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Chapter Title: The Financial System and the War - A General Statement

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Canada's Financial System in War

NOT SO LONG AGO, financial resources were commonly regarded as "the sinews of war." Modern economists, however, eager to tear aside the "monetary veil" and reveal the basic relationships behind it, have pointed out that wars are not fought with money at all, but with men, materials, and machines. Given adequate supplies of these resources, they have argued, the money needed to obtain them for war can always be found or created. But this argument has been oversold, as is so often the case; it has tended to divert attention from the very real difficulties of establishing control over financial resources in wartime.

Money — no less than men, materials, and machines — is hard to mobilize for war. The more a nation relies on the money mechanism rather than on conscription to reallocate resources for war purposes, the greater the danger of inflation. When resources are obtained for war through the market, their prices must be bid up to their "transfer level" and money incomes rise without any commensurate increase in supplies of consumer goods. Sterilizing enough of the rise in money incomes to prevent inflation is extremely difficult, as Canadian experience shows. Even if resources of a money economy are drafted into wartime uses, the task of making money incomes follow them is far from simple. Indeed, the crucial problem of war finance is to dislodge money from its customary channels and guide it into the public treasury, in a manner that provides enough income incentive to shift resources and nevertheless avoids undue hardship for any group.

Postwar demobilization, too, presents difficulties for both financial and physical resources. If wartime increases in money incomes are diverted from peacetime channels by methods other than taxation, pent-up demands tend to accumulate in the form of volatile stocks of money and other liquid assets. Money held harmlessly idle

during war may become dangerously active in peace; money safely diverted through investment in government obligations may return too quickly to consumer spending. Even if war is tax-financed, there is still the chance that new money may spring to life after the war as long-suppressed demands break through present restraints. Consequently, while men, materials, and machines need mainly guidance into peacetime occupations once the war is won, money may need continued surveillance. A major aim of postwar finance must be to so order financial resources that inflation is averted while a high level of production and consumption is encouraged.

All financial institutions, including all concerns handling money in significant quantities, are inevitably involved in war finance. They will have a vital role in the accomplishment of postwar readjustment. Knowledge of how they are affected by war finance and what readjustments they will have to face after the war will help to solve more general postwar problems.

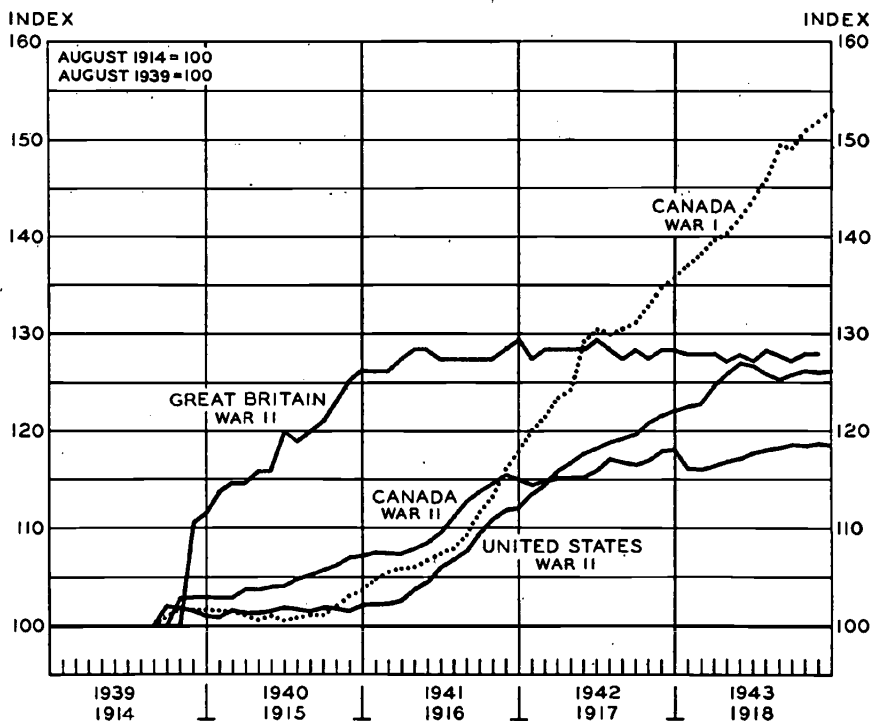
Canada has been at war two years longer than the United States. Her expressed financial objectives are the same: to make sure that financial resources are available in whatever degree may be required by the war effort; to do this with a minimum of wartime inflation and without storing up insuperable postwar financial problems. Canada and the United States have faced common problems before, have often arrived at similar solutions. An examination of the functioning of Canadian financial institutions in wartime, and the effects of war upon these institutions, may provide useful guides for dealing with American problems.

