
Squeaky Wheels Get Greased

Wage Controls

in Canada

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TAKING A STRONG position against wage and price controls, the Liberal party and Prime Minister Pierre Trudeau were resoundingly successful in Canada's parliamentary election of July 1974. A little more than a year later, on October 13, 1975, Trudeau announced a set of anti-inflation policies that included mandatory wage and price controls. The irony of this about-face was not lost on press or public. In fact, there has been speculation that the reason Trudeau's controls did not begin with a sixty- or ninety-day price and wage freeze—a typical feature of such programs—was that he was trying to differentiate his program from the one the Conservatives had advocated during the previous election campaign.

Imposed by Order in Council effective October 13, 1975, and subsequently by act of Parliament in December, the program was given a three-year life ending December 31, 1978. The order created the Anti-Inflation Board (AIB) to administer the controls, with the board's members being appointed from the private sector by the cabinet, while senior members of the supporting bureaucracy were almost entirely brought in from elsewhere in government service. The bureaucracy of the AIB was

organized into two separate branches, one to control wages and one to control prices. This article looks at wage control, examining how the AIB's decisions were arrived at and, from this, drawing conclusions about the way any such agency is likely to act.

The Decision Process

The compensation branch of the AIB was given jurisdiction over wage increases in private firms with more than 500 employees, in all construction firms, and in the public sector. For all wage increases in each of these areas, the employer was required to provide the board with detailed information on the increase and on past wages, so that the board could calculate the wage guideline appropriate to the particular employee unit involved. (A couple of definitions here: "wage increase" means all increases in compensation, including fringe benefits; "employee unit" refers to both union and non-union groups; and "wage increase" includes increases resulting from both collective bargaining and employer actions.)

For guidance in their negotiations, employers or employees could ask the board to calculate their permissible increase in advance or, since the guideline formula was fairly straightforward, they could calculate it themselves. As prescribed, the guideline was the sum of (1) a basic cost-of-living component of 8 percent for the first year of the program, 6 percent for the second year, and 4 percent for the third, (2) a

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national productivity factor of 2 percent, and (3) an experience adjustment factor of minus 2 to plus 2 percent, according to the employee unit's compensation history as related to the consumer price index over the previous two years.

When a wage increase was submitted to the AIB for approval, an officer in the compensation branch would compare the percentage increase negotiated to what would be allowed by the guideline. If the increase fell within the guideline, no action could be taken. If not, the officer examining the case would look for grounds that might justify special consideration (for example, the need to maintain a historical relationship to the wage rates of comparable employee units). He would then present the case to the board with his recommendation—which, in general, the board would follow (not surprisingly, since, once established, the board was averaging over 200 decisions for each day it met). The approved increase could fall anywhere between the guideline (at the low end) and the negotiated increase (at the high end).

One aspect of the decision process is worth special mention. When a wage increase was within two percentage points of the guideline, the senior bureaucrats of the compensation branch were authorized to determine whether it should be approved or rolled back fully or partially, and the case would be sent to the board for *pro forma* approval only. This procedure raises the questions of differences in decision patterns between cases above the two-percentage-point cutoff (decided by board members, albeit with an examining officer's recommendation) and cases below that cutoff (decided by the senior bureaucrats). We will look at this later on.

After the AIB handed down its decision, the employer or the employee unit, if unsatisfied, could go back to the board, *with additional information*, to ask that the case be reconsidered. (Frequently, employer and employees appealed together, a provision to that effect being written into a number of labor contracts.) The AIB could revise its decision on appeal, and in some of the cases we have looked at, decisions were revised. (A second appeal procedure, involving an independent officer called the administrator and empowered to adjust the board's decision, is beyond the scope of this article.)

These procedures seem to have been designed for an environment in which wage increases were likely to exceed the guidelines—the intention being to placate labor. When the program was put in effect, the Canadian Labour Congress (an umbrella federation like the AFL-CIO) advised its member unions to act as though the AIB did not exist and deal with possible AIB rollbacks at a later date. And there was something of a consensus on the subject. The Ontario Labour Relations Board ruled in fact that an employer who refused to discuss a wage increase in excess of the guidelines was not bargaining in good faith (there is no National Labor Relations Board in Canada, but Ontario is Canada's largest and most industrialized province). And even employers preferred to offer settlements above guideline levels in situations, for example, where the choice was between exceeding the guidelines and being unable to hire workers.

