Incomes, Productivity and Prices

The relationship of incomes and productivity, of wages and salary increases which exceed productivity increases, is in our view crucial to the problem of rising prices, to the problem of inflation.

During the period 1952-1968 according to evidence presented to us, wage increases in Canada have exceeded productivity increases by an average of 2.1% per year. The consumer price increase during the same period averaged 2% per year.

The same relationship appears to have held true over the last year. Average wage increases (about 8.5%) over this period exceeded the productivity increase (3%) by about 5½% compared to the average price increase of 4½% for the period.

There are two other points which we would like to comment on with respect to wage-productivity-price relationships. We were particularly interested in the view that labour and management in certain key industries (referred to by Galbraith as the "industrial heartland") agree to wage settlements perhaps at times no greater than their own productivity increases, but greater than the average productivity increase for the economy. Such a practice would have the effect of encouraging other less productive industries to follow the wage pattern of the pace setting industries. When such wage settlements are accompanied by corresponding price increases there is an inflationary cost-push. We recommend that a study in depth be undertaken of the influence of wages and prices in key industries on the Canadian economy.

Similarly, the importance of the service industries employing about 50% of the labour force seems little understood as contributors of inflation. We think more research is needed.

Effects of Inflationary Psychology on Interest Rates

Though it is possible to show an historical relationship between the level of interest rates and the degree of inflation, there is a tendency for the relationship to vary above and below the average. Today's interest rates, as measured by the yield on long-term government bonds, (8.3%) are greater than the sum of a "real rate" of interest of 3% and the inflation factor of 4½%. The reason may be found in inflationary psychology—the expectation that inflation will escalate. This particular attitude develops after prolonged periods of inflation and in the absence of any effective countermeasures. Inflationary psychology can destroy the willingness of persons to save, the essential financial base on which future growth depends. This particular point was emphasized in a number of briefs presented to the Committee.

We noted in this connection the disruptive effects which inflationary psychology has had on the Canadian capital market. Equally we noted the effect of high interest rates on housing. The cost of carrying a mortgage, for instance, of $18,000 increases $15 a month for each 1% rise in interest rates.

Federal-Provincial Joint Planning is Needed

Finally, the influence of governments at all levels needs to be examined in far greater detail. We noted that there has not been enough collaboration between the federal government and the provinces in discussing their separate