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PRICES AND WAGES

VARIOUS witnesses during our hearings referred to the relationship between wages and prices in particular industries or establishments. Labour organizations and a number of other groups dealt with the subject in a general way in their briefs.

The relationship is complex and the basic data necessary to make an exhaustive investigation is incomplete. Some facts are available, however, which establish certain broad relations between wages and prices during the period since the outbreak of World War II. A discussion of the relationship is useful even though the effects themselves cannot be measured.

The relation between wages and prices may be looked at either from the standpoint of the whole economy or from the standpoint of the individual workers. We shall discuss this relationship from each of these points of view, although, due to limitations of data and other circumstances, most of the discussion will relate to the latter.

RELATIONSHIP BETWEEN WAGES AND PRICES IN THE ECONOMY AS A WHOLE

The connection between wages and prices from the standpoint of the whole economy may be illustrated by referring to the evidence of Mr. Percy Bengough, President of the Trades and Labour Congress, who stated in part:

> "It has been contended in many quarters that organized labour in constantly seeking higher wages is the cause of higher prices . . . Wages do not rise with prices and our experience has shown that high prices for business do not necessarily mean good wages for workmen. As previously pointed out, price increases usually precede the requests for increases in wages."[1]

An alternative form of the question which underlies Mr. Bengough's remarks is: to what extent do changes in wages bring about changes in prices and to what extent do changes in prices bring about changes in wages?

Changes in wages throughout the whole economy may affect prices in two main ways. In the first place they usually have an effect on the cost of producing goods and services. On the other hand, changes in wages usually have, at least in the aggregate, an important effect on the spending power of the population. In other words, "under some conditions, changes in wages may affect prices more as a cost than as a source of demand; under other conditions, changes in wages may affect prices more as a source of demand than as a cost."[2] Let us look at each of these more fully.

[1] Evidence, Royal Commission on Prices, p. 4614.
[2] S. H. Slichter, "Wages and Prices", Proceedings of the Academy of Political Science, May, 1948, p. 47.

On the cost side there are exceptional conditions where higher wages do not necessarily mean higher labour costs per unit of output. Similarly lower wages do not necessarily mean lower labour costs per unit of output. Increased productivity through greater skill on the part of the worker, more mechanization, more efficient organization of the firm, or other related factors, may individually or collectively offset increases in wages. Furthermore, there are many other ways in which costs for an industry or for an individual firm may be affected in addition to changes in wage rates. These other ways include fluctuations in the rate of output, size of plant, technological changes, as well as changes in the prices of the other factors of production.

During the recent war years the large expansion in output of most industries greatly reduced overhead costs per unit of production compared with pre-war years. Thus increases in wage rates might occur, without necessarily involving similar increases in the prices of the goods being produced. Later, scarcities of raw materials by interrupting production had the opposite effect. These shortages of raw materials raised unit costs apart altogether from any change in wage rates.

The complexity of this relationship between wages and prices on the cost side was brought out by Mr. K. W. Taylor in his evidence before the Special Committee on Prices, as follows:

> "Labour costs have gone up, how much it is very hard to say. There are a great many variables in the equation of wage rates and unit labour costs. It all depends upon "productivity". Productivity in turn depends upon the combined efficiency of labour and of management. Wage rates can go up and unit labour costs come down; and lower wages are not infrequently associated with higher unit labour costs. It seems reasonably certain that on the whole unit labour costs in Canada have gone up, but the amount of increase will vary considerably from firm to firm and from industry to industry."[1]

Mr. Eugene Forsey in his evidence before us, and commenting on Mr. Taylor's evidence, pointed to the lack of Canadian figures on productivity and went on to say:

> " . . . the factors just mentioned at least show how unsafe it is to assume that an increase in wages means an equivalent increase in labour costs, let alone total costs. Labour costs depend not only on what you pay but also on what you get for the payment, and labour costs, even if indirect labour costs are included, are only part of total costs, and a varying part."[2]

Although it is impossible at present to measure the magnitude of these various forces influencing costs, or their effects, we know that wage rate increases have been one factor among others contributing to rising costs

[1] Evidence, Special Committee on Prices, pp. 59-60.
[2] Evidence, Royal Commission on Prices, p. 4397.

of production over recent years. These rising costs, no matter what their origin, have undoubtedly led manufacturers to attempt to increase the prices of their products. Prices, however, are not ordinarily advanced, whatever may have happened to costs, unless manufacturers and others expect enough customers will be ready to pay the advanced prices. This leads us to a discussion of the other main way in which wage changes may affect prices, namely through their influence on spending power.

As shown in Table 39, total labour income has increased year by year from 1939 to 1948, being estimated at $2,583 millions in 1939 and $7,134 millions in 1948. In 1948, this labour income constituted more than one-half of the total national income.

Included in this expansion between 1939 and 1948 were wages to persons who had been unemployed in the pre-war period or who had been in the relatively low wage brackets. Wage earners generally are not in a position to save much of their current income and so a high proportion of the increased wages was quickly translated into an active demand for goods and services. Since many of the goods and services in demand were in short supply, especially after 1940, this total increase in wages was one of the main inflationary forces tending to force up prices which had to be brought under control.

TABLE 39

TOTAL LABOUR INCOME COMPARED WITH NET NATIONAL INCOME

1939 to 1948

	1939	1940	1941	1942	1943	1944	1945	1946	1947	1948[1]
Net National Income at Factor Cost (millions of dollars)	4,289	5,255	6,594	8,382	9,093	9,712	9,772	9,765	10,981	12,802
Labour Income[2] (millions of dollars)	2,583	2,944	3,586	4,251	4,746	4,908	4,915	5,322	6,235	7,134
Labour Income as Percentage of National Income, (per cent)	60.2	56.0	54.4	50.7	52.2	50.5	50.3	54.5	56.8	55.7

[1] Preliminary.
[2] Wages, salaries and supplementary labour income, such as employer contributions to pensions, living allowances, workmen's compensation and unemployment insurance, excluding military pay and allowances.
Source: National Accounts, Income and Expenditure 1926-1947 and 1948 (preliminary), Dominion Bureau of Statistics, Ottawa.

With the gradual termination of most of the controls after the war, the increased incomes, especially in the face of continuing shortages of many goods and services, began once more to exert an upward pressure on prices. In addition to advancing wage rates, there were many other factors forcing prices upward at this time. Among these were the accumulated backlog of demand for consumers' durable goods, the production of which was interrupted during the war, the large fund of wartime savings in existence, and the continued needs of European and other countries for Canadian food and other essential products.

So far we have considered only some of the effects of changes in wages on prices. We shall now look at the other side of the question raised earlier, namely, to what extent do changes in prices bring about changes in wages? As before, we have in mind here general price changes and wages in a total or aggregate sense.

While rising wages have added both to costs of production and to volume of demand, rising prices, in turn, have undoubtedly led to higher wages. This is the aspect of the situation emphasized in Mr. Bengough's statement before us, quoted above.

Rising prices enabled employers to pay higher wages and made them willing to pay higher wages in order to maintain and if possible increase their labour force. At the same time, higher prices, by raising the cost of living, gave workers a reason for demanding higher wages. Thus rising prices had both a pulling and a pushing effect on wages.

All this may appear to be arguing in a circle—wages affected prices and prices affected wages—and in a sense it is. For a price inflation includes a wage inflation. They are part of the same general economic process and we doubt if it is possible to disentangle the complex pattern of events since 1939. Certainly more information than is now available to us would be necessary to make such an analysis feasible. Moreover, our inquiry had led us to believe that other factors, such as fiscal and monetary action, external influences and the accumulated demands arising from the war period, had a greater influence on wages and prices jointly than wages and prices had on each other.

It should not be concluded, however, that the relationship between wages and prices is unimportant. Indeed, we would go so far as to say that in the period that lies ahead, this relationship is of the greatest significance for our economic well-being. Our objective is a high and stable level of employment and incomes. The attainment of that objective within a free society will be difficult, particularly for a country such as Canada which is affected so largely by events outside its borders. It will require policies on the part of the government, management, labour and others, designed to reduce and to offset fluctuations in the volume of business activity. For, even if the general economic environment is healthy, unemployment and loss of income can result from internal maladjustments such as those between wages, prices and profits.

In terms of real wages there is a limit to how high they can go. This limit is set by the productivity of the country's resources and this productivity will be increased in the main by technological improvements. These fundamental facts are usually obscured by the emphasis upon money wages. But is is most important that the place of real wages and money wages should be understood. Otherwise an obsession with money wages may lead to rigidities in the economic structure which will be detrimental to every group in the economy.

The importance of the wage problem is well shown by the following statement:

"Labor's interest in the maintenance of stable prosperity transcends even that of management, because while profits may fall more than wages in a period of depression, workers and their families bear the real brunt of hard times. Pushing for the highest possible wage advance is dangerous to the economy in a period when that advance necessitates even higher prices. It is more dangerous if this course is followed when rising labor costs lead to reduction in employment. Wage advances that contribute to inflation are undesirable; but wage advances that may contribute to serious deflation are more so. With the balance between inflation and deflation more closely drawn than it was a year ago, a restrained wage policy is now even more urgent in the interest of labor as well as management.