Canada also provides an opportunity of comparing results when financial resources are marshalled with military precision, as they appear to have been in World War II, and when they are allowed to dodge the draft, as they obviously were in World War I. In the first World War, the wholesale price level doubled and the cost of living rose 55 percent, although war expenditures of the Canadian government never reached 10 percent of gross national product.¹ Inflation continued at an accelerated pace for a year and a half after the war and was followed by a sharp recession, an unbalanced recovery in the twenties and prolonged depression in the thirties. During the first two years of the present war the wholesale price level

¹ Total value of all goods and services produced.

was permitted to rise only 27 percent and the cost of living only 13 percent, while in the next two years wholesale prices rose only 9 percent and cost of living less than 5 percent; yet war expenditures by the end of 1943 exceeded half the gross national product. For comparison of indices of Canada in the two wars with those of Great Britain and the United States in War II reference is made to Chart I.

CHART I—CANADIAN COST OF LIVING RISES LESS IN WAR II



Sources: Canada — Dominion Bureau of Statistics, *Cost of Living Index Numbers for Canada, 1913-1942 and Prices and Price Indexes*; United States — *Federal Reserve Bulletin*; Great Britain — Ministry of Labour, *Gazette*.

Of course, prices of civilian goods are a less reliable index of conditions in the economy as a whole in War II than they were in War I, just because they cover a much smaller share of total output. In wartime, ordinary indices of prices and production are of limited reliability even for civilian goods and services; they are still less reliable for war products. Perhaps a species of "inflation" not revealed by available data has developed this time within the war sector of the

economy. Swelling wages and profits in war industry give some hint that such may be the case, despite relatively stable prices in the civilian sector. As suggested below, any such development may bring new kinds of postwar problems in its wake. Despite statistical difficulties, however, Canada's experience in the two World Wars reveals such striking contrasts that a comparison should yield lessons both for war finance and for postwar reconstruction.

Canada Mobilizes Its Financial System

Leadership in formulating Canadian financial policy in War II has been assumed by the executive branch of the government. Budgets have included proposed tax legislation, and proposals for wartime tax increases have been drastic; yet each war budget presented by the Ministry of Finance has been passed by Parliament with little discussion and with minor modifications. The tug-of-war between the legislative and executive branches of government that has at times complicated American wartime economic policy has been much less apparent in Canada — partly, perhaps, because all war agencies are responsible to a few Ministers, and these Ministers are themselves Members of Parliament. The Canadian financial system is a relatively simple one; it consists of a single central bank in close working relationship with the Department of Finance, half a dozen major branch banking systems whose head offices keep close contact with Ottawa, a handful of large insurance companies under a Superintendent in Ottawa, and a number of smaller banks and insurance companies, investment houses, trust companies, and retail credit concerns. This simplicity has facilitated cooperation both in the formulation and the administration of financial policy.

Table 1 provides a summary picture of Canadian war finance over the first four "war years," August 31, 1939 to August 31, 1943, in general the period covered by this study.² It shows the rapid growth of government outlays from 10 percent of gross national product in the twelve months before the war to 49 percent in the fourth year of war. It also reflects the government's determination since the early stages of the war to cover only half of its total outlays by borrowing and the other half by taxes and other current revenue.

² In the Canadian economy, seasonal fluctuations have a marked effect upon financial and other economic data, and it is important to start and finish historical economic analysis in the same month where possible.

TABLE 1 — CANADIAN WAR FINANCE, 1939-43
(dollar figures in millions)

Item	Twelve Months Ending August 31				
	1939	1940	1941	1942	1943
<i>Cash Requirements</i>					
War ^a	\$36	\$788	\$1,655	\$3,042	\$4,253
Other ^b	510	481	425	540	568
TOTAL	546	1,269	2,080	3,582	4,821
<i>Sources of Financing</i>					
Current revenue ^c	467	615	1,100	1,757	2,403
Net borrowing ^d	67	677	1,285	1,378	2,693
Balancing item ^e	12	- 23	- 305	447	- 275
TOTAL	546	1,269	2,080	3,582	4,821
Gross national product ^f	5,330	6,140	7,570	8,920	9,900
Cash requirements in percent of gross national product	10%	21%	27%	40%	49%
Current revenue in percent of cash requirements	86	48	53	49	50

Source: Bank of Canada, *Statistical Summary* (August-September 1943).

^a Includes outlays under War Appropriation Acts, War Appropriation (United Kingdom Financing) Act, United Nations Mutual Aid Act, war advances, advances to the Foreign Exchange Control Board, repatriation of Dominion and Canadian National Railway securities held in the United Kingdom, special loan to the United Kingdom Government, and increases in the government's foreign balances.

^b Includes a compensation to Provinces, unemployment insurance costs, reserves against deficits of Canadian Wheat Board, Special Agricultural and Relief Expenditure, C.N.R. deficit, interest charges, cost of loan campaigns, and other ordinary expenditures. The total governmental outlay might quite legitimately be considered "war expenditure" for the four war years.

^c Almost entirely taxes. Excludes return on investments, which are deducted from interest charges.

