VOLUME I

REPORT

of the

ROYAL COMMISSION

on

PRICES

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ROYAL COMMISSION ON PRICES

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Right Hon. Louis S. St. Laurent, M.P.,

Prime Minister,

Ottawa.

Dear Mr. Prime Minister,

In accordance with the instructions contained in Order in Council P.C. 3109 of July 8th, 1948, I am conveying to you herewith for transmittal to His Excellency the report of the Royal Commission on Prices which has now terminated its activities.

Yours faithfully,

C. A. CURTIS,
Chairman.

Ottawa, March 18, 1949.

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P. C. 3109

Certified to be a true copy of a Minute of a Meeting of the Committee of the Privy Council, approved by His Excellency the Governor General on the 8th July, 1948.

The Committee of the Privy Council have had before them a report, dated 7th July, 1948, from the Right Honourable W. L. Mackenzie King, the Prime Minister, representing:

That, by a resolution of the House of Commons passed on the 10th day of February, 1948, a Select Committee of that House was appointed to examine and to report from time to time as to:

(a) the causes of the recent rise in the cost of living;

(b) prices which have been raised above levels justified by increased costs;

(c) rises in prices due to the acquiring, accumulating or withholding from sale by any persons, firms or corporations of any goods beyond amounts reasonably required for the ordinary purposes of their businesses;

That the Committee so appointed has, in a report to the House of Commons, recommended that the Governor in Council consider the immediate appointment of a Commission under the Inquiries Act to continue the work initiated by that Committee;

That the House of Commons, on June 28, 1948, concurred in that report; and

That it is, therefore, expedient to cause inquiry to be made into and concerning the matters hereinafter referred, such matters being connected with the good government of Canada.

The Committee, therefore, on the recommendation of the Prime Minister, advise,—

1. That

   Professor C. A. Curtis, Queen's University, Kingston, Ontario,
   H. C. Bois, Esquire, Montreal, P.Q.,
   Mrs. T. W. Sutherland, Parksville, B.C.,

   be appointed Commissioners under Part I of the Inquiries Act, Chapter 99, Revised Statutes of Canada, 1927, to continue, after familiarizing themselves with the work initiated by the Special Committee on Prices appointed by the House of Commons, the inquiry into and concerning price structures, factors leading to price and cost increases and increased profits margins in Canada, paying particular regard to essential commodities and services in common daily use;

2. That the said Commissioners adopt such procedure and methods as they may, from time to time, deem expedient for the proper conduct of the inquiry and sit at such times and in such places in Canada as they may decide from time to time;

3. That the said Commissioners be directed to make such interim reports to the Governor in Council, from time to time, as they may consider advisable; and in any case to present a general report to the Governor in Council not later than the opening of the next session of parliament;

4. That when, pursuant to the powers conferred by section eleven of the Inquiries Act, the said Commissioners have authorized and deputed any qualified person as a special Commissioner to inquire into any matter within the scope of the aforesaid inquiry as may be directed by the said Commissioners, any person so deputed be authorized to exercise the same powers which the Commissioners have to take evidence, compel them to give evidence, and otherwise conduct the inquiry;

5. That, pursuant to the powers conferred by section eleven of the Inquiries Act, the said Commissioners be authorized to engage the services of counsel to aid and assist them in the inquiry and to engage the services of such technical advisers, or other experts, clerks, reporters and assistants as they deem necessary or advisable;

6. That the said Commissioners be directed that a record should be made of all the evidence given before them or before any special Commissioner in the course of the inquiry; and

7. That Professor C. A. Curtis be Chairman of the said Commission.

"A. D. P. HEENEY"
Clerk of the Privy Council.

His Excellency Field Marshal The Right Honourable The Viscount Alexander of Tunis, K.G., G.C.B., G.C.M.G., C.S.I., D.S.O., M.C., L.L.D., A.D.C., Governor General and Commander in Chief of Canada.

May it Please Your Excellency:—

Pursuant to the terms of Order in Council P.C. 3109 of July 8, 1948, we, your Commissioners appointed under Part I of the Inquiries Act have the honour to submit herewith our Report.

We have held 77 public hearings and have examined 179 witnesses during the course of our inquiry. Because of our wide terms of reference, and the limited time at our disposal we held all our hearings in Ottawa. Witnesses were called, however, from trades and industries located in every province of Canada and we therefore believe we have acquainted ourselves with local trade practices insofar as has been possible.

In addition to summoning representatives of business and industry for the more precise purpose of investigating pricing practices, costs, profit margins and mark-ups, etc., we invited twelve national organizations to present briefs. These organizations, covering wide fields of social and economic activity sent to Ottawa representatives who appeared before us in public hearing and whose views, diverse as they often were, contributed much to our appreciation of the subject under inquiry.

We did not confine ourselves to the information elicited at our public hearings. We consulted informally a number of private individuals and government officials who furnished us with pertinent and valuable material.

In view of our concern, as specified in our terms of reference, with the activities of The Special House of Commons Committee on Prices, we have considered in this Report the evidence presented before that body as well as before ourselves. A study of the industries investigated by The Special Committee is included in Volume III.

We wish to acknowledge our appreciation and thanks to our Secretary, Mr. A. G. S. Griffin, who carried out his duties in a competent and effective manner. We also express our indebtedness to our Counsel, Mr. H. A. Dyde, K.C., whose able advice and assistance have been invaluable to us. To our Accountant, Mr. Marcel Caron, C.A., of Clarkson, Gordon & Co. we are grateful for his capable efforts and guidance. We acknowledge with thanks the co-operation of several government departments in making available to us personnel for various special duties. Finally to all the members of our staff we express our very particular gratitude for their faithful and assiduous labours.

PREFACE

Volume I contains the Introduction to the Report of the Royal Commission on Prices, a summary of our analysis of the "causes of the recent rise in the cost of living" contained in Volumes II and III, and some specific gestions and general conclusions. The summary of Volumes II and III presents only the barest outline of the most significant features of our analysis and necessarily entails the omission of much subsidiary and underlying argument and discussion. We would therefore caution the reader against forming definite and critical conclusions concerning our analysis from a perusal of this summary. We would refer him to the more detailed and definitive analysis which forms Volume II and Volume III.

INTRODUCTION

In the main, this is a report on "the causes of the recent rise in the cost of living". It is an attempt to answer the question:

> Why has the cost of living of a representative Canadian family, after being virtually stabilized during the final and most intense phases of World War II, increased by nearly one-third as measured by the cost-of-living index since the conclusion of hostilities?

While the impact of rising prices has been felt most sharply by consumers, especially those living on relatively low or fixed incomes, it is of interest to note that national groups representing agriculture, labour, manufacturers and retailers, as well as consumers, expressed grave concern to us over the recent rise in prices and over the "peaks and valleys" in our economy of which the upswing of inflation is but one phase.

Nature of Inquiry

Broadly speaking, there are two ways of conducting an inquiry into rising prices and we used both. The first, and perhaps obvious way is to investigate the prices being charged for services and for individual goods such as bread, butter and shoes. Like the Special Committee on Prices of the House of Commons, we followed this line of inquiry and gathered a good deal of useful and significant information which could not have been obtained in any other way. We called before us representatives of manufacturers, wholesalers and retailers, and obtained detailed information as to costs, margins and mark-ups and the over-all profit position of individual firms in each industry investigated.

But an investigation along these lines, however thorough, cannot, by its very nature, yield a full and satisfactory explanation of a general rise in the cost of living. This may be illustrated by reference to conditions during the middle 1930's. At that time business was in the doldrums, prices low and unemployment widespread. Inquiry into each case of poor business, low prices and lack of a job would have revealed a different set of circumstances. But we know that whatever the particular circumstances of each case, the underlying cause of most of the trouble was lack of profitable markets, lack, in other words, of effective demand.

We therefore studied the problem from a wider point of view. We sought the common factors, the generating forces causing the upward movement of prices.

As a result, this report is a blend of the particular and the general. It deals with the rise in the price of bread as it does with the rise in price of many other articles in common use, not in isolation, but in relation to what was going on elsewhere in the economy.

The analysis of the economic factors underlying the general price rise is presented in Volume II of this Report. The detailed studies of the ten industries or commodities investigated by us and by the Special Committee on Prices—bread, butter, fruits and vegetables, meats, primary textiles, fertilizers, hides and leather, shoes, secondary textiles and lumber—appear in Volume III.

In this first volume of the Report, we present a brief summary of the analysis contained in Volume II and of the ten industry studies in Volume III together with some general observations and suggestions by way of conclusion.

Our inquiry led us to make special studies of a number of highly important and difficult questions. It was clear from the outset that World War II had more to do with the recent rise in the cost of living than any other single factor. We therefore found it essential to review in some detail the methods by which the war was financed and the effect of fiscal and monetary action in the post-war period. Since Canada is so dependent upon trade, the influence of external factors upon the Canadian price level was examined in some detail. Because of its direct and indirect effects upon prices, we attempted to analyze and appraise the impact of the great upsurge in demand for new plant and equipment, which has come to be known as the investment boom.

Perhaps the most difficult part of our task was to form some judgment as to the results of price control during both the war and post-war periods. Why was price control so successful in wartime? Could it have been maintained longer into the post-war period?

We then turned to some special aspects of rising prices. It was suggested to us that one of the main causes of rising prices was higher profits. On the basis of the information available we tried to arrive at some tentative conclusions on this point. On the same basis we looked into the relationship between wages and prices and considered the effect of higher agricultural prices upon prices in general.

The evidence presented to us by the representatives of various in-
istries and by the representatives of consumers, prompted us to give some
tention to the practices followed in setting mark-ups and margins and
the extent to which restrictive business practices had contributed to
e recent rise in prices.

These special studies will be found in Volume II. Here we give only
r general findings.

SUMMARY OF VOLUME II

Economics of Rising Prices

We are concerned in this Report with a general rise in prices which is commonly called "price inflation" or just "inflation". How does inflation come about? Briefly, it is a symptom of too much spending in relation to the available supply of goods and services, or, to use an overworked but expressive phrase, it is a case of "too much money chasing too few goods".

Spending can increase without causing a significant rise in prices. For example, in a period of recovery from a depression, increased spending will call forth new production as idle men and other productive resources are re-employed. But once full employment has been attained, the attempt to increase spending by more than the increase in average output per worker is bound to raise the general level of prices.

Consider, for example, what happens when, as at the end of a war, business men decide that the time has come to embark on a program of plant expansion. With savings or borrowed money they try to buy additional labour and materials to do the job. Assuming full employment and no increase in productivity, the necessary labour and resources must be withdrawn from some other use.

But on the other hand, spending by business men for capital investment puts money into the pockets of wage and salary earners and business men who work on the projects or supply the materials. So unless adequate counter measures are taken, or there are some other offsetting influences, the chase of money after goods begins. Business men, intent on expanding their productive facilities, endeavour to bid resources away from other uses and from each other. Everyone's income and ability to pay being just as great as before, there is resistance to the transfer of resources. The resulting competitive bidding-up of wages and prices adds to the incomes and to the general willingness to spend. Thus the spiral of rising prices moves upward.

