not, except in cases involving the national interest in a vital way, be expected to report on the specific price decisions of individual firms or the wage decisions of particular collective bargaining situations. At first glance it might seem that there would be advantages to such precise investigations, but the difficulties and deficiencies of this approach are quickly apparent. Any system of detailed review would raise constitutional and legal issues of major proportions in our federal system of divided jurisdiction. Moreover, to undertake a comprehensive surveillance and review of the thousands of price and income decisions occurring regularly

in all parts of our economy would require the services of a vast bureaucracy. Such a bureaucracy could operate only on the basis of highly simplified rules and standards which would conflict with the needs of a dynamic growing economy. For all these reasons, detailed review of specific price and income decisions would be highly inadvisable, and the Government rejects this approach.

64. The major role of the Commission is therefore conceived as one of providing information, education and understanding. Its primary influence should be directed to rallying a strong sense of social responsibility, on the part of those making private price and income decisions, in support of the national interest in price stability. But it is also expected to contribute substantially to the evolution of new policies and to the coordination and adaptation of many existing policies necessary for good economic management.

65. In its studies, the Commission will concentrate on short-term developments and its primary focus will be on costs, prices, productivity and incomes. It will not duplicate the work of the Economic Council of Canada with its longer-range perspective and wider scope. However, although its frame of reference will be the short-term, the Commission's inquiries will be more continuous than those of government departments and will be less subject to the pressures of departmental policy requirements. The Commission will be expected to make projections and forecasts so that potential inflationary problems may be anticipated. In turn, the Government can facilitate the work of the Commission by making references to it, whenever possible, before the situations to be examined have reached a critical stage. It is highly important to free the work of the Commission from the pressures of crisis conditions. The anticipatory approach will be particularly important in situations where collective bargaining is likely to emerge as the main pressure. The Commission must be able to conduct its investigations sufficiently far in advance to provide an objective framework of information and analysis for collective bargaining without interfering directly in the course of particular negotiations. It is not intended that the Commission should in any way interfere with the established and recognized processes of collective bargaining nor should it relieve management, unions or other parties of their own right to make free but responsible decisions affecting prices and incomes.

66. Much of the Commission's work is expected to be concerned with the movement of costs and prices in the economy as a whole, to determine the causes behind broad developments, their likely future course, the general consequences to be expected, and so on. The Commission should examine the adequacy of the statistical data now available and the problems of price measurement through the traditional indexes. It is intended that its broad inquiries would be supplemented from time to time by more detailed research in depth into such matters as productivity, supply bottlenecks or other factors which influence cost and price determination in certain industries or sectors of the economy. These studies would no doubt be undertaken in cases where particularly sharp cost or price movements appear or are anticipated in an industry or sector. In carrying out inquiries of this kind, the Commission may be guided by a number of criteria. For example, there would be a concern for pace-setting situations, where large price and income increases tend to become a standard for others whose conditions may not justify gains of the same magnitude and where general inflationary pressures may result. Special attention should be paid to those industries and services which are relatively unexposed to the thrust of international or domestic competition and those sectors producing goods or services which flow as inputs to a wide range of other industries. Price increases in such areas have pervasive effects on the cost structure of the whole economy.

67. The Price and Incomes Commission will consist of three prominent and highly qualified Canadians serving full time who will direct a professional staff. One of the three board members will be Chairman. The Government hopes that well qualified Canadians will make themselves available for appointment to the Commission or its staff and it is eager to make such appointments at an early date.

68. One of the essential features of the approach to price stability outlined in this Paper is its voluntary nature. The Commission is not designed to impose measures of restraint. 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. To achieve this it will be necessary for the Commission to win the continuing acceptance and co-operation of major economic interest groups—management in industry and commerce, trade unions, agricultural and other organizations. It can win this support only by maintaining close consultation with such groups on a regular basis.