^d Includes borrowing from Bank of Canada by Foreign Exchange Control Board.

^e Mainly increase (-) or decrease (+) in government's Canadian cash balance.

^f Dominion Bureau of Statistics figures (April 1943 revision) adjusted by the author on the basis of *Financial Post* figures for 1938 and 1942, and extended to "war years." The DBS figures are currently under revision, and *The Financial Post* figures are considered reasonably satisfactory by many economists working on income data.

In the United States, the growth of war expenditures relative to gross national product has been much the same as in Canada, but both countries have lagged behind Britain in this respect. Neither Britain nor the United States has been as successful as Canada in meeting war expenditures by taxes. In the fiscal year 1943-44, however, both Britain and Canada will probably cover half their outlays

by taxes, while the United States will probably increase tax revenues to more than 40 percent of cash requirements.³

War Expenditures

As the fourth war year ended, Canada was spending about \$3.5 billion annually on war production and was maintaining armed forces numbering nearly three-quarters of a million men.⁴ Each week, with a working force just over 10 percent of the American, Canada was producing 10,000 tons of chemicals and explosives, 25 million rounds of small arms ammunition, 4,000 military vehicles and 450 armored fighting vehicles including tanks, 1,200 gun barrels or mountings, \$4.3 million of instruments and communications equipment, 80 fighting aircraft, and 6 ships. Only 30 percent of this output was delivered to Canada's own fighting forces; 70 percent went to the other United Nations.

These figures represent enormous industrial expansion for Canada. Before the war, the country was producing less than one plane per week, and had built no seagoing vessels for 20 years, while in 1943 her various types of fighters and bombers were outstanding in their respective classes, and Canada rivaled Britain as a shipbuilder. In that year her tonnage delivered per capita was well in excess of American. Canada now has the two largest blast furnaces in the British Empire, and total steel production has more than doubled. Output of tool and alloy steels has increased fivefold, and of aluminum more than six times over. Canadian agricultural output rose from \$1.2 billion in 1939 to \$2 billion in 1942. Canadian railways are handling 50 percent more freight than ever before. Using August 1939 as a base, the indices of industrial production suggest a somewhat greater expansion in Canada than in the United States.⁵

³ See R. A. Musgrave and H. L. Seligman, "The Wartime Tax Effort in the United States, the United Kingdom and Canada," *Federal Reserve Bulletin* (January 1944) p. 16, and *Proceedings* of the National Tax Association, covering the conference for November 22, 1943.

⁴ Wartime Information Board, *Canada at War* (September 1943) pp. 12, 24. Other sources of data used in this section are: Department of Munitions and Supply, *The Industrial Front* (January and July 1943), and the report to Parliament of the Minister of Munitions and Supply (C. D. Howe), House of Commons *Debates* (June 11, 1943).

⁵ Federal Reserve Board for the United States and Dominion Bureau of Statistics (henceforth DBS) for Canada. Expansion was about 154 percent for Canada and 128 percent for the United States, but in view of the inevitable inaccuracy of indices when the components are changing rapidly, comparisons may be misleading.

The financing of such a war effort without a serious rise in prices of civilian goods has been no simple task, although it has been alleviated by the excess capacity and unemployment that existed at the beginning of the war. At that time, there were some 330,000 unemployed workers,⁶ and another 400,000 have been added to the labor supply by the growth in population during four years of war. Also, over 270,000 women, boys and older men, not previously considered part of the labor supply, were drawn into employment.

Thus total employment, including the armed forces, increased from 5 million on August 31, 1939 to 5.9 million on January 30, 1943.⁷ The armed forces grew from 10,000 to 645,000, and employment in war industries from nearly nothing to 1,036,000. In these two fields combined, employment increased 750,000 more than total employment, a development made possible by a drop in agriculture of 500,000 and in civilian industries of 250,000.⁸

The techniques and market structures of Canadian manufacturing are such that it has a margin of excess capacity even in peacetime prosperity.⁹ At the outbreak of war agriculture was depressed, the pulp and paper industry was operating far below capacity, the iron and steel industry at 50 percent. Although the metal industries most closely related to war production — nickel, aluminum, copper — had been brought to a high level of output by European rearmament, even they were not operating at maximum capacity. However, for producing such highly important war supplies as tanks, arms and munitions, aircraft, naval vessels, and alloy steels, new plant and equipment were necessary. Thus, the absorption of idle resources has been a more important factor in the war effort than diversion of resources already employed in 1939.

⁶ The 330,000 figure of unemployment is the official estimate of the DBS. Professor Plumtre estimated prewar unemployment at 600,000, defining "labor supply" more comprehensively than the DBS. (*Mobilizing Canada's Resources for War*, Toronto, 1941.)

⁷ It will be noted that according to Professor Plumtre's definition of labor supply, there must have still been 100,000 unemployed in Canada in January 1943.