Or, consider what happens when prices rise in countries from which we buy or to which we sell. What this really means it that non-Canadians want to buy more of our goods or want to keep more of their own goods at home, either because their demands have risen or their alternative sources of supply have been reduced. The basic situation is no different from an internally generated inflation, except that the competition for labour and other productive resources is on a world-wide scale rather than on a national scale. These two illustrations show how difficult it is to blame any particular individual or group for an inflationary price rise.

The business man can hardly be blamed for attempting to increase his productive facilities to meet the demand. Yet while labour and other resources are being used to build new machinery and factories, they cannot be used to make shoes and build houses. The business man who sells for what he believes the market will justify providing he is not guilty of restrictive trade practices, is following legitimate business practice. The farmer who sells at the going market price is in much the same position.

Wage and salary earners, too, are following a natural enough course in striving to increase their earnings, for, on the one hand, they are faced with rising costs of living, and, on the other hand, they believe employers are well able to afford a higher wage bill. Consumers for their part have a normal human desire to maintain and if possible raise their standard of living. For some of them increased spending is not a matter of choice, but of necessity.

Even larger government expenditures may be unavoidable. The salaries of civil servants must be adjusted to the market. New roads and bridges and public utilities may be necessary. The international situation may call for foreign aid and large defence expenditures. It can be argued that family allowances, increased old age pensions, veterans' benefits, etc., are inflationary, but from other points of view they are wholly justifiable and desirable expenditures.

When the world price of cotton goes up, Canadians must pay more or do without. The same is true of nearly all imported goods. So it is with exports. When United States buyers are willing to pay more for newsprint or cattle, Canadian producers may expect consumers at home to pay equivalent prices.

The fact is that a serious rise in prices can occur even though everyone works efficiently and behaves in what seems to him or to her to be a perfectly reasonable manner. There may be no villains in the piece, only honest, hardworking citizens.

Rising prices can be cured only by removing the excess of demand over supply. Any other proposed remedy, no matter how different it looks can succeed only if it somehow or other increases the supply of goods or decreases the rate of spending.

While everything possible should be done to increase output by removing restrictions on trade and improving productive efficiency, the results are bound to be relatively small during a period of full employment. A serious inflation can be held in check only by reducing the rate of spending.

This is not only a matter of curtailing what might be called unnecessary expenditure. It is also likely to include the curtailment of expenditure which most of those concerned consider necessary and certainly desirable. For this reason too much reliance cannot be placed on voluntary restraint to check a strong inflationary movement. Those who should exercise the restraint find it difficult to believe that their particular activities, which from their particular point of view appear quite reasonable, should be curtailed. Hence, the people as a whole acting together through the government must agree to apply restraints of general application.

Government policy can operate to reduce the volume of spending by:

1. Levying higher taxes which have the effect of leaving less money in the hands of the public for spending.
2. Discouraging borrowing and the raising of capital, e.g., by higher interest rates and by putting indirect pressure on the banking system to curtail lending.
3. Encouraging saving and the deferring of expenditure, e.g., by government bond selling campaigns and by postponement of its own capital expenditures.
4. Controlling prices and supplies and thus making it illegal for people to spend as much as they would otherwise have done.

All four methods are extremely difficult to apply and are bound to encounter opposition. While there is widespread support for the idea of halting an upward movement in prices, there is a good deal less support for the particular measures that have to be taken to put the idea into practice.

Taxes are a case in point. It can be demonstrated that in an inflationary situation additional taxation of the appropriate kind does not really impose any additional burden on the community for it merely takes away money that would otherwise have gone into paying higher prices. Nevertheless, there will always be resistance to taxation if only because of the feeling that it would be very pleasant for one if there were only other people who were taxed to keep spending down.

Prices and Income Since 1939

At the outbreak of war in September, 1939, conditions in Canada were far from prosperous. There had been some recovery from the lowest point of the depression but unemployment was still widespread, amounting to perhaps 17 per cent of the civilian labour force. Construction, both of new industrial plant and of housing, was at a low ebb. Agriculture was in a position of serious disequilibrium.

The situation then existing was one to which few people would wish to return. Since a price level is to a considerable extent the result of prevailing economic conditions, the Canadian price level in 1939, should not be regarded as an ideal against which to assess the present price level.

From September, 1939, to the date of this Report the cost-of-living index[1] (which we found to be a useful though not, a perfect guide to the effect of changing prices on all family budgets) has gone up 58 per cent. During the inflationary period which accompanied and followed World War I the cost of living rose by 90 per cent.

At the same time there has been a very great improvement in the volume of output and in the average standard of living. Under the impetus of wartime demands and post-war accumulated needs the Gross National

[1]A description of the cost-of-living index is included in Volume III.

Product increased in value terms by 139 per cent between 1939 and 1947, and it is estimated that there was a further large increase in 1948. After allowing for price increases there has been a tremendous expansion in real output of goods and services. In terms of constant dollars having a buying power based on prices during the years 1935 to 1939, the Gross National Product per capita was $500 in the prosperous year of 1928. fell to $300 at the low point of the depression in 1933, climbed back to $500 in 1939, and reached an all-time high of $800 in both 1947 and 1948.[1]

On the basis of the statistics available to us we estimate that the actual quantities of goods and services purchased by consumers in 1948 were 69 per cent larger than in 1939.

We put these facts down at the outset so that the rise in prices will be seen in perspective. Some recovery in prices from the 1939 level was probably desirable, and some adjustment as between various kinds of prices was certainly desirable. Nor should the very real improvement in output and average living standards be overlooked.

Even so the rise in prices which did occur between 1939 and 1948 was of major proportions and brought hardship to many Canadians whose incomes did not rise at the same rate. Why was there such a major rise in prices and could it have been avoided?

Price Control and Rationing

Looking back at the war period, we are impressed by the remarkable stability of consumers' prices. From September, 1939, to November, 1941, the cost-of-living index rose by 15 per cent and from November, 1941, to September, 1945, by only three per cent. There can be little doubt that this degree of stability would not have been achieved without the timely introduction of the over-all price ceiling late in 1941, and the efficient, determined and imaginative way we believe it was administered by the Wartime Prices and Trade Board. But we do not believe that the price ceiling by itself could have prevented prices from rising. A price ceiling is like a lid on a boiling pot. It can be held down only if the pressure within the pot does not become excessive.

Therefore, although for reasons which we give elsewhere, it would have been impractical to use fiscal and monetary measures with sufficient force to prevent prices from rising under the conditions that existed in Canada in wartime, they were an indispensable part of the stabilization program. The high rates of individual taxation necessary for war purposes helped to keep consumer spending down. Taxes on corporations, particularly the excess profits tax, took much of the profit out of war and thus helped to reduce the pressures that would otherwise have arisen from labour for a larger share in the gains and from Canadians generally for relief in individual income tax.

Although wages were never held under a rigid ceiling, a substantial degree of wage and salary control was maintained and seems to have been

[1]Figures given to nearest hundred dollars. See Table 6, Chapter 2, Vol. II, The Course of Prices and National Income.

indispensable. It is significant in this connection that except on rare occasions, wage increases were not recognized during the period of the over-all ceiling as justification for the payment of subsidies or for price increases. Export controls, import subsidies and foreign exchange control too were indispensable. Without them a sufficient supply of essential goods could not have been kept in Canada and rising prices for imports would soon have made the domestic ceiling untenable. Even so, the evidence presented to us and our own investigations have led us to the conclusion that it would have been exceedingly difficult, if not impossible, to hold the line in Canada, had it not been for the timely control of prices in the United States early in 1942. It should not be overlooked, too, that although the over-all ceiling was maintained more or less intact at the retail level for some four years, there was, in fact, a considerable increase during that time in returns to Canadian producers, made possible by the payment of domestic subsidies on a large and rising scale.

Over and above all else we are convinced that the lid was kept on largely because the people of Canada were determined to keep it on. Persuaded by a skilful and extensive publicity campaign as to the dangers of inflation and the purpose of the price regulations, they held themselves in check and they held each other in check. The retention of the price ceiling became an integral part of the war effort, or as one witness put it "the public support of price controls was a patriotic duty".

There may be some argument as to whether an over-all price ceiling was the right policy or whether it would not have been better to have permitted somewhat greater flexibility. For example, a less rigid policy might have made post-war adjustments less difficult. But this is arguing after the event. In 1941, we were engaged in an all-out war effort and it was prudent public policy to anticipate the worst and to prepare for it. Nonetheless, the very success of the over-all price ceiling did add to the post-war difficulties of restoring freedom of trade.

We considered whether or not, in view of the rapid rise in prices following decontrol, the wartime price ceiling should have been continued longer. Because of the representations and evidence of groups speaking for a significant proportion of our people requesting a reimposition of controls and stating their belief that there should not have been decontrol at all, it constituted a most pressing matter for our examination, and posed one of the most difficult questions for us to answer.

It seems to us that the vital issue was whether it would have been in the general interest to attempt to hold to a price line that could only have been held by a degree of government intervention in the economic life of the country without parallel either in war or peace.

To have held prices at the 1941 level, would not have meant merely a continuation of the kind of intervention that had been necessary to hold the price ceiling in wartime. For while the ceiling held prices down below the levels which would have prevailed under open market conditions in wartime, it must be remembered that Canadian prices in fact never diverged very far from United States prices which were also under control and there was a reasonably close relationship between internal costs and prices. At the end of the war, however, both import and export prices and internal costs began to move upward and away from the Canadian war-time ceiling level. As one expert witness said:

> "... even if the price ceiling policy had been continued in full effect there would almost certainly have been a very considerable rise in prices. To have held the old ceilings in the face of increases in both domestic and import costs would have involved enormous increases in total subsidy payments and at the same time could not have avoided hampering and restrictive effects on production."

To put it bluntly, the continuation of the war-time price ceiling into the post-war period would have fixed on the country a structure and level of prices quite remote from reality one which could only have been maintained by the most detailed and elaborate kind of government planning and direction. At one time there might have been reason to hope that as war-created shortages disappeared, demand and supply would come into balance at price levels not far above or even at, or below ceiling prices. But events turned out otherwise.

We find ourselves in agreement with the decision not to continue and augment the wartime controls. We are satisfied that the preservation of 1941 prices far into the post-war period under totally different domestic and world conditions would have been not only impractical, but economically highly undesirable.

Could another ceiling have been established and held at a somewhat higher level? We have considered this possibility and it seems to us that there would have been one well-nigh insuperable obstacle. That obstacle would have been the establishment of a new over-all ceiling in the immediate post-war period before prices had settled down at an equilibrium level, The 1941 price ceiling adopted a relationship in the pricing system which had been established in the market. In a period of inflation the process of adjustment of prices and costs is rough and its continuity is marked by uneven pushes and pulls. The actual setting of every price in the economy is the more difficult in a period of inflationary unbalance because in price setting it is first necessary to determine an economic balance of every factor by artificial means rather than by the normal process of adjustment of supply and demand.

To have reimposed the ceilings after the war would have involved the refixing of prices at every step of production and distribution at a level so unrelated to the realities of the economy that their use in the post-war period would have been wholly impracticable and undesirable. Moreover, in a peace-time economy there could be no discrimination in price setting between essential goods and luxury goods, or essential services and luxury services. Also every wage and every salary would have to be set and controlled. Perhaps these measures could have been adopted to the satisfaction of both consumers and producers, but we very much doubt it. In any case, unless the new ceiling had been fixed at levels reasonably close to the levels which would have been established on the open market, the degree of government intervention might not have been much less than if the original ceiling had been retained.