What Theory Tells Us

What factors can be expected to determine to what degree a wage increase above the guidelines would be allowed to stand?

A growing body of literature dealing with decision-making in central policy and regulatory bureaus provides our lead for answering this question. This literature concludes that the chief bureaucratic goals are power, prestige, and survival. For example, Keith Acheson and John Chant have identified self-preservation and prestige as the main objectives at central banks, with such other goals as minimizing conflict and ensuring room for action being secondary. Milton Russell and Robert Shelton have found that regulatory agency officials (both board members and staff) are influenced by concern for survival and their post-agency futures, for doing the right thing, and for their reputations with their peers. Albert Breton has suggested that fiscal authorities want to maximize power and minimize risk of confrontation. These conclusions may be adapted to explain the behavior of the AIB, if we keep two points in mind. First, the AIB was new in 1975 and still relatively new in 1978, and it was administering a policy that aroused considerable uncertainty and public skepticism. Second, the AIB was limited to a three-year life, so that no bureaucrat could make a career of it.

We might thus expect board members and senior bureaucrats to have had relatively short time horizons compared to their counterparts at ongoing regulatory bureaus—and, given their backgrounds, we might also expect them to have been concerned with their *post-AIB* futures and their reputations with their peers. In addition, we would expect the main objective of the AIB early in its life to be winning acceptance and credibility as a legitimate instrument of the government's overall anti-inflation policy, both with the rest of the bureaucracy and with the general public. These operational objectives might be realized in two ways: first, by making the AIB appear effective in curbing the rate of inflation (for the compensation arm, this would mean lowering negotiated wage settlements) and, second, by making sure the AIB avoided alienating the affected groups to an extent that would lead to public discontent and demands for changes in its mandate (including, at the extreme, prematurely ending it). These objectives could, of course, contradict each other, leaving AIB officials with difficult trade-off decisions.

What Happened in Practice

In this context, let us examine how a number of specific factors affected the AIB's decisions. The basis of our examination is two separate sets of AIB decisions. The first set, 292 cases from March, April, and May 1976, comprises decisions in the AIB's start-up phase—these months being the first in which the board processed a substantial number of cases. The second set, 2,672 cases in roughly equal numbers per month from May 1976 to November 1977, comprises decisions from the AIB's established phase. (These latter results are, in some respects, preliminary because they are drawn from research we are still conducting for the Institute for Research on Public Policy.)

Both sets of decisions include only those cases where the negotiated wage settlement exceeded the guideline. (In our tests, we used multiple linear regression analysis to discover the impact of a specific variable on the approved percentage wage increase, holding the effects of all other variables constant.)

First, we looked to see whether board decisions have been affected by the size of the

wage increase submitted to AIB for a ruling. What we expected was that the greater the amount by which the negotiated settlement exceeded the guideline, the greater would be the amount above the guideline the board would

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approve. In other words, "the more you ask for, the more you get." Compromise solutions of this sort might be expected to emerge, given the need for trade-offs between achieving effective rollbacks and avoiding undue alienation of the groups concerned. This trade-off problem would suggest a desire to avoid extreme positions and, indeed, even a casual look gives strong support to the view that the AIB has tended to "split the difference." For the decisions from the start-up phase, the average (mean) negotiated wage increase was 16.3 percent and the average guideline or permissible wage increase 9.9 percent. Lo and behold! The average approved wage increase was 13.1 percent, exactly halfway between the upper and lower bounds. (Or to put it another way, the mean settlement in excess of the guideline was 6.4 percent and the mean approval in excess of the guideline was 3.2 percent.) For the decisions from the AIB's established phase, the average negotiated settlement was 11.9 percent and the average guideline 8.5 percent. The average approved settlement was 9.7 percent, somewhat below the midpoint of the range but close enough to represent splitting the difference.

Evidently, "squeaky wheels get greased"—and this, in fact, is the major finding of this part of our study. For every one percentage point negotiated in excess of the guideline (or allowable increase), the AIB, in its start-up period, rewarded the employee unit with about half a percentage point more in its final approved increase (holding other variables constant—the strike index, the guideline, and so

on). After the board was established, it was a bit more stringent, awarding one-third percentage point for every full percentage point negotiated over the guideline.