⁸ The source of these figures of employment is a speech delivered in the House of Commons on June 23, 1943 by Minister of Labour Mitchell (*House of Commons Debates*, June 23, 1943, p. 4035). The figure of agricultural employment includes farm women.

⁹ See L. G. Reynolds, *Control of Competition in Canada* (Cambridge, 1940), and *Report of the Royal Commission on Price Spreads* (King's Printer, Ottawa, 1937) p. 193.

This excess capacity, together with depletion of inventories and improvements in technique, prevented any wartime reduction in the aggregate supply of civilian goods during the period covered. Figures provided by the Dominion Bureau of Statistics show production of consumer goods was 60 percent above the prewar level in December 1941, and still nearly 40 percent above that level in April 1943. Wholesale sales for the first eight months of 1943 were nearly 50 percent higher than before the war, and even 7 percent higher than in the same period of 1942. Retail sales in the first eight months of 1943 were more than 50 percent above the prewar level and 4 percent above the same period for 1942, with sales still climbing above records of previous years for all categories of commodities except highly durable consumers' goods such as automobiles and radios.¹⁰ The above figures suggest that physical consumption has actually increased during the war. The Chairman of the Wartime Prices and Trade Board has estimated that individual outlays on goods and services rose from \$3.5 billion in 1939 to \$4.5 billion in 1942. Even when the price rise is taken into consideration these figures suggest that for the period covered the war effort did not reduce the total volume of physical consumption. There has been, of course, some deterioration in the quality of certain goods and services, but this factor is difficult to measure.

The elasticity of Canada's productive capacity has greatly aided the financing of her war expenditures; nevertheless, holding individual consumer spending to a 30 percent increase in face of a 60 percent rise in individual incomes from 1939 to 1942 was a financial achievement of high order.

Taxation

The Canadian government has relied heavily upon taxation to "sterilize" much of its large-scale war expenditures, and thus to prevent runaway price inflation. As Table 2 shows, tax revenues for the four war years were nearly five and a half times the level of the last prewar year. Budget estimates for fiscal 1944 place tax revenues at nearly six times the level of fiscal 1939.

J. R. Beattie, Deputy Chief of Research for the Bank of Canada, has described the bold use of income taxation as "the backbone of

¹⁰ DBS, *Economic Conditions in Canada During the First Nine Months of 1943* (October 1943) and *Monthly Review of Business Statistics*, various issues.

TABLE 2 - GOVERNMENT REVENUES OF CANADA AND THE UNITED STATES, 1939-44
(dollar figures in millions)

Year	Personal Income Taxes a		Corporation Income and Profits Taxes b		Liquor and Tobacco Taxes		Sales Taxes		Import Taxes c		Other Revenue d		Total Revenue
	Amt.	% of Total	Amt.	% of Total	Amt.	% of Total	Amt.	% of Total	Amt.	% of Total	Amt.	% of Total	
1939	\$46	9.9%	\$77	16.5%	\$52	11.1%	\$118	25.3%	\$78	16.7%	\$96	20.6%	\$467
1940	55	8.9	97	15.8	74	12.0	156	25.4	135	22.0	98	15.9	615
1941	178	16.2	250	22.7	95	8.6	200	18.2	222	20.2	155	14.1	1,100
1942	373	21.2	524	29.8	120	6.8	238	13.5	243	13.8	259	14.7	1,757
1943	677	28.2	753	31.3	142	5.9	249	10.4	237	9.9	345	14.4	2,403
1944	930	33.8	850	30.9	135	4.9	225	8.2	185	6.7	427	15.5	2,752
C A N A D A E													
1939	\$1,028	18.1%	\$1,156	20.4%	\$1,167	20.6%	\$ 397	7.0%	\$ 319	5.5%	\$1,601	28.3%	\$ 5,668
1943	6,630	28.4	9,669	41.3	2,347	10.0	670	2.9	324	1.4	3,746	16.0	23,385
1944	18,238	45.2	13,720	34.0	2,445	6.1	623	1.5	334	.8	4,990	12.4	40,350

Sources: Canada - Bank of Canada, *Statistical Summary* (August-September 1943), and *Budget Speech* (March 1943) p. 23. United States - *Bulletin* of the Treasury Department, various issues, and *Statement by the President on the Summation of the 1944 Budget, August 1, 1943*.

a Includes National Defense Tax for Canada and Victory Tax for the United States, and includes refundable portions.

b Includes refundable portions, and for the United States includes "miscellaneous profits taxes" (Winson Act, unjust enrichment taxes).

c Includes War Exchange Tax for Canada.

d Sundry excise taxes, succession duties, non-tax revenue.

e Figures for 1939-43 are for years ending August 31. The 1944 figure is the budget estimate for the fiscal year ending March 31, 1944.

f Figures are for fiscal years ending June 30. Revised budget estimate of July 1943 used for fiscal year 1944.