We considered also the serious administrative difficulties in operating over-all price controls in peacetime. Briefly these are:

(a) An over-all price ceiling produces a large number of extremely complex problems. If the system is to function, these problems must be solved quickly, fairly, and efficiently. This implies a fairly large and extremely competent staff of experienced officials. During wartime such a staff was obtained largely by borrowing senior officials from industry and trade, because personnel with the necessary experience could not be obtained elsewhere. In peace-time conditions private companies could not be expected to continue to lend their top officials to the government and the government could not attract these men to its service permanently unless it could offer permanent employment and could pay salaries on a scale much higher than those now being paid by the government. Without a competent staff, inefficiences of administration are inevitable.

(b) Continued acceptance of controls by the trade and by the general public could not be expected without an extensive educational campaign explaining both the need for the controls and the details of the regulations. As the Chairman of the Wartime Prices and Trade Board said in his testimony before us, such a campaign is "really indispensable" in obtaining public compliance. It does, however, cost a lot of money, and in peacetime might well be identified with political propaganda.

(c) Experience since the war has shown in many instances, an unwillingness on the part of the courts to impose on those who break the regulations a penalty sufficiently large to deter would-be offenders.

Whether or not the actual process of decontrol followed was in every respect the best under the circumstances is a matter of judgment. In our opinion it was wise to move gradually rather than to remove all controls at once, both to lessen the shock of adjustment and with the hope that demand and supply might come into better balance before the process was complete. There undoubtedly was a point, however, beyond which the retention of particular controls over prices on the 1941 base while other prices were free would have produced serious inequities and distortions.

Two controls related to, although above the 1941 ceiling, are still in effect, namely, those on house rents and sugar, and a few have been reimposed in the post-war period of which the ceilings on bread, flour and butter and mark-up controls on certain imported fruits and vegetables are the most important. A consumers' subsidy is also being paid on flour.

The fact that these controls do exist led us to make inquiries as to the practicability of some form of selective price control rather than over-all price control during the post-war period.

As we see it, selective price control may be justified under exceptional circumstances for a temporary period. It may, for example, be justified by a temporary restriction of imports for exchange conservation purposes which, if allowed to affect prices, might result simply in a fortuitous profit to domestic producers and (if some imports are permitted) to importers. Selective price control, combined with subsidies, may also be justified as a means of slowing down the wage-price spiral. In specific cases of acute shortage of vital commodities direct controls may be necessary to ensure that the scarce supplies are directed where they will best serve the national interest.

Except under such circumstances it is doubtful, however, if selective price control has much to commend it in ordinary times. It is bound to be discriminatory. It is extremely difficult and complicated to administer. Most important of all, and particularly if subsidies are paid on the controlled goods, selective controls are more likely to augment the inflationary gap between demand and supply than to reduce it. If a general attack on inflation is to be made, the weapons should, in the main, also be general, directed to bringing the flow of money available for expenditure into equilibrium with the supply of goods and services available for purchase.

External Influences

That there is a connection between Canadian and foreign price levels is obvious enough. What we have tried to establish is the closeness of the connection and to what extent it is a necessary connection. In particular we are concerned with the answers to two questions:

1. To what extent have Canadian price trends followed or deviated from price trends in other countries, particularly the United States, and for what reasons?
2. Under what conditions can Canadian prices be held down while prices in the United States and elsewhere are rising?

Foreign prices affect Canadian prices most directly through the purchase by Canadians of goods produced outside the country and through the impact on domestic prices of the prices received by Canadians for the goods they export.

As an indication of the importance of imports we think it likely that the import content of goods purchased by Canadian consumers is around 30 per cent; for capital goods and equipment purchased by business men the figure may be even higher.

The list of goods which Canada buys abroad is so comprehensive and varied that only a few of the more important items can be mentioned here. For example, ninety per cent of the petroleum used in Canada in 1947 was imported. Two-thirds of coal burned in Canada, including all the anthracite coal used, is imported. All the cotton and most of the wool, the basic components of most Canadian clothing, come to us from abroad. Fresh fruits and vegetables in the winter season, citrus fruits the year round, and a host of manufactured goods from automobile parts and automobiles to complex electrical machinery all form an integral part of Canadian consumption habits and Canadian productive processes.

If an increase in the price of imports may be said to have a "pushing" effect on Canadian prices, then the prices which can be obtained abroad for Canadian goods may be said to exert a "pulling" effect. But since the bulk of the goods that Canada produces for export are concentrated in a few products which have a limited sale within the country these direct effects of export prices are probably not as great as the direct effects of import prices.

The effect of export prices upon domestic prices can also be modified more readily than the effect of import prices. Whereas insulation of the Canadian economy against higher import prices requires the payment of subsidies, the direct effect of higher export prices can be offset by export embargoes which prevent foreign demand from draining away domestic supplies, by bulk contracts which may fix the export price at levels below world prices and by export controls combined with price control.

Export prices are less likely to follow United States prices closely than are import prices, since the proportion of exports sold to the United States is smaller than the proportion of imports bought from that country, and since the principal United States purchases are newsprint and woodpulp which exert relatively little direct influence on Canadian price levels. However, during the past year the intensification of Canada's efforts to expand exports to the United States, and the greater diversification in those exports, have resulted in closer relationship between Canadian export prices and the United States price level.

It is doubtful whether the closely related movement of Canadian and United States prices can be entirely accounted for by the actual interchange of goods between the two countries. Other less obvious influences are at work. It does not, for example, require an actual shipment of goods across the border to bring price trends into line in the two countries. The mere possibility that such a movement might take place is often sufficient.

In addition to the direct price increases resulting from the higher price levels prevailing abroad for exported products, the bidding of Canadian exporters for factors of production have raised wages and prices of materials generally in all industry. In this way, for example, prices under the British cheese contract have affected the price of butter consumed entirely in Canada. These indirect effects of higher export prices are matched on the import side by the effect of higher prices on wage demands, which in turn produce secondary effects on the price structure and on the prices of competing or substitutable domestically produced goods.

The influence of proximity is another intangible which cannot be overlooked. The influence of the United States has permeated the thinking of Canadians in almost all fields of business and economics.

Having these facts in mind, let us look at the course of prices in Canada in comparison with prices in the United States. Following the fixing of the Canadian dollar at a discount of 10 per cent below the United States dollar at the outbreak of war, wholesale prices tended to rise somewhat more rapidly in Canada than in the United States. The situation was reversed following the introduction of the over-all price ceiling in Canada in the autumn of 1941. The more rapid increase in United States prices ceased, however, after controls were imposed in that country in 1942 and for the remainder of the war the difference between the two indexes remained approximately the same as in 1942.

The Canadian wholesale index which had been at approximately the same level as the United States wholesale index when the war began, was between three and four points higher when it ended. That the increase in Canadian price levels was less than one might expect from the Canadian-United States dollar exchange rate may possibly be attributed to the superior efficacy of Canadian controls and related fiscal policy, but if United States prices had risen more sharply, ours would probably have been somewhat higher too. As we have said before, it would have been exceedingly difficult, if not impossible to hold the line in Canada had it not been for the timely control of prices in the United States early in 1942.

The cost-of-living indexes showed a wider variation during the war period which suggests that the Canadian government's efforts in this field met with more success. Some of the burden of price increases in imported necessities was shifted from the low-income group to the population as a whole through the greater use of subsidies.

The first real test of whether Canada's price level could be insulated from increases in United States and world prices came in the summer of 1946, when controls were lifted in the United States. From May, 1946, to March, 1947, the United States wholesale index increased by 35 per cent and the consumer price index by 19 per cent. During the same period the Canadian wholesale index increased by only 10 per cent and the cost-of-living index by less than six per cent.

If it is true that United States prices have a significant influence on Canadian prices, how could such a wide divergence occur in so short a period? Our investigation suggested the following explanation:

1. The government took action to moderate the effect of United States price increases by appreciating the Canadian dollar to parity with the United States dollar, by retaining price controls and subsidies on both imported and domestic commodities and by retaining embargoes on the export of scarce products.
2. Prices of the principal Canadian imports from the United States showed on the whole a much lower rate of price advance in the ten

months May, 1946, to March, 1947, than did United States prices generally.

3. Partly as a result of the bulk contracts on wheat and other commodities to the United Kingdom, prices of Canadian goods sold for export increased by only 14 per cent.

Since 1947 Canadian prices have risen much more rapidly than United States prices. Could Canadian prices have been held down or were the forces tending to bring prices in the two countries together too great to be harnessed without at the same time bringing about a degree of state intervention incompatible with the functioning of a free economy in peacetime? This is a matter of opinion, but we are convinced that, in view of the intimate relationship between the economies of the two countries, prices in Canada could only have been insulated by an elaborate and continuing system of export controls or by a government monopoly of selling and by a very complicated system of import subsidies and import allocations or by a government monopoly of buying.

Perhaps such subsidies and controls could have been justified if there had been a prospect that external prices would shortly have fallen to correspond with internal Canadian prices. But the outlook was highly uncertain and in fact external prices have not yet fallen to anywhere near that level.

The difficulties of holding prices down at home were increased by the emergence of the dollar problem in 1947. The subsidies and mark-up controls on imported goods, although a partially effective price control measure, tended to produce an increased volume of imports in the subsidized products. When steps were taken in late 1947 to restrict the purchase of some United States goods, the use of domestic substitutes or similar goods obtained from other countries resulted in higher prices in Canada. A larger volume of exports to the United States to improve the dollar position meant in many instances an increase in the domestic price.

As one of what might be termed external factors we examined the effects of the loans and credits extended to overseas countries. We are inclined to agree with one of our witnesses that "it was not only our moral duty but also in our long-run economic and political interest to extend such loans and assistance." But the decision to provide this aid, however much it was justified, did add to demand without adding immediately to supply and thus contributed to inflationary pressures.

The Investment Boom

Several witnesses dealt with the effect of the recent high level of capital expenditures upon price levels in Canada.

Clearly enough, these expenditures were very large in both dollar amounts and physical terms, exceeding those of any previous period in our history. Yet they absorbed probably a smaller share of the available goods and services than they did in 1929 when investment went forward without any important rise in the general price level.

The only firm conclusion that can be reached, therefore, is that domestic investment expenditures plus other expenditures by consumers, by government and by foreigners in Canada were too large in total to be made without upward pressure on the price level. It was a case of trying to do too much of too many things at one time. Moreover, even if competing demands had been on a smaller scale, there would have been sharp increases in construction costs and prices of capital goods generally because of the impact of the greatly increased demands upon the capital goods industry.

On the whole, investment expenditures by government, apart from housing, were not responsible for much of the increased demand. This is indicated most clearly by the fact that these expenditures in the post-war period have not been larger in physical terms than in the years immediately preceding the outbreak of war. The Federal government appears to have adhered fairly well to its stated policy of deferring postponable projects. Provincial and municipal expenditures on public works have been relatively larger but we cannot say that they have been excessive considering the urgency of some of the demands such as those for schools, hospitals, etc.

The chief elements in the investment boom were therefore the high level of business investment expenditures and housing construction. To a significant extent the Federal government itself is responsible by its own housing program and its priority and financial assistance to private builders, supplemented by some provincial help, for the large volume of new housing. Without this government intervention it is unlikely that as large a proportion of labour, materials and equipment would have been devoted to house building during the period since the end of the war. We doubt whether any other aspect of government policy in the post-war period had greater public support.