This admonition should not lead to the assumption that wage principles and profit principles are identical. Profits become unreasonable when they yield more than the amounts which support adequate incentives for production and growth; but there is no upper limit to wages in exactly that sense. Certainly an objective of the American economy is to provide constantly higher real wages and a constantly improving standard of living as rapidly as our resources will permit. Money wages may, however, become too high when they run ahead of the supply of goods so that they lead only to more inflation instead of more consumer enjoyment; or when they attempt to yield to a particular group a larger share of the national output than can be theirs without undue deprivation of others; or when they induce unemployment."[1]

Relationship Between Wages and Prices from the Standpoint of the Individual Worker

Let us now turn to the second way in which the relationship between wages and prices may be considered, namely from the standpoint of the individual worker. Here the connection between wages and prices is a much less complicated one than that looked at from the standpoint of the economy as a whole. There are also more complete data available for our analysis.

The basic question here is, to what extent is the worker's economic position affected by changes in wages, in prices, or in both? If the wages which the worker receives increase more than the prices of the things he buys, not only do his money wages increase, but his money wages, expressed in terms of what they will buy, or his real wages, also increase. Similarly when his increase in wages is less than the rise in prices of goods and services, his real wages decline.

Trends in Real Wages Over the Past Decade

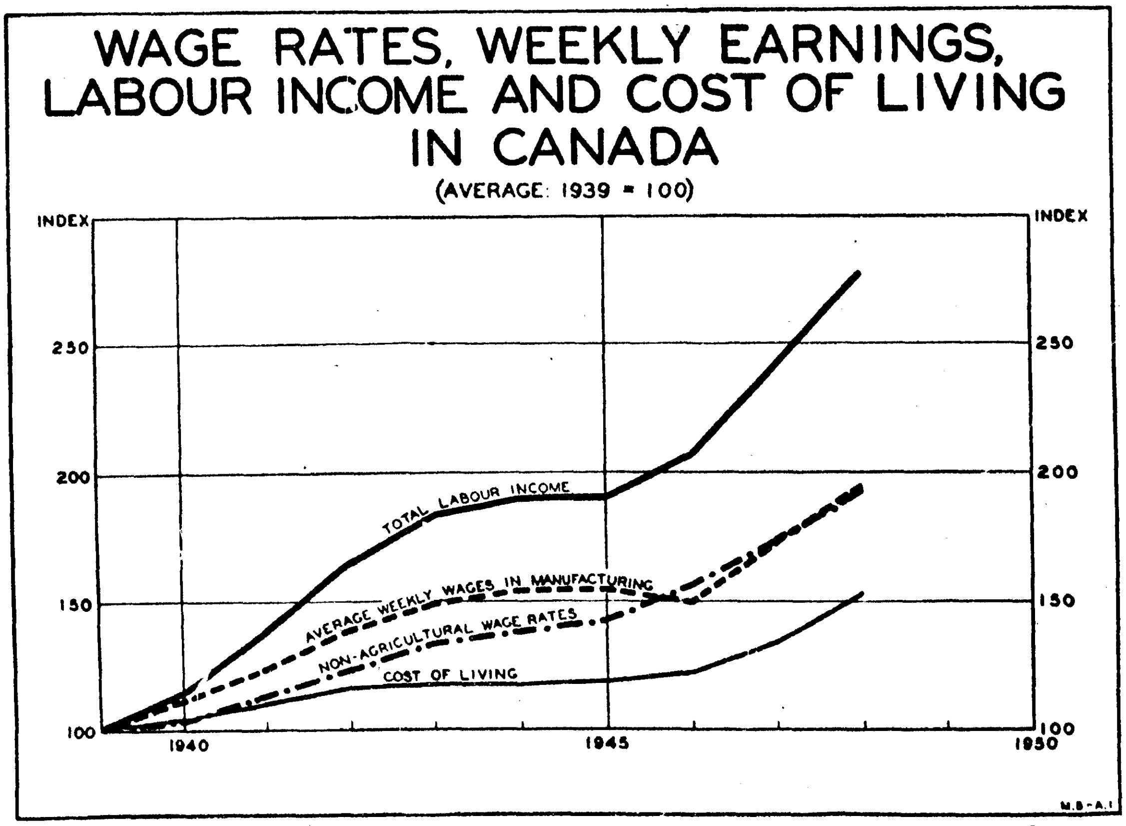
Real wages are computed by measuring the changes, on the one hand, in money income, whether it is expressed in terms of wage rates, earnings per employment period, or total income from wages and salaries

[1]The Economic Report of the President to the Congress of the United States, January, 1949, p. 45.

throughout the whole country, and changes, on the other hand, in the prices of the goods and services which the wage-earner buys.

Starting with the year 1939 as a base, the year-to-year changes in average wage rates for non-agricultural workers are shown in the accompanying chart. These may be compared on the same chart with changes in average weekly earnings of wage-earners in manufacturing and with fluctuations from year to year in the total expenditures on wages, salaries and supplemental income for all persons employed in the economy. Broadly speaking, it will be seen that the increases in wage rates during the war years were not quite as high as the increases in wages expressed in terms of weekly earnings. Weekly earnings increased more than hourly rates because of an increase in the number of hours worked per week, increased pay received for overtime work, and shifts of workers to higher paid jobs. As might be expected the great increase in the number of persons employed gave rise to an even larger increase in the total of salaries, wages and supplementary labour income.

CHART VII

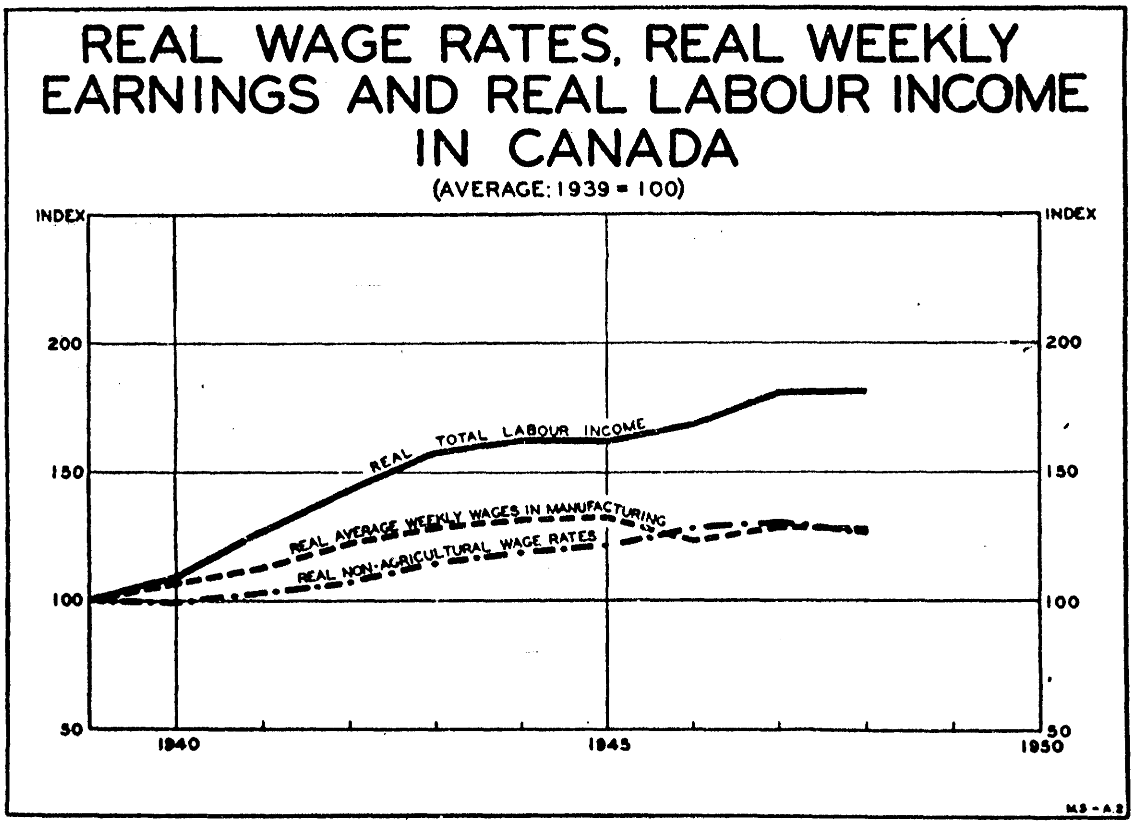


Source: Dominion Bureau of Statistics and Research and Statistics Branch, Department of Labour, Ottawa.

A further comparison may be made on this chart between these changes in wages and the prices of consumer goods and services, as measured by the cost-of-living index. It appears, if one considers only the statistical picture as represented here, that from 1939 to the present, increases in consumer prices have been relatively less than increases in wages.

Before reaching any such conclusion, however, it is necessary to look at the second chart on which the relationship between changes in prices and wages are expressed in terms of real wages. The most significant thing about this chart is that, no matter which of the three money wage series is used, it is clear that real wages have risen substantially since 1939.[1]

CHART VIII



Source: Dominion Bureau of Statistics and Research and Statistics Branch, Department of Labour, Ottawa.