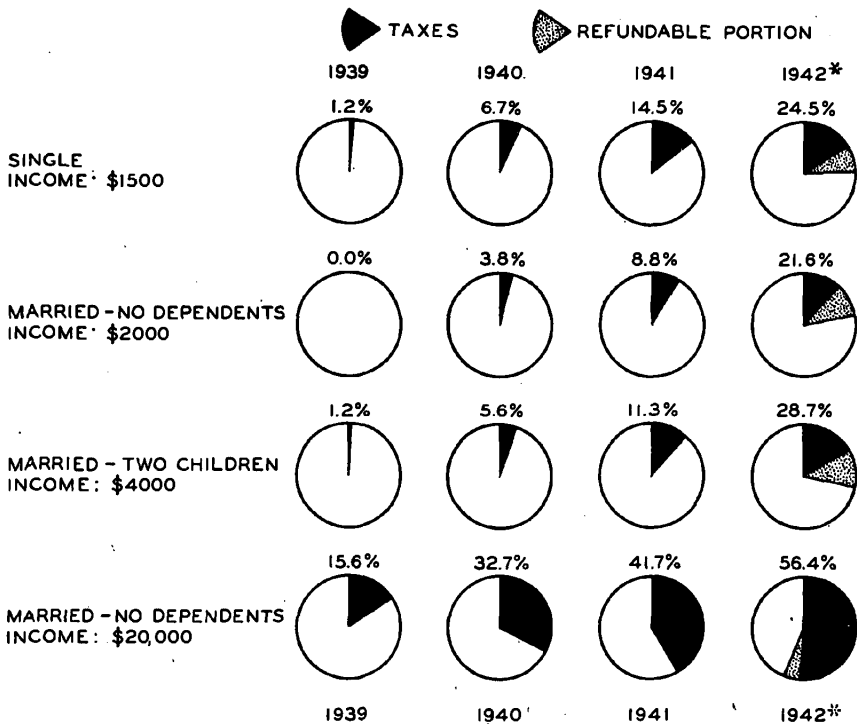
the government's policy."¹¹ The number of people paying income tax has risen from 300,000 before the war to more than 2,000,000 at the present time. Rates have been raised until total tax liability, including the refundable portion, is now the highest in the world for incomes in the middle brackets. A portion of taxes paid on 1942 income is refundable within two years of "cessation of hostilities," part of 1943 taxes is refundable a year later, and so forth. This refundable portion, officially called "minimum savings requirement," is substantial. It declines as a percentage of total tax liability as income rises, reaching an upper limit of \$800 for a single person, \$1,000 for a married person, plus \$100 for each dependent, at the \$10,000 income level.

Deductions from the minimum savings requirement are permitted for net payments on life insurance, retirement funds, and principal payments on one personal residence. Consequently, most taxpayers make use of permitted reductions from refundable taxes, and taxes net of refundable portions may be a better basis for comparison. When refundable portions are excluded, Canadian rates are somewhat below the Australian and British for some categories of taxpayers, although still well above the American rates, especially in the middle brackets. Australian rates are clearly the highest on incomes between \$7,000 and the very top brackets, even with minimum savings included. In the top income brackets, rates in all four countries are virtually confiscatory, but American rates are somewhat lower than the others.¹² Charts II and III show the development of Canadian income taxes during the war, and a comparison of British, American and Canadian rates.

¹¹ "Canadian War Finance," *Industrial Canada* (February 1943).

¹² For comparisons of Canadian, American, British and Australian income tax rates, see Commonwealth Bank of Australia, *Statistical Bulletin* (April 1943) p. 59, and Musgrave and Seligman, *op. cit.* The Finance Ministry considered placing a "ceiling" on incomes net of taxes when preparing the 1942 budget. In his budget speech, Mr. Ilsley dealt with the matter as follows: "I have considered the suggestion that a maximum level should be set for net income after tax — that we should place a 'roof,' so to speak, on what a person may be allowed to retain, whatever his actual income may be. In the United States, where there is an awkward problem arising from the existence of large incomes from tax-exempt securities, there may be some special need for legislation of this character. In this country, however, there would be no substantial amount of revenue to be gained from imposing a 100 percent top rate rather than the 98 percent rate I am proposing." He pointed out that a married man with \$100,000 income, of which \$30,000 was earned, is left with about \$21,000, while another with \$500,000 is left with only \$37,000.