Business investment in new plant and equipment was high primarily because of the desire to make good the deficiencies which accumulated during the pre-war depression and the period of the war and to enlarge productive capacity to meet the anticipated high level of post-war demand for consumers goods and exports and to some extent, it would appear, because financial conditions were favourable. There was a coincidence of desire to expand, availability of the necessary funds and some positive encouragement from the authorities.

That there should have been a large scale expansion in the productive capacity of the country can hardly be questioned. The crucial point is whether or not such a large program should have been concentrated into such a short period when other demands were competing for resources.

The objective for which we should aim is not only a high standard of living but a reasonable degree of stability. We shall not presume to say that recent investment expenditures have been on too high a level, for only time will tell if this is so. It is reasonable to assume, however, that there seems to have been a good deal more concern about a possible deficiency of demand in the post-war period than of a possible excess of demand. In Canada, as in the United States, there has been a good deal of "caution lest in ending a prosperous inflation, the prosperity should also be ended."

Finally, while it is evident that our desire to make investment expenditures on a large scale at the same time as we were bidding for resources for other purposes has contributed to rising prices, it is very difficult to determine how important this factor has been in relation to other price raising factors that were at work in the economy. As we have pointed out elsewhere, strong upward pressures were placed on Canadian prices by the rapid increases in prices in markets to which we sell and from which we buy. Canadian prices would have responded to these external pressures in any event. Probably the most that can be said is that if investment expenditures had been on a smaller scale, external influences would not have spread through the economy as rapidly as they did and construction costs would not have risen so high in relation to prices generally. Furthermore, external influences not only affected prices in Canada through imports and exports but played their part in the generation of the investment boom. True, there was no great influx of capital such as occurred early in the century and again in the twenties; on the contrary this investment boom has been financed almost wholly from Canadian sources. Nonetheless, external demands for Canadian goods, new methods and ideas originating abroad and the example and effect of the United States boom have played no small part in spurring Canadian investment.

Fiscal and Monetary Policy

Government spending, taxing, borrowing and debt repayment can be looked at from two points of view. Primarily governments spend money to provide services that the public wants. They tax to raise the necessary revenues and to repay debt. They borrow, as any individual or corporation borrows, to raise capital for projects of a durable character or to meet temporary or extraordinary expenses such as arise in wartime. But these government operations also have effects on economic activity. We shall be concerned more especially with these economic effects. Nevertheless, while most of our discussion will be along these lines, it should not be concluded that we are unaware of the primary purpose of spending, taxing, borrowing and debt repayment. Whatever other effects it may have, a tax is primarily a means of paying government expenses. Equally a budget surplus arising from an excess of revenues over expenditures, while it will be examined in terms of its effect as an anti-inflationary measure, is after all simply a means of reducing the public debt and thereby reducing future charges on the public exchequer.

In theory fiscal and monetary action alone can prevent a general rise in prices. All that is required is a policy which reduces purchasing power and otherwise restricts expansion in the money supply and the rate of spending to the point where money demand is equal to the available supply of goods and services at the existing level of prices. If such a policy is carried through, so the theory runs, even a rising level of external prices can be neutralized by allowing the domestic currency to appreciate in terms of other currencies.

In practice, however, there are some very real limitations on the extent to which fiscal and monetary measures could have been used to reduce inflationary pressures that have existed in Canada since the outbreak of World War II.

One such limitation lies in the reaction of taxpayers to tax rates which they regard as unduly high. Personal income taxes which are regarded as too high may, under certain circumstances, lead to slackening of personal effort, or to demands for higher wages. Unduly high taxes on corporate profits may, under certain circumstances, interfere with maximum output and may increase costs and prices through lowering the penalties on waste and inefficiency in business. Unduly high indirect taxes are less likely to impinge on incentives, but may cut across accepted standards of equity in taxation, and there is danger that because of their effect on the cost of living they, too, may lead to higher wage demands. In other words, if the remedy is administered in too large doses, it may produce reactions opposite to those intended.

Apart from the effects on incentive, experience has confirmed that neither fiscal nor monetary measures can be sufficiently selective and flexible to relieve the bottlenecks in particular commodities which arise in an acutely inflationary situation. Such measures may be able to control the situation ultimately but the over-all results may be much too drastic. To use them for such a purpose is like using a butcher knife to perform a delicate surgical operation. The cause of the trouble may be removed but a good deal of unnecessary damage may have been inflicted in other parts of the system.

More important perhaps than any of these limitations is that imposed by the degree to which the public is willing to give support to a government which attempts to put into effect the kind of fiscal and monetary policies required to prevent rising prices. Inflation is undesirable and unpopular in many ways, but full employment and prosperity also have a very wide popularity.

Our appraisal must therefore be made with these economic and public limitations held clearly in view. The test we apply is, under all the circumstances have the policies followed made as much of a contribution to stability as could reasonably have been expected?

Without necessarily concurring in all the views expressed by the government, we would commend the efforts that have been made, through the budget speeches of the Minister of Finance and elsewhere, to clarify the purposes of fiscal and monetary measures in an inflationary situation. As we have already said, government cannot move beyond the point of public acceptance in these matters but, thanks to the growing sense of public understanding of economic issues, that point is now well beyond what one would have thought possible 10 years ago.

Reviewing the period as a whole, it is clear that little use was made of monetary policy in the older orthodox sense, that is, the general restriction on the supply of money, leading to higher interest rates. It appears that fiscal measures, supplemented by direct controls, were depended upon almost entirely to reduce the excess of demand over supply. Various official explanations were offered from time to time for the decision not to follow a more vigorous monetary policy, not all of which appear to us to be entirely consistent. When during the war the prospect of higher interest rates might have interfered with the current sale and retention of Victory Bonds, it was suggested that higher rates would "only become intelligible if, after war shortages are over, consumers' expenditure and capital development were to proceed at a rate which would overstrain our productive capacity".

In 1948, following a limited decline in the price of long-term government bonds, we find the Bank of Canada saying that it

> "does not regard the increase in rates of interest which has taken place as one of the most important factors in combating a general rise in price levels. The Bank is not in favour of a drastic increase in interest rates which would be likely to create a situation that might hamper, and might even prevent, essential forms of capital investment which Canada needs and which it is desirable should be proceeded with."

The Budget Speech of May 18, 1948, puts emphasis on the relatively small effect that any "reasonable" increase in interest rates would have on business expenditure or on consumer spending or saving.

The argument that in the circumstances of the post-war period most consumers and business men would not have been deterred from proceeding with their spending plans by a moderate rise in the rate of interest is very similar to the argument, sometimes advanced in the pre-war depression, that a reduction in interest rates would have an insignificant effect in stimulating spending. In both depression and boom and, for that matter, at all times, economic forces are at work far more powerful than the possible effects of a change in the cost of borrowing money or in the rate of return on savings. To conclude, however, that the change should not be made because the probable effects would be small is quite a different matter. The easy money policy adopted by the Canadian government in the early thirties did not cure the depression, but it was generally acknowledged to be a step in the right direction and that higher interest rates would have caused an even greater curtailment of spending in individual cases.

In appraising monetary policy since the beginning of World War II it therefore seems fair to say that it was largely passive and deliberately so. Whether it should have been more positively anti-inflationary is a matter of judgment. A tighter rein would have involved a drop in the market price of Victory Bonds and other longer term government securities. Since the Canadian government debt has now grown until it forms a very large part of the total debt held by Canadians and a similarly large part of the total assets of institutions like banks and insurance companies, we can understand the reluctance of the monetary authorities to create unsettlement in the financial markets. We can understand, too, their reluctance even to appear to break faith with individual holders of Victory Bonds who may have purchased such bonds in the expectation that they would always be able to sell them if need arose, at around par.

Nevertheless, it is our view that monetary measures could have been used to a greater extent than they were during the recent inflationary period. We hold this view even though we are aware that Canadian policy was similar to that followed in the United States and the United Kingdom. The policies followed probably reflected public thinking and discussion which seemed, on the whole, to be more concerned about the dangers of a post-war recession than of a post-war inflation.

On the other hand the government did not hesitate to pursue a vigorous fiscal policy. It made a determined effort to pay for a high proportion of the costs of the war out of taxes and to finance the remaining deficit by methods calculated to reduce the volume of spending. There are no absolute standards against which to measure achievements; we can only record our view that the policies followed by the government indicated a true appreciation of the principles of war finance and that more was done, than most people thought possible, to translate those principles into practice. Even so, there remained in the hands of the public at the end of the war a large volume of liquid savings held in banks or government bonds ready to be spent. These savings have added to the difficulty of keeping the post-war inflation in check.

To some extent at least the Canadian government shared the widely-held view that the problem in the post-war period was more likely to be a deficiency than an excess of demand; hence, its special tax concessions to business to encourage capital expenditures. In the light of subsequent events it is possible that these concessions gave a greater stimulus to spending than was needed to keep the economy operating at full capacity.

We must observe, however, that the spending stimulated by these concessions and by a continuation of low interest rates may have been wholly desirable since it increased the productive capacity of the country. It can be argued that spending for consumption purposes should have been curtailed either by higher taxes or increased voluntary saving in order to make the additional capital investment possible without inflation. The trouble has not necessarily been an excessive rate of capital investment. But the combination of a high rate of spending on capital investment and the maintenance of a high rate of spending on current consumption made some inflation inevitable.

The purpose of fiscal policy in wartime was relatively simple. Apart from avoiding an unnecessary increase in the public debt, it was to curtail civilian spending so that it did not compete with the government's spending for war purposes. Government spending generated the excess income that threatened to raise prices, and efforts were concentrated on trying to get the excess income back into the hands of the government through taxes or the sale of government bonds or on trying to "sterilize" it in the form of other kinds of savings.

At the end of the war this simple pattern disappeared. Government spending was no longer the main generator of inflation. It became clear that total spending would exceed total available supplies of goods and services even if the government took back in taxes as much as it spent. The situation called for a budget surplus, and, for a reduction in the public debt.

How far did the policies followed meet this requirement? As to expenditure, we are not in a position to comment other than to say that most of the increases in spending on current account compared with prewar are to be found in the expansion of the social services, the payments to provinces under the tax agreements and the greatly enlarged scale of defence and veterans' expenditure, all of which are presumably part of the accepted pattern. As already pointed out the Federal government seems to have adhered in large measure to its professed policy of postponing major public works to a more propitious time. Most of the limited postwar increase in the government sector of capital investment is accounted for by provincial and municipal expenditure and by Dominion government housing expenditure.

In assessing post-war tax policy it is necessary to take account of public acceptability as well as of economic desirability. Looking at the matter only in the light of what was economically desirable and leaving out of account the question of public acceptability, we are inclined to think that taxes might have been maintained at a somewhat higher rate. No doubt prices would still have risen, but the rate of the increase would probably have been smaller, and the resulting pressure on those with small, and relatively fixed incomes, less severe.

When account is taken of over-all government spending and investment, rather than merely those particular forms of expenditure that are included in the budget, the surplus of government intake over government outgo in the past few years has not been large.

Prices and Wages

We studied the relationship between wages and prices from two points of view. First, we considered how changes in wages bring about changes in prices and, in turn, how changes in prices bring about changes in wages. Second, we looked at wages and prices from the point of view of the individual wage earner.