There have been, however, so many factors influencing both prices and wages during the past 10 years that it is essential in our analysis to look behind the data shown in these charts. It is important, not only to know what wage and price changes occurred, but to understand, as far as possible, why those changes took place. For convenience our examina-

[1] Chart VII shows annual indexes, taking the annual average for 1939 as 100, for the following series (from bottom to top):

(1) The cost-of-living index, published in the monthly and annual reports, Prices and Price Indexes, Dominion Bureau of Statistics, Ottawa.

(2) Wage rates in leading industries other than agriculture, from Wage Rates and Hours of Labour in Canada, published annually by the Research and Statistics Branch of the Department of Labour, as a supplement to the Labour Gazette. The figure used for 1948 is a preliminary estimate only and is subject to revision.

(3) Average weekly earnings of wage-earners in manufacturing: for the years 1939 to 1945, the index was computed from data by sexes given in the report Weekly Earnings and Hours of Work of Male and Female Wage-Earners in Manufacturing, 1945, by the Census of Industry Branch, Dominion Bureau of Statistics; figures for later years are available in the monthly report Average Hours Worked and Average Hourly Earnings, by the Employment Section, Dominion Bureau of Statistics.

(4) Total labour income: This index is computed from the annual total "salaries, wages, and supplementary labour income", included in National Accounts, Income and Expenditures, 1926-1947, published by the National Income Unit, Dominion Bureau of Statistics. The figure for 1948 is preliminary.

Chart VIII shows the indexes of wage rates, average weekly earnings in manufacturing, and total labour income, adjusted for changes in the cost of living, and thus converted into indexes of real wage rates, real weekly earnings, and real total labour income.

tion is broken down into three periods, the early war years, the control period and the post-war period.

Early War Years

The rapid expansion of production and employment after the outbreak of the war gave an initial stimulus to both prices and wage increases.

On the wages side, the large number of unemployed persons and the still larger number of partially employed workers in 1939, cushioned to a marked extent the impact on wage rates of the substantial increase in manpower requirements. The average earnings of individuals, with many more now employed for longer hours and in higher paying jobs, and the total national wage bill, with much higher employment, both expanded rapidly. These changes in wages both per worker and for the country as a whole, are shown on Chart VII.

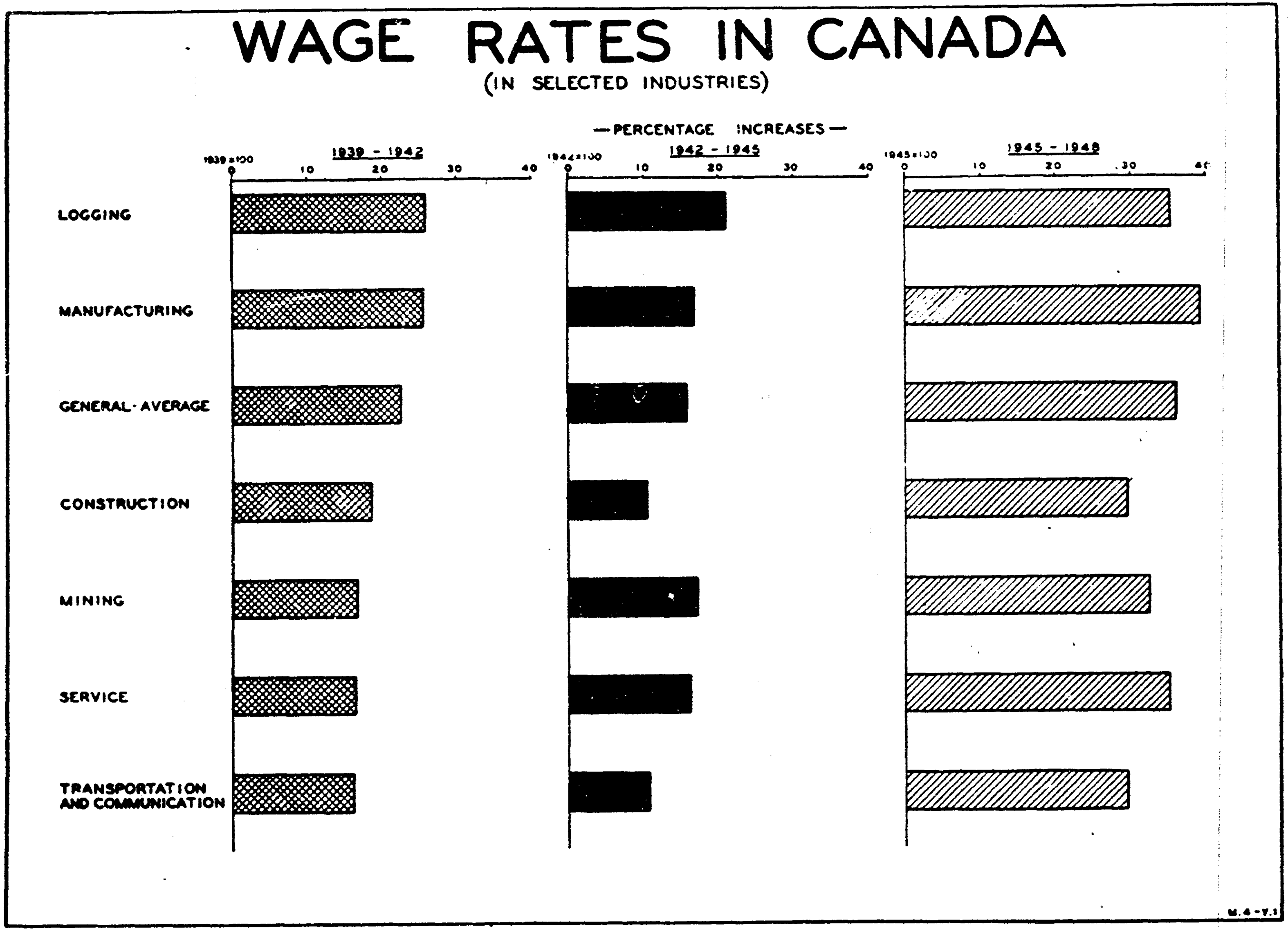
As one would expect, wage rate increases began to show up first of all in those industries where either wartime requirements were expanding rapidly such as machinery, shipbuilding, electrical goods and clothing, or in areas where there was a severe shortage of skilled workers. The large scale government expenditures on both producer and consumer goods during these years, combined with the "cost plus" provisions of many government contracts, were additional factors stimulating the wage increases for workers in war and ancillary industries.

Large scale shifts of workers between industries and areas during these years also had important effects on wages especially on both average earnings and the total national wage bill. Between 1939 and 1943, over 600,000 workers were added to the manufacturing industries alone. In addition to those who were formerly unemployed a large number of these workers came from agriculture; others came from industries not so essential to the war effort, still others came from retirement, schools, and work in the homes, and finally they came from the increase in population.[1] Insofar as these shifts represented transfers from lower paid to higher paid jobs, both average earnings and the national wage bill were expanded even apart from changes in wage rates.

As production expanded it was to be understood that supplies of both raw materials and labour would become less plentiful. This was especially true because of the highly specialized nature of much of the production required for the war effort plus the withdrawal, by the end of the second year of the war, of about 400,000 men and women into the armed services. In an effort to meet the increased labour requirements, hours per day and per week were expanded, which again had an important effect on average earnings. As the war progressed, wage rates in an expanding number of industries also increased due both to the continuing shortage of skilled workers and to the surpluses of manpower, in existence in 1939, now being almost completely absorbed.

[1] Cf. Changes in Population and in the Labour Force. (Issued as a supplement to the Labour Gazette), December, 1945, Research and Statistics Branch, Department of Labour, Ottawa, pp. 20-23.

CHART IX



Source: Dominion Bureau of Statistics and Research and Statistics Branch, Department of Labour, Ottawa.

The actual and the threatened shortage of goods and services and of manpower led the government to introduce direct controls of both prices and wages in the fall of 1941.

Over the period as a whole from 1939 to 1943 it is clear that substantial increases in average earnings occurred. These increases were due to important shifts in the labour force and to the lengthening of the average period of employment as well as to increases in wage rates. The fact that these first two factors played a part in swelling the earnings of wage-earners explains the larger proportionate increase in the index of earnings shown in Chart VII.

Aside from the increases in wage rates in the individual manufacturing industries closely related to the war effort noted above, a substantial rise also occurred in logging over these initial three years of the war. This increase in logging wage rates compared with the increase in other selected industries may be seen in Chart IX. Wages in the logging industry were forced upward during these years due to the drain of large numbers of physically fit workers into the armed forces and into war industries. Another influence was the greatly expanded construction program of these years which required large supplies of wood products.

An even more substantial increase occurred during these years in wages paid in agriculture. Over the three year period farm wage rates more than doubled.[1] The exodus from the rural areas was partly responsible for this rapid rise in the case of agriculture just as it was in the case of logging. The fact that farm wages were abnormally low in 1939 following several years of depression is another reason for this high proportionate change.