Second, we tried to find out whether labor militancy had an effect on AIB compensation decisions. While there are many aspects of labor aggressiveness, we focused on just two, a union's ability to negotiate a settlement in excess of the guidelines and its willingness to go out on strike to protest an AIB decision (such a strike being legal in virtually all cases in virtually all jurisdictions).

What we were interested in here was the degree to which the threat of a strike would affect the AIB's reaction to negotiated settlements that exceeded the guidelines. Note that the behavior could change as the AIB, so to speak, found its feet. In the start-up months, it may well have been that the greater the strike threat, the greater the percentage above the guideline the AIB would approve. That is, the board, when faced with the real prospect of a strike if its decision were viewed unfavorably, would approve a more generous wage increase than it would otherwise, other things being equal. In terms of the board's desire for acceptance and legitimacy, the perceived costs of a decision prompting a strike during the start-up phase could be very high. Presumably as the board's position became more secure, those costs would diminish (so far as the board, if not necessarily the country, was concerned).

To test the likelihood that strike threats would influence board decisions, we constructed a strike index. For nonunion groups, this index took the value *zero* (because unionism is a necessary condition for a strike); for union groups, its value was a sliding one, determined by taking a moving average of industry-wide man-days lost due to strikes and lockouts divided by average employment in the industry for the previous two years. We expected to find a positive relationship between the strike index and the percentage wage increase approved by the AIB, at least in the start-up phase.

The evidence clearly supports our expectation. In March, April, and May 1976, the AIB granted significantly higher approvals to unions in strike-prone industries. According to our estimates, a union group from an industry where days lost due to strikes were at the na-

tionwide mean received three-tenths of a percentage point more in excess of the guideline than an otherwise identical nonunion group. In addition, a union group from a high-strike industry (say, with a strike index one standard deviation above the mean) received almost two-thirds of a percentage point more than an otherwise identical union group from a low-strike industry (say, with a strike index one standard deviation below the mean). These values seem small until we note that the average approval in excess of the guidelines was 3.2 percentage points—and two-thirds of a point is more than 20 percent of 3.2. Somewhat surprisingly perhaps, a weaker but still significant positive relationship existed after the AIB was well established: the comparable union/non-union differential was under one-tenth of a percentage point, but still evident.

Third, we tested to see if the AIB had tried to gain acceptance by being tough on groups that are more in the public eye. On balance, public employee contracts are more visible than private employee contracts and large labor groups are more visible than small. All other things being equal, we expected the size of the wage increases approved to decrease as the number of workers affected by the decision increased, and we expected lower wage approvals for public employees (federal, provincial, and municipal workers) than for private sector employment. It turns out that, in both samples, the AIB decision was *not* affected by the size of the group covered, but that public employee groups experienced approved wage increases about one-half a percentage point lower than otherwise identical private groups.

Fourth, we looked for the possibility of a time pattern in the AIB's decisions. As any bureau becomes better established and its procedures more ritualized, the amount of discretion its individual officers enjoy diminishes. In addition, there was a "borderline" problem: The AIB may have been hesitant to roll back a contract soon after the beginning of controls (October 13, 1975) if rolling it back meant a large deviation from comparable contracts signed just prior to controls. However, a weaning process should have occurred over time as precontrol wage settlement faded from prominence.

We therefore expected to find fewer exceptions to the guideline and thus lower wage-rate

approvals as the months went by, again all other things being equal. In fact, those cases decided in May 1976 showed average approved settlements almost one percentage point lower than in otherwise identical cases decided in March 1976. After that, the decision date was not a significant factor.

Fifth, some of the settlements submitted to the AIB were two- or three-year agreements. We expected that, given a choice of which year's wage increase to cut back in a multi-year contract, the AIB would have chosen to come down harder in the first year and less hard thereafter. If this were the case, contract length would be inversely related to wage increases approved for the first year of the contract. In fact, in the start-up phase, two-year contracts had one-third percentage point more trimmed from their first-year wage increase than was trimmed from one-year contracts. This fits with the view that the board would have sought to gain credibility from large rollbacks early in the program and would have placated the union with leniency in the later contract years.

Sixth, as an indirect test of this last possibility, we segregated the multi-year contracts and compared the rollbacks in years one and two. The AIB consistently rolled back the second-year contracts by fewer percentage points than the first. And, as expected, contract lengths did not influence board decisions after the AIB had been in operation for a time.