Wages are a cost of production. In the aggregate they also form part of the spending power of the population. Thus rising wages have a double-edged effect on prices in an inflationary situation.

Although a cost, higher wages do not necessarily mean higher labour costs per unit of output. Nor do lower wages necessarily mean lower labour costs per unit of output. As one witness said, "It all depends upon productivity." Furthermore, wages are only part of total costs and a varying part.

As an indication of the importance of rising wages as a factor on the demand side, we noted that total labour income rose from $2,583 million in 1939 to $7,134 million, in 1948. In 1948 this labour income constituted more than on-half of the total national income.

Rising prices not only result from, but lead to higher wages. When prices are rising, employers are prepared to pay higher wages in order to attract and hold their labour force. Similarly workers, seeing higher profits and facing higher living costs, seek higher wages.

To put the matter in its broadest terms, a price inflation usually includes a wage inflation. We reached the general conclusion, therefore, that no simple answer can be given to the question: Do rising wages cause rising prices or do rising prices cause rising wages? They affect each other. Furthermore, it is our view that in, Canada, since 1939, other general forces and influences, such as fiscal and monetary policies, external influences, the development of new resources, and technological improvements, have had an important influence on both wage and price movements.

An examination of the relationship between wages and prices from the point of view of the wage-earner revealed that since 1939 consumer prices, as measured by the cost-of-living index, have risen less than the increase in wages. That is, real wages have risen substantially since before the war, whether viewed as hourly wage rates, average weekly earnings or total labour income.

In the early war years as both production and employment expanded rapidly, the average earnings of individuals increased substantially. In the following period of price and wage control the percentage increase in money wage rates was considerably less than in the pre-control period, but real wage rates rose more rapidly because of the stability of consumers' prices. When prices and wages were decontrolled after the war, the average rate of increase in wage rates roughly paralleled the increase in the cost of living, so that real wage rates have changed but little. Taking into account the post-war reduction in income taxes it seems probable that most workers are as well off as they were in 1945.

We also made a comparison of the position of wage-earners in Canada today with what it was in 1929, a year of high employment. The striking feature of this comparison is the fairly steady upward trend in real wage rates throughout the whole 20 year period, an upward trend which has been more rapid since 1939 than previously. Provided labour-management relations remain on a satisfactory basis, it seems reasonable to expect that the upward trend in real wages will be resumed during the next few years as a result of post-war developments, such as the renovation and expansion of industrial plants and the exploitation for peacetime use of wartime technological advances.

Prices and Corporate Profits

The view was expressed before us on a number of occasions that high profits earned by business corporations are partly to blame for the recent rise in prices. We found the relationship to be complicated because, in the short run, profits are a residual return. The owners receive whatever is left over after all other claimants have been paid. For this reason corporate profits are subject to more extreme fluctuation than other forms of income.

Corporate profits are related to prices in a number of different ways. They result from higher prices as market conditions make it possible for business firms to increase their prices. Corporate profits may also have an effect on prices through the way in which they influence spending, particularly spending on capital goods. Finally, corporate profits may exert an indirect influence on prices by means of the part which these profits play in the wage-price spiral.

Reported profits during a period of rapidly changing prices have to be corrected to give a true picture of the position. We found that the profits reported by Canadian corporations in recent years contain an element of what is essentially an inventory profit arising from the particular method commonly used in valuing inventories. They also tend to be somewhat overstated because the allowances made for depreciation are probably insufficient to replace, at today's cost, the capital which has worn out during the year. In addition, corporate profits have been increased by extremely profitable sales on the export market, and to that extent do not form part of the price charged to Canadians.

The available data do not enable very definite conclusions to be reached as to the size and significance of corporate profits as a whole in relation to the recent rise in prices. For the year 1947 profits earned by all Canadian corporations, before deduction of tax, formed 14.4 per cent of the Gross National Product (less certain government expenditures) as against 12.0 per cent in 1945 and 11.3 per cent in 1939. After deducting tax, corporate profits formed 7.6 per cent of this total of Gross National Product in 1947 as against 5.7 per cent in 1945 and 9.0 per cent in 1939. These calculations may be taken to mean that the margin of profits has tended to be somewhat larger in recent years, although allowance must be made for the various special factors such as inventory profits, depreciation reserves and export profits mentioned above.

In our investigations of specific industries, we studied the profit position of a great number of manufacturers, wholesalers and retailers. We found that in most cases their net profit had increased very substantially over pre-war years in dollar amounts, especially in the past two years. Calculated as a percentage of total sales, however, the net profit of the majority of companies appeared much more moderate. While the percentage of net profit had risen very considerably for some, for others it had remained fairly steady and for still others had decreased as compared to pre-war years. Even where the percentage had declined, however, the increased volume of sales usually resulted in higher dollar profits.

Although it cannot be assumed that we live under conditions of pure competition, neither can it be assumed that all corporations are in a position to determine the market price of their products at any level they see fit. In some respects, therefore, to say that higher profits are a cause of higher prices for manufactured goods is like saying that higher incomes for farmers are a cause of higher prices for farm produce. The farmer sells at the going market price; if he sold for anything less, the dealer rather than the consumer would be the probable beneficiary.

Looking at corporate profits as a whole we do not conclude that the raising of prices to earn exceptionally high profits was general, or played a major part in the rise in prices since the end of the war. This point is dealt with in the industry studies in Volume III. So that there may be no misunderstanding we should add that in making such a statement we are not in any way expressing an opinion on the question of whether the returns to the owners of corporate businesses were or were not excessive in relation to the rest of the community. Our sole concern here is to attempt to trace the causes of the recent rise in the cost of living.

Profits are income, like wages or rents, which can either be saved or spent. Assuming that the profits have been earned, does it matter whether they are paid out as dividends or retained as undistributed profits in the hands of the corporations?

If the retained profits had been distributed, a part of them would have been paid over in the form of taxes by shareholders. These shareholders, taken as a group, would not spend all of the additional dividends they receive. Moreover, a proportion of the dividends of Canadian corporations is paid to non-Canadians. On the other hand, a corporation, in making its plans for expansion or improvement, is no doubt influenced not only by profit expectations but also by its liquid position. It is more likely to go ahead, or at least to go ahead more quickly, if it has all or most of the necessary funds on hand than if it has to go into the capital market to obtain them. Corporate undistributed profits plus depreciation allowances in 1947 were sufficient to finance over one-half of the total private investment in plant, equipment and inventories in that year.

Whatever merit there may be in this argument we do not think too much weight should be given to it. Some corporations have not spent all their undistributed profits and therefore have created savings which would not necessarily have been made by individual shareholders. Furthermore, to the extent that profits are overstated because of inventory profits or inadequate allowance for depreciation, the apparent extent of undistributed profits may be misleading.

Finally, corporate profits affect prices in an indirect manner through the part they play in the wage-price spiral. High corporate profits, even though these are earned through export sales or contain an important element in inventory profits, provide an incentive or support for labour to increase its demands for higher wages. In this way the higher profits, though partly fictitious, probably played an active part in the wage-price spiral.

Agricultural Prices

Prices of farm products have been extremely unstable. They have been quick to respond to general inflationary and deflationary influences. It is not surprising therefore that they have risen more rapidly than prices in general since the outbreak of World War II. The official index shows that farm prices have risen by 122 per cent since 1939 as against an increase of 112 per cent in general wholesale prices. If wheat is included in the index at the current domestic and British contract price rather than at the subsidized price to consumers, the gain in farm prices would be 137 per cent.

The largest increase in farm prices, amounting to 75 per cent, occurred between 1939 and 1945. Since the end of the war, farm products prices have risen less than prices of most other groups in the whole ale index. Yet, because the cost of foods has risen so sharply during this period, this fact is often overlooked. The chief explanation for the apparent anomaly is to be found in the removal of food subsidies which kept food prices down during the war.

In general we found that prices of farm products moved upward in response to the acute world shortage of food, a shortage that was an inevitable aftermath of war. To some extent the rise was moderated by the food contracts negotiated with the United Kingdom. Both these agreements and the restrictions that were placed on the export of farm products to the United States have kept Canadian prices from rising to the levels prevailing in export markets.

This has undoubtedly helped to keep the whole Canadian price structure at a lower level, for if food prices had risen to world levels it seems likely that wages and prices of manufactured goods would also have been affected.

To the farmer the higher prices for his product have meant higher incomes, both gross and net. At the outbreak of war, farm products prices were relatively low and the farmers' position similarly depressed. Since that time farm incomes have improved a good deal, although the outlook for agricultural prices is by no means clear.

Mark-ups and Margins

Are the mark-ups taken by the wholesalers and retailers unnecessarily high, and to what extent are these mark-ups responsible for the recent rise in prices?

The wholesaler and retailer provide very essential services such as transportation, storage, merchandising, financing and advertising, in moving goods from the primary producer or manufacturer to the ultimate consumer. The mark-up charged on an article is expected to cover operating expenses plus a margin of profit. Over a period of years, certain percentage mark-ups have come to be considered as "normal" for the varying types of goods. A highly perishable line, such as fresh fruits and vegetables, will normally carry a higher percentage mark-up than a more staple line like sugar, and style merchandise, such as women's hats or dresses, will carry a higher mark-up than a utility garment such as a pair of overalls.

The question of most concern, however, is whether or not the mark-ups and margins increased unduly as prices rose during the past three years.

In our investigations, we found that it was general for the distributive trades to maintain the same fixed percentage mark-ups on their various lines of merchandise as their costs rose, and that the effect of this practice was to increase prices to the consumer much more than a dollar and cent mark-up would. Where a fixed percentage mark-up is used by the manufacturer, wholesaler and retailer, an initial cost increase at the manufacturing level is pyramided through the entire price structure.

One reason given by retailers and wholesalers for adhering to a "traditional" percentage mark-up when their cost for the article increases, even though their other expenses may remain the same, is that it is a convenient and quick pricing procedure. They say that adding a dollar and cent mark-up would require much more complicated record keeping. Also, they claim that their other operating expenses usually do rise in a period when the cost of their merchandise is rising. This was borne out by the evidence before us in a general way, but it was to be noted also that among a considerable number of merchants the operating expenses did not go up as much in proportion to sales during the recent period as did their costs, leaving them an enhanced profit. Another argument put forward is that merchants need a higher mark-up in times of rising prices as a hedge against inventory losses when prices decline.

The indiscriminate application of fixed percentage mark-ups gives no consideration to the effect of the volume of sales. When the rate of stock turnover increases substantially there tends to be a reduction in operating expenses, and we find it difficult to justify the augmented dollar profits made by distributors who invariably maintain the same percentage mark-up as when their rate of stock turnover was lower.

In our investigations, we found that a fixed percentage mark-up was very generally used by retailers of shoes, men's shirts, and women's and children's clothing. Increases in the percentage mark-ups taken by retailers were found in connection with recent rises in the price of bread. In the work clothing field, it was stated in evidence that the retail mark-up on overalls had risen quite generally from about 25 per cent of selling price before the war to 33⅓ per cent during and since the war.

In general, we found that retail operations in Canada between 1939 and 1948, showed fairly steady gross margins as a percentage of sales, a somewhat decreased ratio of operating expenses and higher net dollar profits. The increased rate of stock turnover during the war and post-war years, combined with a comparatively small number of mark-downs, would have made it possible for the distributive trades to take a lower percentage mark-up on their merchandise and still realize larger net profits in dollar terms.