As might be expected, wages increased most in those parts of Canada where the impact of war was most pronounced. This is borne out by the increases in weekly earnings of salary and wage-earners in manufacturing, shown by regions in Table 40. The highest increases were in Ontario and

TABLE 40

PERCENTAGE INCREASES IN PER CAPITA WEEKLY EARNINGS OF SALARY AND WAGE-EARNERS IN MANUFACTURING, BY ECONOMIC REGIONS, 1939-1948

Region	Percentage Increase		
	1939 Average to May 1, 1942 (1939 = 100)	May 1, 1942 to May 1, 1945 (1942 = 100)	May 1, 1945 to May 1, 1948 (1945 = 100)
Maritime Provinces	26.5	21.5	13.1
Quebec	27.1	20.1	19.3
Ontario	27.7	11.8	23.6
Prairie Provinces	14.3	11.2	21.4
British Columbia	25.2	15.2	18.3
Canada	26.3	15.0	21.4

Source: Dominion Bureau of Statistics, Ottawa.

[1] Cf. Prices and Price Indexes, 1944-1947, p. 51, Dominion Bureau of Statistics, Ottawa.

Quebec, where war plants tended to be concentrated, and in the Maritimes, where a considerable stimulus was given to shipping, shipbuilding, iron and steel, and related industries.

The Control Period

While the first wage control order was introduced in November, 1941, at about the same time as the price ceiling order, it was not until 1943, or in fact early in 1944, that wage controls came to have their most extensive applications. Under the initial order, wage rates for most industries other than agriculture were stabilized at their level of November 15, 1941. Allowance, however, was made for increases in wages in two ways. First, a bonus was required to be paid proportionate to increases which might occur in the cost-of-living index. Second, increases in wage rates were also permitted upon application to the Regional or National War Labour Boards in cases where the rates being paid by the firm were found to be lower than comparable rates in a comparable locality. The controls were tightened during 1943 through placing greater authority in wage matters in the hands of the National War Labour Board. This board was given the power to review the decisions of the Regional War Labour Boards and to hear appeals from their findings. The wage bonus plan, introduced in 1941, based on increases in the cost-of-living index, was discontinued at the end of 1943 and existing cost-of-living bonuses were incorporated into basic wage rates. A measure of flexibility was retained through permitting some increases in cases of gross inequality or gross injustice, but the increases allowed were made on a more uniform basis through the centralized control of the National War Labour Board.[1]

In addition to the direct control over wages, the manpower regulations introduced under National Selective Service in 1942 had an important stabilizing influence on wages at this time. The fact that workers were moving into industries where the need was greatest rather than waiting until wages had risen high enough to attract them away from their present jobs, tended to ease the upward pressure on wages. National Selective Service regulations were also designed to increase the available supply of labour. Many measures were adopted to facilitate the entry into the labour market of married women, students, retired persons and others not ordinarily part of the labour force. In general, this controlled organization of the labour market helped offset the effect of shortages of manpower.

The effectiveness of these wage control measures and the manpower regulations may be judged in various ways. It is clear first of all from Chart IX that the percentage increases in wage rates in the various industries shown were less during the three years of control than during the similar period earlier in the war. The fact that these percentages are less is particularly significant when it is realized that shortages of manpower had become even greater.

[1] For statistics on applications made to the National and Regional War Labour Board, see The Labour Gazette, May, 1945, p. 647; December, 1945, p. 1766; and September, 1946, pp. 1201-1202. Over 80 per cent of the total number of applications made were granted in full.

An illustration of the effectiveness of the controls is presented in Table 41. It will be seen from the year-to-year percentage increases that, with few exceptions, the wage increases which occurred following the tightening of controls in 1943 were quite small.

TABLE 41

PERCENTAGE INCREASES IN WAGE RATES IN SELECTED INDUSTRIES

Industry	Percentage Increase		
	1942-1943	1943-1944	1944-1945
Logging	13.7	2.1	4.9
Manufacturing	9.0	3.4	3.6
Mining	6.1	9.0	1.3
Services	9.3	1.3	5.0
Transportation	9.1	0.8	0.4
Communications	8.8	0.4	2.6
General Average	9.1	3.1	2.8

Source: Wage Rates and Hours of Labour in Canada, 1947: Supplement to The Labour Gazette, October, 1948

The continued increase in farm wages over this period stands in sharp contrast to the situation in the industries covered by the control orders. The actual percentage increases were 52 and 16, respectively. It must be remembered, however, that the drain of manpower out of agriculture continued during the early part of this period. The drain became so serious in the face of mounting food requirements that special measures were necessary to meet farm labour shortages. These included the freezing of manpower on the farm, organized transfer of farm workers to meet seasonal needs and the employment of special groups of workers, including students, conscientious objectors, prisoners of war.

The effectiveness of the wage control shows up in the weekly earnings' data for manufacturing in Table 40. In every region, the percentage increase in earnings during the control period was less than it was during the earlier war period. The differences in the amount of increase from region to region between 1942 and 1945 tend to reflect the fact that the Regional War Labour Boards frequently permitted increases in low paying jobs. They also suggest, at least in the Maritimes and Quebec, that the earnings were still rising due to the lengthening of the average period of employment and to shifts from low to high paying jobs. The fact that the increase in British Columbia was once again higher than it was in the Prairie provinces arises no doubt primarily from the stimulus to production and employment in this region following the spread of World War II to the Pacific. The growth of the shipbuilding and aircraft industries was also an important factor. The increased employment on the Pacific coast in this and other war industries exerted a strong upward push on average earnings.

The success of wage control during these critical war years must be judged not only by the slowing down of the rise in wage rates, but perhaps still more by the success of price control, to which wage control was intended as a support. Over the three year period, as will be seen in Chart VII, there was only a small increase in the cost of living.

Through the control measures taken on the price side, and especially through the payment of food subsidies, which amounted to an indirect wage bonus, it was to be expected that the rise in the cost of living would be held even more effectively than the rise in wage rates. Besides, wage control did not imply a rigid wage freeze. It had to be firm enough to prevent inflationary increases but flexible enough to allow for essential adjustments. Real wages, expressed in terms of real wage rates, rose more rapidly during the control period than they did during the earlier years of the war when the increases in consumers' prices and wage rates were more nearly the same. This is borne out by the data presented in Chart VII.

While real wage rates were rising during this control period, the reverse appears to have been the case with real weekly earnings, at least in manufacturing. These had risen rapidly from 1939 to 1943, but thereafter tended to level off. Probably the chief reason for this was that the major shifts in employment had taken place by 1943, although smaller movements continued to occur chiefly from non-essential to essential jobs. The average number of hours worked per week was reduced by the enrolment of an increased number of part-time workers. Wherever this meant a reduction of overtime, the drop in earnings was further affected by any difference which existed between straight and overtime wage rates. The hours of full-time employees were also reduced slightly in some cases

TABLE 42

PROPORTION OF FEMALE WORKERS IN MANUFACTURING, AND MALE AND FEMALE HOURLY EARNINGS

Year	Females per 1000 Workers Employed	Average Hourly Earnings		
		Male	Female	Female Rate as Percentage of Male Rate
1939	220	46	28	61
1940	218	49	29	59
1941	226	54	32	59
1942	260	62	37	60
1943	282	67	43	64
1944	286	71	48	67
1945	263	74	47	63
1946	245	81	50	62
1947	232	—	—	—
1948	226	—	—	—

Source: Weekly Earnings and Hours of Work of Male and Female Wage-earners in Manufacturing, (annual until 1945), Census of Industry, Dominion Bureau of Statistics; and Annual Review of Employment and Payrolls in Canada, 1947, and other recent publications, Employment Section, Dominion Bureau of Statistics, Ottawa.

due to an increase in shifts and in others to a recognition that there is a negative correlation after a time, between efficiency and hours of work.[1]

Still a further factor tending to reduce average weekly earnings was the increasing number of women workers during these years. The proportion of female workers in the total working in manufacturing and a comparison of male and female hourly earnings are shown in Table 42.

Although on balance, the wage and price data available seem to show an increase in the real income of the worker during the second half of the war, it seems doubtful whether this was really the case, due to the increases in income taxes,[2] the increased shortages of many goods and services, the lowered quality of some commodities, and the other incommensurable hardships of wartime.

Post War Period

It was inevitable, during the first year after V-E day, that there would be many major adjustments in the economy. Demobilization, decontrol and reconversion plans generally all brought with them temporary disturbances in both the labour and commodity markets. Control machinery was retained during the first year of reconversion.

The National Selective Service machinery was used to move workers to peacetime jobs. Their primary task now was to find jobs for people rather than people for jobs. But the layoffs from war plants, the return of war veterans, the industrial disputes of 1946, and the continuing shortages of many goods and services all had their effect on the average earnings of wage and salary workers. As a result of this, average weekly earnings at least in manufacturing, dropped through this initial post-war year, while

[1]Cf. Studies of the Effects of Long Working Hours, Parts 1 and 2, Bulletins Nos. 791 and 791-A, and Hours of Work and Output, Bulletin No. 917, Bureau of Labor Statistics, U. S. Department of Labor, Washington, D.C.

[2]Taking a wage-earner with annual earnings of $2,000, and assuming that this income remained constant throughout the period, the changing impact of Federal income taxes, according to selected types of marital status, is shown below.