Seventh, since the guideline wage increase represented the lower bound of the AIB's decisions, we looked to find out whether it were true that the higher the guideline, the higher would be the wage increase approved. And so it was. Throughout the life of the AIB, a one-percentage-point higher guideline translated to seven-tenths of a percentage point higher increase approved by the board.

Eighth, we looked for an effect from the average wage level of the workers in the bargaining unit. At the extremes, there would necessarily have been some effect because the control regulations exempted workers earning less than \$3.50 per hour and limited high-paid workers to a \$2,400-per-year increase, regardless of the appropriate guideline. Our data do not include cases in which these upper and lower bounds are relevant. In any event, we were more interested in examining intermediate

wage contracts to see whether the board had engaged in income redistribution by allowing disproportionately high wage increases to lower-wage workers. The answer is that the board did redistribute income in this fashion, but only slightly (in both samples, the effect was statistically significant but inconsequential).

Last, we tested to see if there were differences in decision-making between the AIB board and the AIB staff, particularly in response to union militancy. As already noted, administrative procedures were such that negotiated wage settlements exceeding the guideline by no more than two percentage points were decided by the senior bureaucrats, while those exceeding the two percentage point level were decided by the board itself. For the start-up phase, in the less-than-two-percentage-point cases, the strike index shows no independent effect on the approved wage increase; but in the more-than-two-percentage-point cases, the index is strongly related to the approved wage increase. These results suggest that it has been the board itself—that is, the political appointees, *not* the bureaucrats—that has reacted to the threat of a strike by being

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generous to militant unions. Of course, as we noted, the effect of a strike threat on settlements diminished once the board found its feet. Thus our preliminary results indicate that political appointees and bureaucrats responded in similar ways over the longer term.

Conclusion

Clearly, the AIB's prime objective in its first months of operation was to establish its legitimacy and gain acceptance as an instrument of the government's anti-inflation policy. This is the light in which we should interpret the fact that higher negotiated settlements led to higher approved wage increases ("the more you ask for, the more you get") and that a higher

strike probability also produced higher approved wage increases. These relationships show a desire to avoid labor dissatisfaction that would come from too-strict rollbacks of negotiated settlements and avert the possibility of strikes in response to AIB rulings, since both of these could have damaged the board's image. But even when the board became more entrenched, it shied away from extreme positions and continued its pattern of splitting the difference or compromising. And it still seemed to be cognizant of strike threats, though measurably less so.

The fact that public sector wages were held down more than private sector wages and that the AIB's rulings were more generous early in its life demonstrates the same kind of behavior. So also does the fact that in the start-up phase, wages were held down more in the first year of multi-year contracts than in the second year or after (and more than wages in one-year contracts).

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avoidance, consolidating its position as an arm of anti-inflation policy. How might this behavior have affected the groups likely to come under its jurisdiction? Over time, these groups might have learned to predict the board's decisions. Employers and employees might then in fact have bargained with specific AIB-approved wage increases in mind and so might have submitted to the board negotiated settlements that would result in their prior "real" settlement being approved. Of course, the more predictable the board's behavior, the more likely this result—and the consistency of the results with respect to splitting the difference suggests that the board's wage decisions may have indeed been predictable within reasonably narrow limits.

What then are the implications of all this for wage regulation in general—and, indeed, for all forms of rate regulation? We believe the behavior of the compensation branch of the AIB provides a model for what will happen in any

such regulation. The regulatory body will compromise—will tend to split the difference. Once this behavior comes to be expected, the subjects of the regulation will build it into their strategies. Both unions going before the AIB and public utilities appearing at rate hearings will exaggerate their demands, realizing they will be trimmed by the regulatory board. If boards actually split the difference between what is asked and the status quo, the more that is asked, the more that will be given.

There may be a way out of this problem. Borrowing from the literature on final offer arbitration, we propose that regulatory boards be required either to choose the entire proposed wage increase (or, as the case may be, utility rate increase) or to roll it back entirely to the guideline (or present rate), with no compromises allowed. This would put regulated industries into a self-policing situation. Gratuously asking for large wage or rate increases far above the guideline would be likely to result in a total rollback. Exceptional cases could still be accommodated but only when the circumstances truly warranted it. In sum, a legislated rule requiring an either/or decision would discourage any regulated group or industry from asking for the moon in the hopes of receiving half of it and would force the regulators to make hard decisions (economic and political) rather than save face by splitting the difference. ■

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