Behind all this, the crux of the matter from the consumers' point of view is how much the profits in the distributive trades did or could affect prices. The fact of the matter is that the cost of the merchandise and the operating expenses of the merchant make up the big proportion of the price in the majority of cases, and that if all profits were eliminated, the saving in price to the consumer would be slight. It would seem that, in the long run, the greatest hope for reduction of margins and mark-ups lies in reducing the costs of distribution.

Restrictive Business Practices

During our inquiry we tried to ascertain whether there has been any marked growth of restrictive business practices during the post-war period and whether the effects of these practices on competition had played a major role in raising prices.

Among the industries on which we report, we found a number where conditions were highly competitive. A good example was the primary livestock industry, in which there are a very large number of producers, no one of whom handles more than a small fraction of the total output. On the other hand, we found a number of industries where competitive forces were limited because of the small number of firms in such fields. For instance, there are only three firms in Canada manufacturing primary fertilizer materials and the very high capital investment required for this industry makes it difficult for new firms to enter this field. Another example occurs in primary textiles, where a few big firms dominate the cotton industry and where the three producers of the three types of synthetic yarns manufacture the entire Canadian output.

More significant is the growing tendency toward monopolistic competition through brand names and special advertising, price leadership by a few large firms in an industry and resale price maintenance whereby a manufacturer sets the retail price for his product.

The experiences and influences of the war period have created conditions conducive to the spread of patterns of behaviour from which active price competition is excluded. The effective organization of industry for war purposes required concerted rather than competitive efforts in many aspects of business activity, leaving a tendency towards less rather than more enterprise.

Another legacy of wartime conditions appears to be the effect which maximum price regulations exerted on the pricing policies of businessmen. Continuance of mark-up controls by business groups themselves, but designed to fix minimum rather than maximum margins, seems to be favoured in many lines of trade. Such methods of determining prices have come to be regarded as established trade practices, approved by the government during the war and therefore "reasonable" in peacetime. The widespread acceptance of such practices can be as effective in maintaining or increasing prices as formal agreements and may become even more significant when improved conditions of supply could be expected to lead to lower prices.

From a general acceptance of a system of fixed percentage mark-ups, it is an easy step to a policy of resale price maintenance, whereby a manufacturer sets the retail price at which his product may be sold and which increases the rigidities of the whole marketing structure.

It is claimed that such a policy by the manufacturer avoids "confusion in the trade" and protects the small retailer from predatory price cutting by large distributors. The danger of such practices lies in the tendency towards a gradual removal of all reasonable price competition at the dealer's level and leads to additional demands for control over new entrants to the trade so that the advantages of a guaranteed margin need not be shared. From the examples we have examined it appears that as a whole the disadvantages to the buying public greatly exceed any possible advantages.

Resale price maintenance, like other forms of restrictive practices, does offer what appears to the manufacturer and distributor to be a happy relief from the unending struggle against the harsh correctives of the free market system. But the solution we think is illusory. It not only vitiates the spirit of enterprise by which all commercial and industrial life is nourished, it deprives the consumer of his right to seek out and patronize the more efficient distributors, namely, those who over a period of time can offer goods for sale at prices lower than their competitors.

Where Canadian industries have only a few producers and where alternative sources of domestic supply are therefore limited, there exists a considerable danger that the free entry of new businesses into the field will also be limited. Under such circumstances, a policy of selling only to recognized customers can have a very limiting effect. In view of this, we would favour the extension of the principle of lifting dumping duties or reducing the customs tariff where domestic suppliers do not treat purchasers on equal terms and where alternative import sources of supply would lessen the danger of monopolistic growth.

Underproduction may also result where there are only a few firms in the field and the spur of competition is not very strong. An example of this may be seen in the primary cotton textiles industry, where production has been decreasing since the war.

The concentration of economic power reduces the "competitive spur of efficiency" and we regard it as undesirable socially and economically. But we have not found monopolistic practices to be a major factor in the recent rise in prices. They are more likely to maintain prices above the competitive level in a deflationary situation. The tendency appears to be for monopolistic enterprises to try to protect themselves from the "peaks and valleys" of the business cycle by obtaining for themselves a stable price over a period of time, the net result of which is generally to place the average price of their goods in the long run above what would be the average competitive level.

SUMMARY OF VOLUME III

In our industry investigations and those of the Special House of Commons Committee, 10 essential commodities were studied and a survey made of consumer credit. These commodities, in which some substantial price increases took place during the past two years, included a number of foods, textiles and clothing, shoes and leather, fertilizers and lumber. Detailed and comprehensive reports on each of these industries are to be found in Volume III, along with a description of the cost-of-living index and a statistical supplement. In the following summaries, an effort has been made to indicate the more significant facts relating to the price increases in each industry.

Bread

The outstanding feature of the bread baking industry in Canada in recent years has been the growth of large-scale plants and the concentration of financial control in the hands of a few dominant groups, frequently related to the flour milling industry. Bread is the most commonly used of all foods and may be baked equally well in the large plant or the smallest home kitchen. It might thus be expected to be a very competitive product, but in actual practice the principal baking firms have been able to establish a rigid structure of bread prices, both for store and house to house sale. In pre-war days, it appeared that the chain store brands of bread and the independent bakers might exercise considerable influence on bread price levels. But these dealers serve only a small proportion of the market and therefore different prices, ranging from 10 to 14 cents a loaf, continue to exist for loaves of bread having the same nutritive value.

The tendency among the large multiple bakeries has been to minimize price competition and to use instead expensive sales promotion and advertising for their particular brand, which is in effect simply an effort to induce customers to "change bakers". Resale price maintenance is used by many of the multiple bakeries and in recent price increases the retailer has frequently been guaranteed increasing margins. The margins now being established appear to be out of proportion with the margins that would exist under competitive conditions on a fast moving packaged food such as bread. If retailers had greater freedom to compete and were more inclined to do so, the availability of lower-priced bread might have a much more significant effect on the general price level.

That the price of bread would increase when bread and flour were decontrolled in September, 1947, was to be expected. The price ceiling had been established on 1939 figures when the price of wheat was at low levels. The removal of the wheat subsidy, together with delayed adjustments in other costs, would have led to a sharp price increase in any event, but it is to be questioned whether the actual increases were entirely justified by these advances in cost.

Butter

The retail price of creamery butter increased from about 45 cents in April, 1947, to approximately 73 cents in January, 1948, when a price ceiling was again applied.

With the removal of the butterfat subsidy there was an expected increase of about 10 cents a pound. The later lifting of the subsidy on coarse grains added a further cost item. But the greater part of the rise in price was due to consumer demand. Many people considered the winter of 1947-1948 as a period of butter shortage, but in actual fact butter stocks were as large as in the preceding year. The "shortage" existed because consumers wished to buy more butter than they had had under rationing. In the ensuing scramble for the existing supply, consumers inevitably bid up prices.

Most of the exceptional profits made as a result of this rise in butter prices went to firms which had substantial stocks of butter in storage. There is a large normal seasonal variation in the output of butter, and stocks are stored in the high production season of spring and summer. The typical seasonal movement of butter prices is the converse of the variation in production, prices being lower in summer and higher in winter. The storage of butter not only serves a useful purpose in providing butter to consumers the year round, but ordinarily helps to keep prices more stable between seasons.

Most of the firms storing butter during the winter of 1947-1948, did not build up abnormally large stocks in an effort to raise prices. But in following their regular routine, they made unprecedented profits on their storage operations, approximately 12 cents per pound, compared to the average profit of 0.19 cents per pound which one of the larger firms had made in its butter operations during the preceding nine years.

Livestock and Meat

The sharply increased prices which Canadians paid for pork and beef in 1948 were largely due to external influence. The price of pork was almost entirely governed by the United Kingdom contracts, while the price of beef was influenced mainly by the lifting of the embargo on exports to the United States.

The price of pork for the United Kingdom contract was twice raised in 1947, each time by $2 per hundredweight; and the price in Canada rose accordingly. Again, in January, 1948, prices on the United Kingdom contract for both pork and beef were raised and domestic prices followed. In 1948, the price of hogs had risen to the level of United States prices, but rising costs of production, resulting from the removal of ceilings and subsidies on feed grains, led to a considerably restricted hog production so much so that the relatively modest export contract for 225 million pounds of bacon for the United Kingdom was not filled.

The real control on the price of beef after removal of the ceilings was the embargo on exports to the United States. Prices moved upward in the first half of 1948 in anticipation of the removal of the embargo. Further price increases took place when the embargo was actually lifted.

The primary livestock industry and the retail meat trade are very competitive, but the processing industry shows a high degree of concentration. The three largest packing firms account for about 60 per cent of the total inspected slaughterings in Canada, which would indicate that competition operates within a fairly restricted framework, though there may be considerable rivalry among these firms. These large firms are efficient in their operations and, though realizing small profits per unit of output, earn substantial returns on their investment. The very heavy capital investment required, together with decreasing cost ratio as the scale of the business expands, tends to keep additional competitors from entering the field.

The three largest packing firms indicated that they made a net profit of $4.3 million in the four months following the simultaneous removal of price controls and settlement of the packing-house workers' strike in October, 1947, compared to less than $1 million in the corresponding period the previous year. Firms holding beef and pork in cold storage at the end of 1947, made substantial fortuitous gains as a result of inventory appreciation as market prices advanced with United Kingdom contract prices. Four firms held over two-thirds of total cold storage stocks and it would appear that they made substantial profits on these holdings.

Fruits and Vegetables

When prices of fruits and vegetables were decontrolled in January, 1947, no significant price increases resulted. However, the following November, when restrictions were placed on the import of a wide variety of fruits and vegetables from the United States, as part of the program to conserve Canada's foreign exchange resources, prices of both imported and domestic fresh fruits and vegetables and canned fruits and vegetables rose sharply.

Fundamentally, the price rise was due to curtailed supplies on the one hand and high consumer demand on the other, which had the effect of bidding up prices. There is, however, evidence that some wholesalers contributed to the rise by increasing their gross margins in order to compensate, they said, for the decreased volume of sales. A comparison of net operating profit, before income tax earned by six fruit and vegetable wholesalers, three operating in Toronto and one each in Winnipeg, Vancouver and Sydney, Nova Scotia, for the months of November to March, doubled between 1946-1947 and 1947-1948. This would seem to indicate that such enhanced margins were not altogether necessary in order to maintain profits.

The wholesaling of fruits and vegetables appears to be very competitive in eastern Canada. But this may not be so true for western Canada, where one-half of all wholesale establishments are controlled by three chains operating throughout the western provinces.

Primary Textiles

The Canadian primary textile industry is divided into three main sections, cotton, wool and synthetic fibres, each of which have distinct characteristics and pricing problems.

Cotton

Since Canada must import all raw cotton used in the primary industry, the prices of Canadian cotton yarns and fabrics must follow closely changes in world prices for raw cotton. The domestic mills produce 95 per cent of all yarn required in Canadian production but a large proportion of our broadwoven fabrics is imported.

The dominance of a few large firms, with heavy capital investment, is an outstanding feature of the primary cotton industry. Five firms account for three-quarters of all Canadian production of cotton yarn and cloth, and competition is further limited by the fact that not all of these larger firms produce identical types of fabrics.