INCOME TAX PAID ON GROSS INCOME (EARNED) OF $2,000, CANADA, 1939-1948
(in dollars)

Year	Single Worker	Married Worker		
		No Dependents	One Dependent	Two Dependents
1939	36	Nil	Nil	Nil
1940	135	55	22	12
1941	300	145	71	42
1942	299(80)	214(100)	160(80)	106(53)
1943	599(160)	428(199)	320(160)	212(106)
1944	519(80)	329(100)	240(80)	159(53)
1945	421	220	154	102
1946	369	192	134	89
1947	265	93	32	Nil
1948	219	69	21	Nil

Provincial income taxes payable in some cases up to the end of 1941 are not included. Compulsory savings are included in the totals for 1942, 1943, and 1944, the amounts of compulsory savings being shown in brackets. The effects of family allowance payments are omitted, and the full exemption is allowed for each dependent.
Source: Department of National Revenue, Ottawa.

wage rates continued to increase. The other wage series shown in Chart VII, namely, the national wage bill, expanded mainly as a result of a new increase in the labour force.

Total employment in November, 1945 was 4,326,000; in the same month in 1946 it was 4,733,000. This increase occurred largely as a result of the expansion of production in industries curtailed during the war.

Following these temporary post-war adjustments, the trends of employment, production, prices and wage rates have been upward. The easing and final removal of wage controls during 1946 and the relaxation of price controls coincided roughly with the completion of reconversion and the resumption of an upward trend in employment.

Trade union membership doubled during the war but wage demands previous to 1945, were held in check by wage control and by the support which union leaders gave to government wartime economic policies.[1] Following the end of the war, especially when price controls were being removed, and actual or threatening increases were occurring in the cost of living, when general wage increases had not been permitted for several years, when the profit position of many industries had improved and the taxation of corporations was being eased, it was natural that unions should feel the urge to press their demands for higher wages. The continuing labour shortages in many industries and the large backlog of demand for goods and services have been important related conditions.

Average weekly earnings of wage-earners in manufacturing, shown on Chart VII have displayed a consistent upward trend following the temporary drop after the war. All manufacturing groups, however, have not experienced an upward trend in average earnings. In those branches of manufacturing which were most heavily engaged in war production in 1945, a fairly sharp decline in average weekly earnings has occurred along with a substantial drop in employment. When allowance is made for the rise in the cost of living following the war, as is done in Chart VIII, the resulting figures for real earnings show a much more modest gain in 1947, and in fact a drop in 1948. Looking only at the statistical picture presented here, it appears that the average wage-earner, at least in manufacturing, was nearly as well off in terms of real income at the end of 1948 as he was at the end of the war.

This conclusion is somewhat modified, however, when consideration is given to the effect of reduction in income taxes.[2] If we also take into account the alleviation of most of the wartime scarcities, with the exception of housing, at least in some areas, and of the other hardships and uncertainties of wartime, it seems probable that most workers are as well off as they were in 1945. The most important point, though, appears to be

[1] Membership in trade unions increased from 359,000 in 1939 to 711,000 in 1945 and to approximately one million by the end of 1948. Cf. Labour Organization in Canada, published annually, Research and Statistics Branch, Department of Labour, Ottawa.

[2] See footnote 2, p. 184.

that in spite of the considerable changes in prices and wage rates, which have occurred since the end of the war, the real income position of the average worker has fluctuated within a relatively narrow range.

Over the whole decade, from 1939 to 1949, it seems clear that the economic position of wage-earners in Canada has improved. This is true in the case of those who were employed in 1939. It is also true, of course, for the many thousands who were unemployed at that time. In some ways it is better to compare the position of workers in Canada today with what it was in 1929, a period when there was also a high level of employment throughout the economy. Such a comparison is brought out in Table 143. One of the most striking features brought out by this table is the fairly steady upward trend in real wage rates throughout the whole 20 year period. This upward trend has been more rapid since 1939 than before. Expressed in terms of an annual percentage increase, the figure for the decade of the 'forties has been 2.6 compared with 1.9 for the 'thirties.

The increase in the labour force by 1948, and the rise in wage rates, are chiefly responsible for the large gain in total labour income over 1929. The drop in labour income in 1939 was of course due mainly to unemployment. Total labour income as a percentage of national income has tended to vary inversely with the absolute size of these two amounts, being much larger in 1933, and somewhat smaller in 1948, than in the other years shown.

Summary and Conclusion

In the discussion in the first part of this chapter certain general connections between wages and prices were pointed out. It was concluded that movements in both wages and prices are determined and conditioned to a greater extent by other more basic forces in the economy than they are by each other. It follows that, generally speaking, measures designed to influence these more basic forces and thus to maintain over-all economic stability are more effective than direct controls over prices or wages or both. This appears to be particularly the case at present when the supply and demand of most goods and services are in fairly close balance.

From the standpoint of the individual worker, there is little doubt, judging by our analysis in the remainder of this chapter, that real wages, for by far the majority of Canadians, have increased substantially since 1939. The best guarantee that an upward trend in real wages is maintained in the future is a continued improvement in productivity of both labour and management. Provided labour-management relations remain on a satisfactory basis, it seems reasonable to expect such an increase during the next few years as a result of current post-war developments, such as the renovation and expansion of industrial plants and the exploitation for peacetime use of wartime technological advances.[1]

[1]See Wages (a) General Report, International Labour Conference, 31st Session, San Francisco, 1948, pp. 198-199 and F. C. Mills, "Living Costs, Prices and Productivity" in Review of Economics and Statistics, February, 1948, pp. 6-8.

TABLE 43

INDICATORS OF THE ECONOMICS POSITION OF LABOUR, 1929-1948

(Six of the items are index numbers on the base 1929 = 100)

	1929	1933	1939	1944	1948[a]
Cost of Living	100	78	83	98	127
Wage Rates, Agricultural	100	47	67	173	230[b]
Wage Rates, Non-Agricultural	100	86	101	139	198
Real Wage Rates, Non-Agricultural	100	111	121	142	156
Real Wage Rates, Non-Agricultural: Average Annual Percentage Increase during Preceding Decade	—	—	1.9	—	2.6
Total Labour Income (including Military Pay)	100	63	92	210	254
Total Labour Income as Percentage of Net National Income	61	75	61	62	56
Employment in Eight Leading Industries	100	70	96	154	165

a) All 1948 figures are preliminary estimates, subject to revision, except cost-of-living indexes and agricultural wage rates.

b) For April, 1948.

Sources: Various publications of the Departments of Labour, and Trade and Commerce, Ottawa.

8

CORPORATE PROFITS AND PRICES

THERE is undoubtedly a widespread feeling, and 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. In examining this aspect of the problem we have found the relationship more complicated than is perhaps generally realized.

Corporate profits can be defined as the returns accruing to the equity of stockholders, or ownership interest in the corporation. As such they 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 fluctuations than other forms of income. They are a residual claimant even with respect to the total earnings of capital. A substantial part of the total capital investment in corporations is financed by means of various short or long term creditor obligations. Bank loans and accounts payable are perhaps the most important source of short term funds whereas most of the long term funds are obtained through bond issues.[1] Each of these creditor obligations is paid at some fixed contract rate and has a prior claim on the earnings of capital. Corporate profits consist of the remainder.

However, it is not generally realized that corporate profits are not the same as an economic profit. A corporate profit is an accounting profit, the net income available to pay dividends. An economic profit is what remains after all initial costs, such as an interest return on the equity capital, is allowed. An economic profit is a much smaller amount. Considerable confusion arises because the economist talks about economic profit, the public about corporate profit.

Under an economic system of the free enterprise type such as exists in Canada, corporations and other forms of business organizations are normally expected to seek maximum profits. Using their judgment as to the price the market will allow and taking into consideration their costs they set a price which will yield them the greatest profit. When prices have been established on this basis a further advance in prices will decrease rather than increase total profits because of reduction in sales. The justification for such a system is that it leads to an optimum use of the country's resources and where competition is free the high profits in particular industries will attract new firms into the field until a competitive or normal rate of return is restored. The higher prices offered serve to attract labour and capital into fields whose products are valued most highly. In the past few years high prices have undoubtedly been an important factor in attracting labour and capital into fields where shortages were most acute.

[1]Of the total assets held by Canadian corporations in 1946, 21 per cent was financed by means of short term credits (current liabilities), 16 per cent by funded debt and the remaining 68 per cent represented the stockholders' interest.

But even though this is so, prices and profits may remain at comparatively high levels for some time, particularly under the circumstances that have existed in Canada in recent years. As one of the officers of the Canadian Chamber of Commerce said before us, "I think it would have to be admitted that in periods of abnormal scarcities . . . there has been an enlargement of profit margins."[1]

At the end of the war, competition in many lines of endeavour was limited by lack of productive facilities. Competition in the retail trade for example, was limited by the lack of store space in which new retailers could start up a business. This applied in many lines of activity. It was primarily a reflection of the accumulated shortage of facilities which had developed during the depression of the 'thirties and the war period. Over a period of years new retail stores, new factories, new theatres and new establishments of many other types are being constructed and these are gradually restoring more competitive conditions to many lines of business. But this is a development that requires time. It could not be assumed at the war's end that competition would immediately be sufficient to prevent large profits to the owners of the countries' stock of capital.