CHART II - TAXES TAKE INCREASING SHARE OF CANADIAN INCOMES

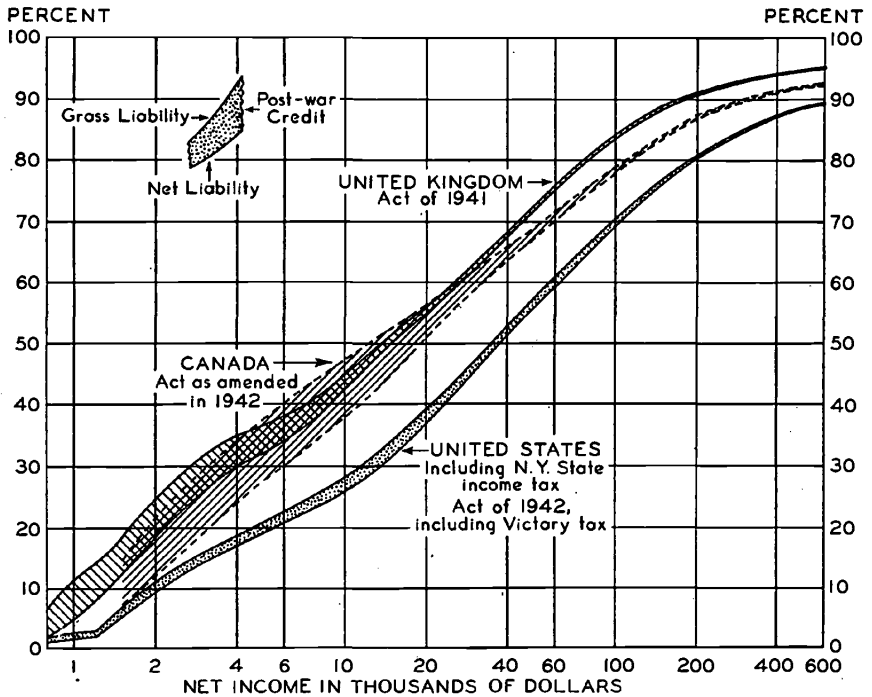


* 1943 and 1944 rates identical to 1942.

Source: Ministry of Finance, *Budget Speech* (June 23, 1942).

The advent of truly high personal income taxes in 1941 made more serious the discrepancies between income tax structures of different provinces. Accordingly, Finance Minister Ilsley wrote to all provincial premiers that the Dominion government would pay to any province vacating the fields of personal and corporate income taxes, either the amounts actually received by the province from these taxes during the fiscal year ending nearest December 31, 1940, or the amount actually paid by the province for net debt service less succession duty collections during the same period. The Dominion budget was drawn up on the assumption that this offer would be accepted, as indeed it was. The government also agreed to recompense the provinces for losses on gasoline taxes, and when rationing, priorities and fiscal limitations on liquor consumption were introduced, the Federal government undertook to make some restitution

CHART III — IN MIDDLE BRACKETS, CANADIAN TAX RATES ARE HIGHEST



Source: U. S. Treasury Department, *Bulletin* (December 1942).

for losses of liquor taxes as well. The absorption of provincial income and corporation taxes by the Federal government must of course be considered when comparing the respective burdens of Canadian and American taxes.

Under the 1942 law, 90 percent of estimated taxes on wages and salaries was collected at the source, and there was an eight months' lag between receipt of income and final payment of taxes. Since April 1943, 95 percent of taxes on earned income has been collected at the source; half the tax liability for 1942 was forgiven and payments already made in 1943 were applied to the 1943 tax. The lag between receipt of income and final payment of income taxes has been reduced from eight months to zero for this 95 percent. Those with investment income pay quarterly instalments in March, June, September and December of 1944, on 1944 income, unless investment income is less than one-quarter of total income. Tax liability is self-assessed on the basis of estimated 1944 income, and interest

penalties are imposed on underestimated statements. Half of the tax liability on 1942 investment income over \$3,000 is deferred until the death of the taxpayer, when it is paid by the estate. For investment income under \$3,000, half of the 1942 tax liability was totally forgiven.

The 1941 budget introduced a Dominion inheritance tax for the first time. The tax rate is a composite one, following the majority of provincial inheritance taxes; it is determined mainly by the amount each individual receives and his relationship to the deceased, and to a lesser extent by the size of the whole estate. An exemption of \$20,000 is provided for the widow, and of \$5,000 for dependent children. Non-dependent children and grandchildren have lower exemptions and pay higher rates. This tax has not been very productive; it yielded only \$7 million in fiscal 1942, around \$14 million in fiscal 1943, and an estimated \$18 million in fiscal 1944.

The corporate income tax has been raised from 15 percent to 18 percent since war began. In addition, under the 1942 law every company pays an excess profits tax of 12 percent of total profits, plus 100 percent of profits in excess of the average for the four fiscal years, 1936-39, or another 10 percent of total profits, whichever is greater. The effect of these provisions is to limit profits after taxes to 70 percent of prewar profits before taxes. However, a refund equal to 20 percent of profits in excess of 116 $\frac{2}{3}$ percent of the prewar "standard" will be made after the war; allowances are made for new companies, concerns unusually depressed in the late thirties, and the expansion of old firms that have been financed by security issues.