Cotton fabric production has fallen from the war peak and in 1948 was barely over the pre-war level. With the great increase in consumer purchasing power since the beginning of the war, the 1948 level of production resulted in a continuing shortage of many types of fabrics. All witnesses representing the primary cotton manufacturers attributed this decline in production to labour difficulties. However, it may also be due to the fact that they operate with some degree of monopolistic advantage behind a heavy protective tariff.

The net profit as a percentage of capital employed for the five largest firms in the industry averaged about 6.5 per cent in 1947 and 1948.

Wool

The Canadian primary wool textile industry is also heavily dependent on imports for its raw materials, 95 per cent of the raw wool for Canadian manufacture being imported.

The concentration of business in the primary wool industry is less than in primary cotton. There is a larger number of firms in the industry but there is little similarity in the fabrics produced, especially by the larger units.

The operating income of the largest firm in the industry as a percentage of sales increased from 2.4 per cent in 1936-1939 to 14.9 per cent in 1947. Percentages of operating income to sales for the second and third largest firms fell in the same period from 10.6 per cent to 5.9 per cent and from 15.6 per cent to 12.7 per cent respectively. However, the average for 51 other firms showed an increase from 5.8 to 11.4 per cent in this period.

As a percentage of capital employed, the net profit of the largest firm decreased from 10.4 per cent in 1945 to 4.5 per cent in 1946 and jumped to 25.5 per cent in 1947. This firm increased some of its prices very sharply immediately after decontrol.

Synthetic Fibres

Three large firms manufacturing synthetic yarns, each occupying a monopoly position in its own field, were examined by the Special Committee. Two of these firms make different types of rayon yarns and one produces nylon. Original patent rights, together with very heavy capital requirements, have effectively restricted the establishment of new firms in this field.

The nylon firm reduced its prices twice since it entered the civilian market in 1945 but, even so, profits after taxes in 1946 amounted to 17.2 per cent of net capital employed.

One of the rayon producers, after having made a net return on capital of 7.6 per cent in 1947, raised its prices in 1948. The other rayon producer raised prices in April, 1948, notwithstanding the fact that net profit in 1947 was 15.5 per cent of the capital employed and that, in the first quarter of 1948, this had increased to the equivalent of an annual rate of 24 per cent. The returns on capital for the nylon producers and the second mentioned rayon manufacturer, were, by any standard, very high indeed.

Chemical Fertilizers

Prices of chemical fertilizers increased much less than the average of all price rises since the pre-war period. World shortages and urgent world needs for fertilizers have resulted in prices on the world market well above Canadian prices. The domestic price level has been kept down by a combination of export and price controls plus restraint on the part of some of the larger firms. In general, the rise in domestic prices may be attributed to higher costs for imported materials and higher manufacturing costs. Only in one instance did we find a greatly increased amount and rate of profit.

The chemical fertilizer industry divides into two sections, the production of fertilizer materials and the mixing of fertilizer materials for sale to the ultimate consumer.

Fertilizer materials are made by a very small number of firms which, in many instances, have a virtual monopoly in a particular area. Plants producing fertilizer materials are on a large scale and call for heavy capital investment and, in consequence, it is difficult for new firms to enter the field. With competition so limited, reliance must be placed on individual producers to keep prices at a reasonable level. Generally speaking, this restraint has been forthcoming in the industry, but one firm, following decontrol, raised its domestic prices to export levels and more than tripled its percentage of net profits to capital employed between 1946, and early 1948. This led to the price being rolled back and a ceiling reimposed by the Wartime Prices and Trade Board.

In the mixing industry there are a greater number of plants but a few large firms dominate the field. Higher costs have been the major factor resulting in higher prices, and we did not find increased profits an element of any great importance.

The industry follows a form of basing point pricing, a system under which it absorbs part of the freight on shipments into areas closer to competitors' plants. This serves to increase competition somewhat, but results in a higher market price for the products. It also leads to an uneconomic and unnecessary cross haulage of fertilizer. It would seem possible to reduce some of the industry's costs, especially in this matter of cross haulage.

The larger firms denied that there is any price leadership in the industry, but some of the smaller concerns giving evidence before us stated that they followed the prices set by the larger firms.

Hides and Leather

The increase in the prices of hides and leather in Canada following decontrol may be attributed mainly to the influence of world market and United States prices, though there were also substantial wage-rate rises and increased costs of tanning materials. At the time of decontrol, the packers and tanners were asked by the Wartime Prices and Trade Board to exercise restraint and keep the price of hides about midway between the former ceiling price and the United States prices. Nevertheless, Canadian hide prices rose quickly to meet the United States prices, though after the two prices equalized, the Canadian price remained steady notwithstanding a further considerable increase in the United States price.

Since hides are a by-product of the domestic meat industry and animals are slaughtered principally for meat, the supply of hides is largely unaffected by their price. The higher prices following decontrol therefore did not bring about any noticeable increase in supply and, consequently, it was deemed advisable to continue export controls for a time. As Canadian prices advanced well beyond the point which could be accounted for by domestic demand and supply conditions, stocks accumulated in anticipation of the termination of export controls. These surpluses in inventories were reduced when export controls were withdrawn in March, 1948.

The lack of uniformity in accounting methods makes it difficult to determine with accuracy the level of profits in an industry, which carries such heavy inventories. The net profits of the upper leather tanners were substantially higher in 1947 than in 1939, though part of the increase was probably due to returns from export markets. The net profits of the sole leather tanners, though larger in absolute amounts in 1947, were smaller as a percentage of sales and yielded a lower rate of return on shareholders' equity than in 1939.

Leather Footwear

The rise in the price of shoes reflects to a large extent the rapid increase in the price of leather since September, 1947. This has been further enhanced by the application by shoe retailers of a fixed mark-up of around 33⅓ per cent of selling price, regardless of the volume of sales or the ratio of operating expenses to costs.

Perhaps the most serious problem facing the buyer of shoes is the tendency of the shoe trade to try to keep within established price lines by shifting to substitute materials, which may or may not have the same wearing qualities. Retailers, finding themselves faced with consumer complaints of higher prices, have been requesting manufacturers to produce shoes of lower cost materials so that they may maintain their established price lines.

The policy of resale price maintenance, while not general in the shoe industry, is practised by a few of the larger manufacturers.

On the whole, the manufacture of leather footwear has been regarded as very competitive. The United Shoe Machinery Company which has a patent monopoly on a large part of the industry's machinery, follows a policy of renting shoe machinery and makes it initially easier for new firms to enter the field.

Secondary Textiles

Clothing prices rose more than any other group except food in the cost-of-living index during the recent period of rising prices. The chief factors in this price rise were the increased costs of materials and labour, together with the cumulative effects of the system of fixed percentage mark-ups prevalent in the industry. The garment industry is heavily dependent on import sources for substantial quantities of cotton and wool fabrics, and import prices were therefore an important factor in the increased costs of production.

Taken as a whole, the garment trades are highly competitive, with an exceptionally large number of plants, varying in size from small concerns operating in an attic or basement to very large, well-equipped factories. Since scissors and sewing machines are the basic equipment needed and premises are often rented, very little capital is required and new firms can easily enter the trade. The larger firms do not dominate most segments of the trade but in men's shirts, men's furnishings and neckwear, the five largest firms account for over half the total employment in each sector.

Production of most garments has increased above pre-war levels, with the notable exception of men's fine shirts. Not only has the total production of men's shirts declined but a larger proportion of the production is going into the higher-priced shirts. This is due in part to the difficulty of getting sufficient supplies of the medium and lower-priced shirting fabrics and in part to a difficult supply situation in the lower-priced cotton fabrics generally. Production in the domestic cotton mills, which supply the bulk of the medium and lower-priced fabrics used in Canadian garment trades, has declined since the war. Supplies from the United States have been limited by import quotas under the Emergency Exchange Conservation Act, and the cotton fabrics available from the United Kingdom have been much higher in price than comparable Canadian fabrics.

The drop in domestic production of cotton fabrics, which has been accompanied by continued informal allocations by the larger mills to their regular customers, has had a limiting effect on competitive conditions in the secondary industry, since it has been difficult for firms to expand in the field of low and medium-priced cotton garments or for new businesses to enter the field.

Accepted price ranges are generally adhered to in the clothing trade and working to a retail price is common pricing procedure for a large proportion of clothing manufacturers. The fixed percentage retail mark-up has become a "law of the Medes and Persians" in most sections of the trade, and manufacturers will reduce their own margins rather than attempt to interfere with "traditional" wholesale or retail mark-ups. There has been a considerable growth of direct sale to retailers by manufacturers, especially in the style clothing field and in nationally advertised brand name lines, such as men's shirts. Resale price maintenance appears to be a growing practice in some sections of the trade. Two of the largest shirt manufacturers have been affixing to their shirts, tags stating the retail price. However, even where the resale price is not definitely set by the manufacturer, the rigid adherence to fixed percentage retail mark-ups may have virtually the same effect.

Profit positions vary in different sections of the trade. The net profit of the five largest manufacturers of men's shirts had increased greatly in dollar amounts but, as a percentage of sales, had decreased from 5.2 per cent in 1939 to 4.9 per cent in 1947. On the other hand, as a percentage of shareholders' equity, the net profits had risen from 6.4 per cent to 14.6 per cent in the same period. The work clothing industry, which was in quite a depressed condition at the beginning of the war, showed the greatest increase in profits. The net profits of five work clothing manufacturers showed an increase as a percentage of sales from 0.5 per cent in 1939 to 5.3 per cent in 1947, while as a percentage of equity they rose from 1.1 per cent in 1939 to 22.3 per cent in 1947. It may also be noted that a number of retailers of work clothing have increased their mark-ups on overalls from the 25 per cent of selling price which was usual before the war to the 33⅓ per cent allowed under the maximum price regulations of the Wartime Prices and Trade Board.

Lumber

Lumber is a competitive industry, with a large number of producers and distributors. There is little evidence to indicate any widespread attempts by the trade to raise or maintain prices by agreement, and no system of price leadership appears to be followed.

The price of lumber, has trebled since 1939. This advance has been due to unprecedented demand both in the domestic and export markets, combined with steadily rising costs of production. In this connection it should be noted that labour wage rates constitute 50 to 60 per cent of the cost of logs and that wage rates in logging showed one of the greatest increases of any industry, during the ten year period.

Price increases were granted during the period of control as incentives to maximize output, but from 1943 to 1947 price control effected a reasonable degree of stability in the face of heavy pressures from world market prices which rose steadily above controlled Canadian prices. In the latter part of the control period, production costs rose substantially following wage increases and were for a time higher than the ceiling prices in force. This situation was only made possible by the large amount of Canadian lumber sold on the export market, so that the over-all earnings of the industry were maintained by the higher returns on exports. In reality, the home market was being subsidized by foreign buyers.

When decontrol took place in September, 1947, the Canadian ceilings were $15 to $20 per thousand feet below export prices. Since the lifting of controls, the Canadian prices have risen substantially but have stayed somewhat below the export price level, due partly to export controls and partly to buyer resistance. The return to percentage mark-ups following decontrol resulted in higher dollar and cents margins at the retail level.

An important consideration in the whole study of lumber prices is the lack of uniformity in grading practices which has made it difficult to draw comparisons between the prices being charged by different dealers in different parts of the country.