It is difficult to define the concept of normal profits with any degree of precision. The large volume of capital investment which is taking place today indicates that the expected rate of return on new investment is high. As the quantity and quality of our capital goods increases, actual rate earned might be expected to decline towards some normal rate. But the rate on new investment is subject to frequent shifts as new inventions are made, new products developed and as the population grows. Thus the tendency for the actual rate of return to approach a normal rate is only a tendency. If it were anything else, of course, the free economy would be robbed of one of its dynamic elements.

A further qualification is necessary during an inflationary period. In these circumstances the costs and expected demands on which the corporation bases its estimate of the most profitable price are not very precisely determined. The corporation must make some guess with respect to the amount it expects costs and incomes to rise. But if all groups in society who are active in establishing prices, and corporations are one of the most important of these, base their decisions on the expectation that other prices will increase rapidly the result may be to accelerate for the time being, at least, the upward movement in prices. More restraint on the part of all groups including corporations might therefore result in a less rapid price increase.

How Profits Affect Prices

Finally, as we will discuss in Chapter 11, it cannot be assumed in all cases that profits are regulated by free and open competition. To an increasing extent business is resorting to practices designed to protect itself against the harsh correctives of the free market system.

[1]Evidence, Royal Commission on Prices, p. 2229.

Corporate profits may affect prices in a number of different ways. They result from higher prices as market conditions make it possible for business firms to increase prices. This is perhaps the most commonly recognized relationship between profits and 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.

In this section we shall examine each of these relationships in turn. This examination cannot in any sense be definitive for the information available to us is by no means all that could be desired. But, we felt that some discussion was better than none. We hope that it will help to clarify at least a few points and to indicate the lines along which further study might be pursued.

Some ambiguities regarding the meaning of reported profits during a period of rapidly changing prices have made it necessary to give some attention to the accounting concepts used in determining profits. Special consideration is given to the way in which accounting practices in treating inventories and depreciation allowances affect reported profits. In addition, because we have been primarily concerned here with prices which have played an important part in the rise in the cost of living, it has been necessary to give special attention to the extent to which the increase in corporate profits has been due to a rise in export prices.

Before examining these points in detail, we should like to stress that our investigation in this field has been severely hampered by the lack of any up-to-date statistics on the amount of corporate profits. The information available on corporate profits during 1948 is still extremely scanty and because of this we have been forced to confine our statistical analysis primarily to the period ending with 1947.

The Valuation of Inventories

During a period when prices are changing, reported corporate profits are affected to a substantial extent by the accounting methods used for valuing inventories. At the present time three of the most widely used methods for valuing inventories in Canada are the "average cost", "first in first out" and "last in first out" methods. When prices are rising the profit reported where the "last in first out" method is used, will be smaller than if either of the two former methods had been used. This arises out of the way in which costs are charged to sales under each of the methods. When a "first in first out" method is used the earliest purchases in point of time are charged to sales first. This means that in a period of rising prices the firm is continually charging to sales the cost of materials which were purchased several months earlier at lower prices. At the same time it is replacing these materials in its inventory at the higher prices prevailing at the time. Consequently, it will show a higher profit merely because it is continually charging to sales the cost of materials purchased several months earlier. If on the other hand this same firm had followed a "last in first out" method of inventory accounting, its reported profit would be lower. Where this latter method is used the most recent purchases (in a period of rising prices the highest priced materials on hand) will be charged to sales first. This means in effect that the current replacement cost of materials is charged to sales during the accounting period. This results in a smaller profit during a period of rising prices. When prices are falling the reverse is true. In such a period profits will be higher or losses will be smaller when "last in first out" is used than where the "first in first out" method is used.

Over a period when prices rise and then fall again, the results obtained for the period as a whole will be approximately the same for each of the methods. Thus the chief effect of the "first in first out" method as opposed to the "last in first out" method is to increase the amount of variability shown in reported profits and losses. The extra profit or loss shown where the "first in first out" method is used is frequently called an inventory profit or loss. It is a profit or loss which arises from the fact that firms sell at the market price which is related to the replacement cost, but calculate their profits by computing costs on a different basis, namely original cost of inventory.

Finally it should be noted that once the rise in prices stops, reported profits of a firm whose profit statement has been inflated by the inclusion of inventory profits, will decline even though it continues to charge the same margin of profit above its replacement cost and enjoys the same physical volume of sales. On the other hand profits of a firm using a "last in first out" method in these circumstances would remain at about the same level.

The "average cost" method gives a result somewhat intermediate between that obtained by using the above two methods, but in general it is much closer to the "first in first out" method. Where it is used an average of all the materials on hand, both the more recently purchased higher-priced materials and the lower-priced materials purchased at an earlier date, is charged to sales.[1]

It must be recognized that the amount of inventory profit or loss shown will depend on the extent to which business firms use replacement costs as a basis for setting their selling prices. While many of the firms which appeared before us indicated that they had used current replacement costs as a guide in setting their selling prices, there were some instances where this was not true. For example there is evidence that retail shoe stores in the autumn of 1947 continued to sell their stocks on hand with little advance in price even though replacement cost of shoes had advanced substantially. Further during at least part of the post-war period when prices were still under control, some business firms were not allowed to advance their prices until they had used up all of the lower cost material in their in-

[1]An example of the results obtained by applying each of these methods to an identical set of hypothetical data is given in Evidence, Royal Commission on Prices, pp. 1730-34.

ventories or repaid the subsidy content of their inventories. This seems particularly to have been true where subsidies were being removed. But although in these instances a firm using a "first in first out" or "average cost" method of inventory accounting may not make any inventory profit it will still find it necessary to find funds to finance the increased value of its inventory. In order to finance this increased value of inventory it may have to draw on its profits or obtain additional funds from other sources such as bank loans. Those firms which do make a substantial amount of inventory profit find this profit is automatically invested in financing the increased value of their inventories and hence is not available to be used for other purposes such as long term capital investment or the payment of dividends.

It has not been possible to make any exact estimate of the amount of inventory profits which are included in the increased profits reported by corporations during the last few years. However, it is possible to suggest roughly the order of magnitude of the amount which may be involved. At the end of 1945 the total investment in inventories of all Canadian corporations amounted to a little less than two billion dollars. Between 1945 and 1947 the index of wholesale prices increased by over 25 per cent. If we take one-half of this price rise as a rough measure of the extent to which inventory profits were earned it gives an estimate of $250 million. This is slightly more than 20 per cent of the total increase in corporate profits before tax during this period. The above estimate should be regarded as a very rough guess which might be subject to a substantial margin of error. Nevertheless it does indicate that at the present time corporate profits are inflated to a substantial extent by inventory profits.

Depreciation Reserves

The amount which business firms are allowed to charge to their reserve for depreciation is another factor which has an important effect on the amount of reported profit. Under Canadian Income Tax regulations the charges business firms are allowed to make for depreciation reserves are based on the original cost of the machine, building, or capital item in question. Once the reserve equals this original cost, no further depreciation can be charged. Much of the capital equipment in use today was purchased during the 1930's or even earlier. In some cases the equipment has been fully written off and so no depreciation is charged. Because of this the depreciation allowances which are made today may not be sufficient to replace at today's higher prices the amount of equipment which wears out each year. Some writers have suggested that because of this, reported profits are overstated. The annual charge to the reserve for depreciation should be increased, they say, so that it would be sufficient to replace at curent costs the capital used up during the year. Profits would then be reduced by a similar amount. They argue therefore that profits are artificially high.

It is possible to recognize that for the country as a whole there is an element of truth in this argument without at the same time agreeing that individual firms should be allowed to base their charges to depreciation for tax purposes on current replacement costs. When all business firms are considered, the amount set aside for depreciation during the past few years may fall considerably short of what is needed to replace at present costs the capital which has worn out during this period. It is particularly important to recognize this when attempting to determine the rate at which Canada's supply of capital is increasing.[1] But for the individual firm the charge to depreciation reserve represents the return in monetary form of the firm's original investment.

The amount of depreciation that has been charged by corporations and other business firms during the last few years is affected by the special provisions for depreciation under the Income War Tax Act. Under Order-in-Council PC 8640, November 10, 1944, business firms are allowed to charge depreciation for tax purposes against approved investment expenditures at not more than double and not less than one-half the rates normally allowed.[2] This provision applies until 80 per cent of the capital project has been written off; thereafter the normal rates apply. Investment expenditures amounting to $1.4 billion have been approved under this arrangement. It may be safely assumed that at the present time, when incomes and tax rates are comparatively high, corporations with projects under these provisions have been taking advantage of their option to charge depreciation at about double the normal rate. The normal rate at which depreciation is charged varies with the type of capital involved and no exact information is available on the rates which would be charged against these projects. However, it is evident that the amount involved is substantial. If the average normal rate of depreciation were five per cent the annual depreciation charged at this rate would amount to $70 million. Charging depreciation at double the normal rates would result in an annual addition of $70 million to depreciation reserves, thus partially offsetting the fact noted above that depreciation allowances based on original cost are insufficient to replace at today's prices the amount of capital which is consumed in turning out our current output.