Before the war, commodity taxes of all kinds, including customs duties, were responsible for two-thirds of Dominion tax revenues. The 8 percent sales tax alone provided nearly 30 percent of Dominion tax revenues, while taxes on liquor, tobacco, beer, and sugar, together with the tariff, yielded most of the rest of returns from commodity taxes. However, the wartime tax burden has been imposed by the government according to the ability-to-pay principle, and therefore little use has been made of commodity taxes. In fact, the increase in their yield has been the result more of increased consumer expenditures than of any upward revision of tax rates. Exceptions are the increased taxes on "luxury goods," the extension of the sales tax to new commodities and a 20 percent tax on expenditures in dance halls, night clubs, receipts of motion picture theatres and so

forth. Minor changes have been made also in tariffs designed to diminish demand for non-Empire goods and conserve foreign exchange. The same is true of the 10 percent "war exchange tax" on non-Empire imports and of the sharp increase in excise taxes on automobiles. In the aggregate these modifications have not constituted a major instrument of fiscal policy.

Control of Prices and Production

One of the principal factors affecting financial institutions is government control of prices and production. Ceilings on wages and prices help to limit the expansion of bank deposits and note circulation. Rationing, by limiting consumption, improves the market for government obligations. Priorities on raw materials and restrictions on the use of labor limit investment and narrow the operations of security markets as well as the scope of bank lending. Rationing, priorities, and consumer credit regulations make drastic inroads into the business of retail credit concerns. Knowledge of these direct controls is necessary to understand the wartime functioning of the financial system, since they are an integral part of the process of mobilizing financial resources.¹³

In Canada, the regulation of production is delegated to the Department of Munitions and Supply, which, like the War Production Board in the United States, determines priority ratings, allocates scarce materials, limits use of materials, and so forth. In cooperation with industrialists, the Department has accomplished notable economies in the use of critical materials and sharp reductions in the cost of war materials and supplies. In Canada as in the United States, during 1943 attention in the war production field was concentrated upon the manpower problem. Efforts were made to improve the allocation of manpower through the National Selective Service, and the Inter-Departmental Committee on Labour Co-ordination endeavored to alleviate the skilled labor shortage through a War Emergency Training Program.

¹³ For a more complete account of direct controls, see Jules Backman, *The Price Control and Subsidy Program in Canada* (Brookings Institution, 1943); National Industrial Conference Board, *Canada's Role in the American Hemisphere*; Department of Munitions and Supply, *Wartime Controls in Canada and The Industrial Front*; Department of Labour, *Wartime Orders-in-Council Affecting Labour*; Jules Backman and Henry Brodie, "Canadian Wartime Control of Industry," *Contemporary Law Pamphlets*, Series 4, No. 10 (New York University, 1942); *Report of the Wartime Prices and Trade Board, September 3, 1929 to March 31, 1943 and March 31 to December 31, 1943.*

Control over prices and supplies of civilian goods and services is concentrated in the Wartime Prices and Trade Board, which corresponds roughly to the Office of Price Administration plus the Office of Civilian Requirements of the WPB in the United States. Unlike these agencies, however, WPTB also regulates consumer credit, and is not an independent agency, since it is responsible to the Minister of Finance. This relationship, it may be pointed out, thus constitutes a link between fiscal policy and direct controls.

The Wartime Prices and Trade Board is linked to the Department of Munitions and Supply through the Wartime Industries Control Board, which has been set up within the Department. The Chairmen of WPTB and WICB are each members of the other Board, and when actions affecting commodities under their jurisdiction are being considered, Controllers of WICB become temporary members of WPTB. Further integration has been obtained by appointing Controllers of WICB Administrators of the same commodities for WPTB.

Restrictions on consumer credit are similar in many respects to those applied in the United States, and were introduced at about the same time, in the fall of 1941. For most consumer durable goods, a down payment of one-third of the purchase price is required. The value of any trade-in articles must be deducted from the purchase price, and one-third of the balance covered in cash. Payments must be completed within six to fifteen months, depending on the type of commodity, and must include a minimum carrying charge equivalent to $\frac{3}{4}$ of 1 percent per month on the total amount financed. Individuals requesting unsecured loans from banks are required to state that no part of the proceeds will be used to finance the down payment of consumer durable goods. "Charge accounts" must be paid by the 25th of the month after the purchase is made.

A general price ceiling was announced in November 1941. Maximum prices were set at the highest figure reached between September 15 and October 11 of that year, with the ceiling to become effective on December 1, 1941. This order covers all commodities, unless specifically exempted, and a long list of services. Up to that time, price controls had been selective. Non-farm rents, which had been pegged in some centers under an order of September 1940, were made subject also to a general ceiling in November 1941. The ceiling came into effect on December 30, and fixed rentals at their

October 11, 1941 level except where a previous limit had been set. Certain commodities subject to seasonal price movements, such as fruits and vegetables, were originally exempted by the Board, but have since been subject to regulations.