Consumer Credit

Consumer credit can be a significant economic factor. Retail consumer credit provides the borrower with goods now for which he would otherwise have to wait, and compels him to save enough to pay for them after they have been delivered. The desire to possess something immediately coupled with available credit reinforces the demand for consumer goods, particularly durables which have a high unit price.

A moderate or even a large increase in the rates charged, seems to have less effect on demand for consumer credit than do changes in the down payments required and the period over which the debt is to be repaid. Lower down payments and longer terms make the actual cost of the commodity to the borrower higher. When such commodities are already scarce, purchasing on credit adds to inflationary pressure.

It is evident that the consumer is generally unaware of what he actually pays for credit. In many cases the rates quoted are discount rates charged on debts which are amortized by equal monthly payments. There is some doubt that the consumer is sufficiently informed as to the effective rates charged or the advantage of any particular contract to be able to choose between one contract and another. If finance charges were stated as annual effective rates rather than as discount rates, the consumer would be able to choose the credit most advantageous to him and the conversion to an effective rate might provide some deterrent to borrowing.

Over the years there have been several factors leading to increased demand for consumer credit. The desire for a higher standard of living coupled with increasing production of consumer goods has led to a considerable increase in the number and size of credit institutions. Financing "on time" has become an accepted practice. The small loan business has grown and has become highly competitive.

The wartime regulations provided a considerable check on demand for commodities and helped to stem inflationary tendencies during the war and early post-war periods. Minimum down payments were set and the periods over which repayment could be made were limited. After the restrictions were removed there was a decided upturn in the volume of credit outstanding. The total of cash and commodity credit outstanding in Canada was $675.9 million in 1941, $947.5 million in 1947, and up to June, 1948, the one billion dollar mark was passed.

CONCLUSION

The Special House of Commons Committee on Prices was directed to examine and to report from time to time as to:

(a) the causes of the recent rise in the cost of living;
(b) prices which have been raised above levels justified by increased costs;
(c) rises in prices due to the acquiring, accumulating or withholding from sale by any persons, firms or corporations of any goods beyond amounts reasonably required for the ordinary purposes of their business.

We were appointed to continue the inquiry into and concerning price structures, factors leading to price and cost increases and increased profit margins in Canada, paying particular regard to essential commodities and services in common daily use.

Within the time at our disposal we have attempted to comply with these terms of reference. The results appear in and throughout this report. As we see it, our main purpose was to inquire into the causes of the recent rise in the cost of living so that the facts of the situation and our analysis thereof should be available to the government.

During the course of our inquiry a number of matters came to our attention which affected particular fields and industries, and which can be dealt with separately from the basic factors. Regarding them we make the following observations:

Publicity

Although we recognize the dangers and difficulties involved, we are impressed with the importance of publicity in influencing business generally through exposing the occasional circumstances of high pricing, profiteering and restrictive practices.

Meat

Our study of the evidence before the Special Committee on Prices on the livestock industry has indicated that further consideration of the applicability of a carcass grading system for beef cattle is warranted. There seems to be little relationship between the live animal categories "choice" "good" or "medium" on which basis the producer sells his cattle, and the resulting grades of beef, "red brand", "blue brand", etc., which the consumer purchases. We therefore suggest that the government should examine the question of establishing a carcass grading system for cattle, similar perhaps to that presently in use for hogs.

Lumber

During our investigation of the lumber industry we found some evidence that grading procedure, particularly in eastern Canada, did not always seem to give sufficient protection to consumers in periods of high demand. Consideration might be given to the establishment of some uniform system of grading, especially in the more commonly used types and dimensions.

Consumer Credit

Our inquiry into Consumer Credit led us to believe that the consumer is inadequately informed about effective rates of interest by lenders. The consumer can be misled by such terms as "discount rates" which work out a good deal higher than apparent annual rates. We suggest that the effective annual rates should be stated clearly in loan contracts as well as in advertising literature.

Statistics

In view of the importance of the cost-of-living index in wage negotiations, etc., we believe the Dominion Bureau of Statistics should explore the possibilities of improvement in the index. There appears to be need for the development of a continuing program of sample surveys such as are now carried out at infrequent intervals. Thus when the articles in the base budget change in importance, or if new articles should be included, adjustments can be made to present a more accurate index number. Further, some system for the measurement of the changes in owner-occupied shelter should be established, as the present system of reckoning shelter costs gives an inadequate picture of the true costs. We are of the opinion that the Bureau should give consideration to including the cost of children's clothing in compiling the clothing group index in the cost-of-living index.

The lack of adequate and accurate statistics is one of the major obstacles to a knowledge of Consumer Credit. We suggest provision be made by the Bureau for broadening and refining the statistics relative to this important economic indicator.

In examining price changes the factor of productivity is extremely important. To use statistical information as a basis for conclusions on efficiency, etc., requires precise measurement of net production and of labour. Small discrepancies in the measure of either of these would lead to inaccurate conclusions. We believe that a statistical study of productivity in Canada should be made available as soon as possible.

We emphasize the recommendation of the Special Committee on Prices that the Dominion Bureau of Statistics publish periodically an analysis of the way in which the consumer's dollar is divided among the various productive and distributive processes having to do with the price of basic commodities.

We think that more adequate collection and publication of current information on the amount of corporate profits, possibly on a quarterly basis, might be undertaken by the appropriate government agency.

Dominion Companies' Act

In the Proceedings of the Special Committee and in our examination of the financial statements of a large number of companies we found a complete lack of uniformity in the quantity and quality of information given.

Because of general misconceptions due to the methods of presenting inventory valuations, we think certain disclosures should be made in financial statements. A statement of the basis of inventory valuation should be made along with any definitions such as "cost" or "market", if used, and the amount of any reserve deducted. It is imperative that an explanation of any change in the basic valuation of the inventory from that employed in the previous year be disclosed as well as the effect this change has had on profits. Finally, if costs are determined on the "last in first out" basis, or if the basic stock method of valuation is employed, the present day value of inventories should be indicated.

We suggest that the Dominion Companies' Act be amended to require that financial statements include:

> Uniform inventory valuations, the disclosure of any changes made in inventory valuations from that in former financial statements, the profit and loss position of inventory, and the item of inventory reserve.
>
> Disclosure of the amounts and purposes of all reserves, before the profit position for the period has been determined.
>
> A statement of the aggregate profit and loss position of all unconsolidated subsidiaries.

We further suggest that statements of profit and loss and surplus be sent to all shareholders and that the auditor report whether in his opinion the statements fairly present the operations of the company for the period.

The Dominion government should, we think, obtain the co-operation of the Provincial governments to develop uniform financial reporting under the Companies' Act.

Public Accounts

We strongly recommend that the public accounts be presented in such a way that the net effect of government transactions is clear not only to the specialist, but to the man on the street.

Resale Price Maintenance

Throughout our inquiry we have been impressed by the degree to which individual manufacturers fix the resale prices of their products and so narrow the area in which price competition amongst wholesalers and retailers is operative. In view of the extension of this practice, we recommend that the Combines Investigation Commission give careful study to this problem with a view to devising measures to deal with it.

Exchange Conservation

The Emergency Exchange Conservation Act provides that import embargoes may be introduced to conserve exchange. There may be pressure on the government for retention of such embargoes beyond the period where their continuance can be justified for purely foreign exchange reasons. In our view import controls should not be used as a protectionist device.

General

The other important part of our analysis was the examination of those basic influences affecting every phase of our economy, and which are the subject of high government policy.

It is our conclusion, stated and implied throughout our analysis, that the main causes of the rise in prices since the war are to be found in these general and basic conditions. In the main the post-war price rise in Canada was a consequence of the war, of rising prices abroad, of large export demands financed to some degree by the Canadian Government, and of our capital boom accompanied as it was by an American capital boom. The effect of these all-pervading and powerful generating forces was offset or held in check to some extent by fiscal and monetary measures and by direct controls. Outside of exceptional cases we did not find in the behaviour of particular industries, individuals or groups a main cause of rising prices. This conclusion leads us to a discussion of public policy as it will affect prices in the future.

The government of Canada has adopted as a primary objective of public policy, the maintenance of a high and stable level of employment and income. This is an objective which in principle must be concurred in by all Canadians. But in practice it requires specific governmental action which may be less generally acceptable.

Such a policy implies positive action by government to mitigate the fluctuations in the volume of private business. It requires on the part of government, competence to judge correctly the state of business and to take such compensatory action as is required. This means that the government must be prepared to apply brakes as well as to provide stimulus.

Obviously such a policy cannot be carried through unless there is general support for this kind of government action. As we have said in several places in our report, government in a democracy cannot move too far ahead of public opinion. It is idle to talk about the responsibilities of government in connection with economic stability if the necessary action to achieve or maintain that stability is not acceptable to the community.

Although we accept and urge the importance of general fiscal and monetary policy we must emphasize the place of external trade in Canadian prosperity. In order to maintain the present standard of living, to utilize Canada's specialized resources, and to support the great capital investment which has been made to equip Canada for its place in the world economy it is vital to Canada that the advantageous international division of labour be maintained. We would, therefore, emphasize the importance of co-operation in trade matters with the other countries of the world, particularly with the United Kingdom and the United States.

Our inquiry has been concerned with an inflationary period; that is, a period of excess demand. Throughout that period it was the role of government policy to apply restraints, to pay off the public debt and to curtail expansion in the money supply. As we write this Report in early

1949, the outlook is far from clear. Inflationary pressures have abated, at least temporarily. The long sustained world-wide rise in prices may have run its course. External demands have lessened. The money supply generated by the war which once was so excessive, is now in closer balance with the supply of goods at present prices.

A government policy aimed at economic stability must be flexible, ready to move quickly to counteract either inflationary or deflationary tendencies as they arise or, better still, before they arise. We shall continue to be affected very largely by events abroad which are beyond our control, but there is much that can be done by sound fiscal and monetary action and in other ways to stabilize the level of demand. To encourage private spending, for example, by reducing taxes, or to embark upon public works which can be held in abeyance at a time when existing or anticipated demands press upon available supplies, does not make good economic sense. On the other hand, to adhere stubbornly to an anti-inflationary policy when the threat of inflation has passed is to run the even more serious risk of reducing the total output of goods and services below the level which it would otherwise attain.

In this connection, we have noted the exaggerated importance that seems to be attached to every change in the cost-of-living index. Even assuming a continuing high level of income and employment and a reasonable balance between total demand and total supply, the general level of prices will move up and down to some extent. At the present time, for example, a decline in consumers' prices would, we think, be a healthy development. It would not necessarily mean that the country was going into a slump. Similarly, a further rise in the cost-of-living index would not necessarily mean that a new phase of the inflationary spiral was under way.

Another important conclusion is that, in our view, general price control should not be relied upon as an important instrument for stabilizing prices in peacetime. There is no doubt in our minds that a general price ceiling would be most inadvisable unless there is a very great change in the present outlook. Selective price controls may be useful in exceptional cases. Price control in any form, however, is no substitute for action designed to bring over-all demand into line with over-all supply. It disguises inflation. It does not remove the cause of the trouble.

We have the honour to be,

Sir,

your obedient servants,

C. A. CURTIS
Chairman

HENRI C. BOIS
Commissioner

MARY SUTHERLAND
Commissioner