Profits from Exports

Before proceeding to a general consideration of the relation between corporate profits and prices it is necessary to give special attention to profits which are earned primarily in the export industries. A number of companies appearing before us admitted that they had earned very large profits but they argued that these were earned almost entirely from the sale of goods on the export market and because of this, these profits had not contributed to the rise in the Canadian cost of living.[3] This point is particularly important in Canada because of our large volume of exports. In 1947, exports of goods and services amounted to 27 per cent of Canada's Gross National Product. Though there is no detailed evidence on the point, it seems reasonable to assume that an even larger percentage of the in-

[1] Cf. Chapter 5, The Investment Boom.
[2] This provision is available only on projects approved and completed before March 31, 1949.
[3] See particularly the evidence in fertilizers. One fertilizer company charged considerably higher prices on export sales than on domestic sales. Evidence, Royal Commission on Prices, p. 130.

creased corporate profits of the past few years have arisen from sales on the export market. Pulp and paper, lumber, base metals and flour are just a few of the commodities which have had a large export sale at extremely favourable prices during the past few years. In a sample group of 665 companies, 41 companies in two industrial groups that sell to a large extent on the export market, pulp and paper and non-ferrous metals, showed an increase in profits before taxes from the $119 millions in 1945 to $260 millions in 1947. This increase amounts to over 60 per cent of the increase of $232 millions reported by the 665 corporations in the sample during this period.[1]

Profits before and after Taxes

A number of criteria are available for judging the part corporate profits have played in the rise in prices. For all corporations the relation of total profits to Canada's Gross National Product provides some guide.[2] For individual corporations or groups of corporations the relation between profits and sales offers a similar basis of measurement. Another basis for judging the size and importance of corporate profits is by comparing them with the firm's investment. In each instance corporate profits before and after tax can be considered.

This last point requires some elaboration. Taxes on corporate income are levied as a percentage of the corporation's total net income or, in the case of the excess profits tax, as a percentage of the income earned over a certain amount. Most economists believe that in the short run such taxes do not affect the price that will yield the corporation the maximum amount of profits before tax. Whether any increase or decrease in the tax would be passed on to the consumer in the form of higher or lower prices over a longer period of time is more uncertain. We, therefore, have used both types of data. They are shown in the following table, where it will be noted that they amounted to $1.8 billion before taxes and $0.9 billion after taxes, in the year 1947.

TABLE 44

CORPORATION PROFITS[a]

(millions of dollars)

Year	Before Taxes	Corporation Income[b] and Excess Profit Taxes	After Taxes
1939	587	123	464
1940	790	337	453
1941	1,094	539	555
1942	1,279	658	621
1943	1,274	669	605
1944	1,181	630	551
1945	1,198	632	566
1946	1,387	699	688
1947 Prelim.	1,789	840	949

a) Excluding approximately $80 million each year for interest and dividends received by corporations from abroad.
b) Includes withholding taxes of $35 million in 1947, and smaller amounts in preceding years.
Source: Dominion Bureau of Statistics, Ottawa.

[1] Statistical Summary of the Bank of Canada, November and December, 1948.
[2] Cf. Chapter 2, The Course of Prices and National Income since September 1939.

We have not dealt specifically with profits accruing to unincorporated business. Net income of unincorporated business is placed in a category separate from that of incorporated business because it includes a mixture of salaries and investment income, which could only be separated on a completely arbitrary basis. The two main forms of unincorporated business income, from which "pure profits" cannot be separated, are net income of other unincorporated business, and net income of farm operators from current farm production.

TABLE 45

NET INCOME OF AGRICULTURE AND OTHER UNINCORPORATED BUSINESS
(millions of dollars)

Year	Net Income of Farm Operators from Current Farm Production	Net Income of Other Unincorporated Business	Total Net Income of Unincorporated Business
1939	461	430	891
1940	508	483	991
1941	548	587	1,135
1942	1,089	664	1,753
1943	969	690	1,659
1944	1,213	749	1,962
1945	971	851	1,822
1946	1,130	1,024	2,154
1947 Prelim.	1,235	1,119	2,354

Source: Dominion Bureau of Statistics, Ottawa.

Relation of Profits to Gross National Product

Some idea of the relation of corporate profits to prices is provided by comparing the increase in corporate profits with the increase in the total value of production of goods and services as measured by the statistical total, Gross National Product. Since corporate profits are not related in any way to the direct purchase of services by the government, which consist largely of military pay and the salaries of civil servants, it was deemed preferable to compare corporate profits with Gross National Product after deducting this part of government expenditures. This last total will be termed adjusted Gross National Product.

TABLE 46

CORPORATE PROFITS AND GROSS NATIONAL PRODUCT, CANADA, 1939, 1945 and 1947
(millions of dollars)

	1939	1945	1947	Net Change	
				1939 to 1945	1945 to 1947
1. Gross National Product	5,598	11,732	13,375		
2. Government Expenditures on Direct Services	431	1,777	896		
3. (1)–(2) G. N. P. Less Government Expenditures of Direct Services	5,167	9,955	12,479	4,788	2,524
4. Corporate Profits before Tax	587	1,198	1,789	611	591
5. (4) as a Percent of (3)	11.3	12.0	14.4	12.8	23.4
6. Corporate Profits after Tax	464	566	949	102	383
7. (6) as per cent of (3)	9.0	5.7	7.6	2.1	15.2

Source: Dominion Bureau of Statistics, Ottawa.

From the above data it is evident that corporate profits considered either before or after tax were not an important cause of the rise in prices between 1939 and 1945. On the other hand, between 1945 and 1947, corporate profits both before and after tax increased at a substantially higher rate than our adjusted total of Gross National Product. For this period 23.4 per cent of the increase in the value of adjusted Gross National Product was due to the increase in corporate profits before tax and 15.2 per cent was due to the increase in corporate profits after tax. In both instances these percentages are substantially higher than the average relation of corporate profits to adjusted Gross National Product as shown in the first three columns of lines numbered five and seven of the above table. Even allowing for the inclusion of some inventory profits in these totals and the understatement of depreciation allowances, it would seem that increasing prices resulted not only from rising costs but contained a higher margin of profit. Some part of this increase is, of course, the result of the high profits earned on export sales. It also may be noted that corporate profits after tax in 1947 were a smaller percentage of adjusted Gross National Product than they were in 1939.

Relationship of Profits to Sales

There are some data on the profits and sales of different types and sizes of corporations though the data now available do not go beyond 1946. The relation between the profit and sales of a corporation varies with the industry, the degree of integration and size of the corporation and even with the way in which it is financed. In an industry where a large amount of capital equipment is used relative to the amount of materials and labour

TABLE 47

CORPORATE PROFITS BEFORE TAX AS A PER CENT OF GROSS SALES OR REVENUE BY INDUSTRIES, TAXATION YEARS

1944, 1945 and 1946

Industry	Profit before Tax as a Per Cent of Gross Sales or Revenue		
	1944	1945	1946
Agriculture, Fishing and Forestry	4.65	2.36	5.49
Mining	16.27	17.97	15.64
Manufacturing	9.07	8.36	9.60
Construction	7.19	7.68	10.54
Public Utilities	17.05	16.62	14.02
Wholesale	3.88	3.65	4.18
Retail	6.26	6.25	6.58
Service	9.24	8.91	8.81
Finance	20.31	19.88	17.78
Unclassified	4.78	5.94	3.43
Average	8.76	8.23	8.69

Source: Taxation Statistics, Department of National Revenue, Ottawa.

TABLE 48

CORPORATE PROFITS BEFORE TAX AS A PER CENT OF GROSS SALES OR REVENUE BY INCOME CLASS OF COMPANIES REPORTING A PROFIT, TAXATION YEARS

1944, 1945 and 1946

Income class	Profit before Tax as a Per Cent of Gross Sales or Revenue		
	1944	1945	1946
Below to $ 1,000	.92	.95	.92
$ 1,000 to 2,000	2.08	2.19	1.63
2,000 to 3,000	2.69	2.84	2.70
3,000 to 4,000	3.45	3.50	3.26
4,000 to 5,000	3.95	3.62	3.42
5,000 to 10,000	3.97	4.22	4.27
10,000 to 15,000	5.03	4.74	5.26
15,000 to 20,000	5.42	5.56	5.53
20,000 to 25,000	5.69	5.12	6.01
25,000 to 50,000	6.89	6.16	6.68
50,000 to 100,000	8.33	6.87	7.64
100,000 to 250,000	9.98	9.60	8.97
250,000 to 500,000	10.68	10.66	11.43
500,000 to 1,000,000	10.37	9.30	10.18
1,000,000 to 5,000,000	11.62	10.18	10.72
Over 5,000,000	11.53	12.84	16.28
Average	9.35	8.81	9.49

Source: Taxation Statistics, Department of National Revenue, Ottawa.

the ratio of profits to sales or revenues will usually be high. This is true of public utilities. Large corporations which operate in several stages of industry will also tend to have a higher ratio of profits to sales because shipments between different stages of the industry will be considered shipments within the firm and will not appear as part of the firm's gross sales. In a smaller firm operating at only one stage, all these shipments would become a part of sales.