69. The Government will now approach leaders of various economic interest groups with a view to setting up a series of consultative meetings. In these meetings the Government will discuss questions relating to the proposals contained in this White Paper and will seek the advice of group representatives on how these proposals may be most effectively implemented. It is hoped and expected that the Commission will find it helpful to establish continuing consultative machinery in order to maintain close contact between the Commission and economic interest groups.

70. The Government will approach representatives of the provincial governments to exchange ideas and information on issues arising out of the White Paper and to consider the establishment of a federal-provincial advisory body or some other means of continuing liaison to obtain maximum cooperation with the provinces in the pursuit of price stability. In view of Canada's federal system of divided jurisdiction, this kind of consultation and advice will be most important to the success of the Commission.

71. The Price and Incomes Commission will be an *independent* body. It will of course carry out studies on problems, issues and situations referred to it by the Government but it will be responsible for the way it carries out these studies. The Commission will not be compelled to accept such references from the Government if other priorities exist or if it feels that a particular reference is not relevant to its primary function. The Commission will also be free to initiate its own inquiries on any matters falling within the jurisdictional field of the Federal Government. Provincial governments may also wish to refer studies to the Commission; this question will be explored in the proposed consultative meetings with the provinces.

72. The power of publication will be an important aspect of the Commission's independence. It will be empowered to issue public reports under its own authority, without intervention by any government representative or department, in the same manner as the Economic Council of Canada. In this way the public can be assured that it will receive an objective presentation of the facts, unhampered by political considerations.

73. In the earlier sections of this Paper it has been emphasized that the attainment of price stability and its reconciliation with other economic goals is a formidably complicated task. The experience of other countries has been examined and their attempts to devise new methods

for containing price movements have been evaluated. Nowhere have such efforts been more than modestly successful and the quest for solutions continues. It would, therefore be hazardous and unrealistic to consider the approach outlined in this Paper as a final solution. We hope it will yield valuable results and help Canada to attain one of its major economic objectives. And it may well point the way to still other methods relevant to future needs.

74. After a few years of operation, a major review will be undertaken as to how well this three-pronged approach has served the objective of price stability. Particular consideration will be given to the feasibility of changes in the Commission's basic terms of reference and procedures. During this period there will be scope for less sweeping amendments in procedures. As the Commission will be appointed under the Inquiries Act such changes can readily be made as the need arises. Thus the approach is both experimental and flexible, allowing for adjustments as experience is gained, and leaving the way free for major revisions.

## **CONCLUSION**

75. While Canada faces a number of major economic challenges today, the objective of price stability has been particularly elusive in recent years. This White Paper has described Canadian experience with price stability, provided some analysis of the causes of inflation, and made certain recommendations for achieving a more satisfactory performance in the future.

76. In making these suggestions for a new approach, the Government has been guided by a number of considerations. First, it has noted the vital necessity of finding out more about the causes of price movements and their consequences for over-all economic performance. Secondly, it has been impressed by the arguments against adopting the kind of formal incomes policies with which other countries have experimented. Finally, it has recognized the importance of developing a new instrument which, while reinforcing other policy measures aimed at price stability, does not introduce any element of regulation into price and income decisions.

77. This Paper has stressed at many points that price stability cannot be pursued in isolation. The Government remains committed to the achievement of a range of economic objectives—including a high level of employment, sustained economic growth, a viable balance of payments, and equitable distribution of rising incomes, as well as reasonable price stability. However, the problem of rising prices has been particularly acute in recent years. It has not responded as expected to traditional policy measures, and failure to achieve a better price performance threatens to undermine our ability to attain our other economic objectives. This consideration has led the Government to a new approach.

78. The Paper has also stressed that the success of this approach will depend, more than anything else, on the voluntary response of all economic interest groups and the general public. The Price and Incomes Commission will provide information and analysis. But much of the success of all these efforts will rest on the extent of the private sector's understanding of the problem and its awareness that price stability is very much in its own self-interest. To help create this understanding and awareness so that the essential co-operation of the public is forthcoming is one of the foremost challenges confronting the Price and Incomes Commission.