A wage ceiling was introduced at the same time, under which employers could not lower wages below the November 15, 1941 level, and could raise them above that level only with permission of the National War Labour Board. However, a cost-of-living bonus was to be paid (or retracted) whenever the Dominion Bureau of Statistics cost-of-living index rose (or fell) by one point. The bonus amounted to 25 cents per week for employees earning \$25 per week or more, or 1 percent of the weekly wage for workers earning less than \$25 weekly, for each rise of one point in the index. Anyone earning less than \$175 per month, regardless of rank, or who was below the rank of foreman but earning less than \$250 per month, was deemed to earn "wages" while others earned "salaries." Salaries were fixed at their November 7, 1941 level, and cost-of-living bonuses were virtually excluded for salary earners.¹⁴ Prior to November 1941, there was only one wage control order issued and it merely instructed Conciliation and Investigation Boards to regard the highest wage prevailing in the 1926-29 period, or any higher level established up to December 16, 1940, as "fair," and permitted—but did not compel—payment of a cost-of-living bonus in addition.

Rationing in Canada also has taken much the same form as in the United States, but it is somewhat less complex. By the end of 1943, ration cards had been issued for gasoline, sugar, tea, coffee, meat, butter and conserves. Liquor was rationed by provincial authorities, and as in the United States, purchases of automobiles, tires, radios, refrigerators and similar scarce consumer durables, were subject to permit. True "point rationing" had been avoided, but meats were divided into four categories, with weekly rations ranging from one to two and one-half pounds per person according to the type purchased; tea and coffee were interchangeable, as were the various kinds of jams, syrups, and so forth, listed under "conserves."

Subsidies, together with remission of import duties and with bulk purchasing, have played a major role in Canadian price control, and

¹⁴ Bonuses to salary earners can be paid only if the employee earns no more than \$4,200 per year, and salary-plus-bonus does not exceed the remuneration of employees not above the rank of foreman in the same concern.

are executed through the Commodity Prices Stabilization Corporation Ltd., a crown company set up under the direction of WPTB and responsible to the Minister of Finance. Subsidies are paid to permit price maintenance in the face of rising costs, generally at whatever stage of the production-and-distribution process has the fewest firms, which is usually the importing or primary processing stage. In some cases, import duties have been reduced to avoid subsidy payments, while in others, the Corporation has bought large quantities in the foreign market, and resold at prices compatible with the ceiling.

In at least one case, subsidies were used for the express purpose of avoiding a cost-of-living bonus. A compulsory bonus was declared in July 1942, since the cost-of-living index rose 2.4 points over the previous quarter. By November 1942, the index had risen another .7 points, and there was danger that another bonus would be required in January. In December, the government announced its intention to use subsidies to reduce the prices of milk, oranges, tea and coffee, and thus depress the index and escape the need for another bonus. The government argued that the incipient wage-price spiral must be checked, that a rise in the cost of living injured everyone and that a wage bonus did not benefit all income earners. It pointed out also that in any case a bonus would result in a flood of applications from individual concerns for subsidies or permitted price increases.

The determination to use subsidies to "hold the line" greatly increased subsidy costs. From November 1941 when the program began until March 31, 1943, they amounted to only \$35 million for imports and \$31 million for domestic goods, and economies of mass buying had kept trading losses of the Commodity Prices Stabilization Corporation down to \$3.3 million.¹⁵ An abrupt rise in subsidies is seen in the fiscal year 1944, for which the Minister of Finance originally requested \$120 million. Later estimates suggest that this figure may be 50 percent too high. The budget for 1945 carries over \$200 million for subsidies, but this figure may again prove to be an overestimate.

Growing subsidy costs were a minor consideration in the government's decision to permit a 35-cent cost-of-living bonus in November 1943. Other factors in the decision seem to have been a feeling that the public needed a "scare," the desire to restore faith in the

¹⁵ See Backman, *op. cit.*, and Wartime Prices and Trade Board, *op. cit.*

cost-of-living index itself, and labor's preference for higher wages rather than stable costs of living. The Prime Minister then announced that the "cost-of-living bonus" would be scrapped, and all bonuses to date incorporated into a "basic wage" above which no increases would be permitted except where "injustices" were apparent. Only if the cost-of-living index rose three points and stayed up for two months would the government consider revision of this wage policy. A new Federal labor code was announced at the same time.

It should be noted that subsidy payments are by no means a total loss to the Treasury, since holding prices down reduces the costs of war. Moreover, because of expansion in total output, some firms receiving subsidies are at the same time subject to 100 percent excess profits taxes, so that subsidy payments are offset by a certain amount of tax liability. It has been argued that the ultimate social costs of subsidies might be negative¹⁶ considering the danger of an increase in costs of war resulting from a continuous raising of the price ceiling.

¹⁶ See S. E. Harris, "Subsidies and Inflation," *American Economic Review* (September 1943).

The matters dealt with in this chapter, especially fiscal policy considerations, are treated more fully by B. S. Keirstead in his article, "Canada's War Against Inflation," soon to be published by the National Industrial Conference Board.