Profits in Relation to Investment

Another basis for judging the level of corporate profits is the rate of return earned by the corporation on its investment. Judgment on this basis is complicated by the difficulty of determining the meaning of investment and the basis on which it should be valued. The total return earned by a corporation is a return to the capital assets held by the firm. Some of these assets are financed by means of short term credits such as bank loans, current accounts payable and accrued taxes payable, items which are usually termed current liabilities. The remainder of the firm's assets are financed by means of the long term bonded indebtedness and the firm's equity, the capital stocks, plus earned surplus and surplus reserves. Corporate profits are what remains for the equity or ownership interest in the firm after payments of the contractual amounts due to the current liabilities and long term indebtedness. The remainder will depend both on the amount of the total earnings of capital and the amount which has to be paid to the creditor claims. The share received by the ownership interest may vary from corporation to corporation depending on the extent to which it was financed by means of creditor obligations. Because of the low interest rates prevailing today a firm which has a substantial amount of bonded indebtedness carrying low rates of interest may easily earn a much higher rate of return on the firm's equity than the rate of return which is earned on the firm's total capital assets.

The amount of earnings obtained will also depend to some extent on the composition of the corporation's assets. Since the end of the war corporations have been selling marketable securities, in most cases government securities that carried relatively low rates of interest, and have been investing the proceeds in active earning assets. This shift in the type of assets held may have played a small part in the increased earnings obtained by corporations during the past few years. This should not be given too much weight, however, because during the period of construction there may actually be no return on the investment.

The basis on which the firm's assets are valued, in particular its fixed plant and equipment, also affect the rate of return a corporation earns on its equity. In many instances the firm's plant will be carried at its original cost less depreciation charged since that time. But in other cases, particularly where a corporation has been refinanced, the assets may have been reappraised at their current value and the firm's equity may have been increased or decreased accordingly. Even where the assets are carried at original cost less depreciation the rate of return earned by the corporation may vary substantially. Assuming equal efficiency, prices which yield a moderate rate of return on new investments at today's costs are likely to yield a very high rate of return on investments which were made when prices were lower. The competition of new investments can be expected to force profits down to a level where a competitive rate of return is being earned on investments made at today's costs. This may still allow the lower cost plants to show a high rate of return on their original costs and accordingly corporations with such a low cost plant may continue to show a high rate of return on their equity. This means that in terms of today's price levels the book value of investments made at lower costs substantially overstates the current earning value of these assets. This conclusion must be modified where the new investments are more efficient. Recent developments in technique may allow gains in efficiency from new investments that will partially or completely offset the disadvantages of today's higher costs. In the longer run, the competitive rate of return that becomes effective will depend to a large extent on the future course of construction and machinery costs.

Statistical data showing the rate of return earned on the corporation's equity are available from two different sources. Data for all corporations are available for the taxation years 1944, 1945 and 1946. These data are based on the reports made to the Department of National Revenue for tax purposes. The taxation year includes all corporations' fiscal years ending within a given calendar year. Thus in the taxation year 1946 would be grouped data for corporations whose fiscal year ended between January 1, and December 31, 1946. Except for those corporations whose fiscal year ended on December 31, the data cover part of the calendar year 1945 and part of 1946. These data are sufficiently up to date to provide an indication of the recent trend in profits but it does show the rates of return which were earned in this base period. These data are shown in the first table for corporations classified by size of income and in the table following according to the industry in which the corporation falls. Table 49 shows that in the two most recent years the highest rate of return was earned corporations with annual incomes between $250,000 and $1,000,000. Table 50 shows that the highest rate of return in recent years has been earned by corporations in retail and wholesale trade. Both groups earned a rate of return before payment of taxes equal to over 24 per cent of their equity in 1946. Corporations engaged in manufacturing and in the service industry also received a high rate of return in 1946, in both instances more than 18 per cent.

TABLE 49

CORPORATE INCOME BEFORE TAX AS A PER CENT OF THE CORPORATION'S EQUITY, CLASSIFIED BY SIZE OF INCOME, TAXATION YEARS

1944, 1945 and 1946

Size of Income before Tax	Percentage Rate of Return on Equity		
	1944	1945	1946
Below $ 1,000	.69	1.57	1.41
$ 1,000 to 2,000	4.45	3.56	4.58
2,000 to 3,000	4.82	6.09	4.61
3,000 to 4,000	8.66	8.38	7.82
4,000 to 5,000	9.87	7.97	7.80
5,000 to 10,000	9.50	11.85	12.33
10,000 to 15,000	11.80	11.22	13.15
15,000 to 20,000	11.22	10.76	16.86
20,000 to 25,000	11.84	12.47	14.60
25,000 to 50,000	13.50	13.00	17.02
50,000 to 100,000	14.37	10.56	13.86
100,000 to 250,000	14.02	18.60	16.29
250,000 to 500,000	17.72	17.46	18.04
500,000 to 1,000,000	15.74	16.03	17.18
1,000,000 to 5,000,000	16.68	13.72	15.11
Over 5,000,000	13.47	13.31	14.14
Total All Profit Companies	13.95	13.57	14.89

Source: Taxation Statistics, Department of National Revenue, Ottawa.

TABLE 50

CORPORATE INCOME BEFORE TAX AS A PER CENT OF THE CORPORATION'S EQUITY, BY TYPE OF INDUSTRY, TAXATION YEARS

1944, 1945 and 1946

Industry	Percentage Rate of Return on Equity		
	1944	1945	1946
Agriculture, Forestry and Fishing	5.34	3.00	7.80
Mining	7.01	7.45	6.57
Manufacturing	19.08	17.28	18.14
Construction	15.39	11.00	14.08
Public Utilities	7.92	7.94	6.52
Wholesale	19.37	20.43	24.53
Retail	21.78	22.34	25.74
Service	16.93	17.38	18.69
Finance	3.02	2.82	3.08
Unclassified	7.56	7.24	12.68
Total All Companies	12.74	12.15	12.65

Source: Taxation Statistics, Department of National Revenue, Ottawa.

The second source of statistical data on corporate income is the sample of companies' annual statements compiled by the Research Department of the Bank of Canada and published in the Bank's Statistical Summary. This sample consists of a constant number of companies for which data are available over the period 1935 and 1947. It is restricted to companies whose assets in 1941 were in excess of $200,000. For a number of reasons the information provided by this sample must be interpreted with considerable care. Because it consists of a constant number of companies it may not accurately reflect changes in profits which are due to the influx of new corporations during period of rising incomes or their disappearance when incomes are depressed. Further, companies are included in the sample on the basis of whether or not annual statements are available over the period covered by the sample. For this reason also the sample may not always be representative of movement in total corporate profits. When the data on total profits before tax for this group of companies are compared over the period from 1939 to 1946 with the total profits earned by all companies, it is found that the Bank of Canada's sample group of companies understates considerably the increase in total profits. Over this period the Bank of Canada sample of 665 companies shows an increase in profits before tax of 71 per cent whereas the increase in profits before tax of all corporations estimated on the basis of taxation data amounted to about 136 per cent. At least part of this difference is due to the heavy weight given to gold mining companies in the Bank of Canada's sample, for the profits of this group have fallen sharply over this period. For these reasons it is necessary to treat the results shown by this constant sample of companies with caution. However, one of its advantages is that it provides some indication of the trend of profits for the more recent period. Profits are tabulated in this sample on the basis of fiscal years that correspond most nearly to the calendar year. This means that data now available for 1947 will include all corporate statements with fiscal years ending between July 1, 1947, and June 30, 1948. While the total for all 665 companies may not show accurately the movement of total corporate profits, the individual industrial breakdowns provide some indication of the changes in profits in different industries.

Table 51 and Table 52 show the ratio of net income after provision for taxes to the companies' equity, that is, capital stock plus surplus and surplus reserves. This is shown for all 665 companies and for 14 industrial groups. In 1947 the highest rate of return, more than 20 per cent, was earned by the non-ferrous group. This was followed by beverage manufacturing companies and pulp and paper companies.

Are Profits Too High?

It will be evident from the foregoing that 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 Canadian prices.[1] These profits 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 costs, the capital which has worn out during the year. In addition corporate profits have been increased by extremely profitable sales on the export market.

For the year 1947, corporate profits, before deduction of tax, formed a higher proportion of the Gross National Product (less certain government expenditures) than in either war or immediate pre-war years.[2] After deducting tax, corporate profits formed a smaller proportion of this total of Gross National Product than in pre-war years. These calculations may be taken to mean that the margin of profit has tended to be somewhat larger in recent years, although allowance must be made for the various special factors such as inventory profits, inadequate depreciation reserves and export profits mentioned above. Comprehensive data available on profits in relation to sales is not recent enough to be of much value but our studies of particular industries seem to bear out this general conclusion.

The rate of return on investment, that is, after deduction of taxes, varies greatly from industry to industry. Industries like pulp and paper which have participated so largely in the export trade show a phenomenal increase in their rate of return. Gold mining, on the other hand, has suffered an equally sharp drop. From the point of view of domestic price levels it is significant that wholesale and retail trading companies have earned a considerably higher return on their investment than at any time

[1] Cf. The industry studies appearing in Volume III for comments on particular industries.
[2] Cf. Chapter 6, Fiscal and Monetary Policy.

TABLE 51

PROFIT STATISTICS FOR 665 SELECTED CANADIAN COMPANIES
FOR THE YEARS 1937 - 1947[a]

(millions of dollars)

	1937	1938	1939	1940	1941	1942	1943	1944	1945	1946	1947
Preferred Stock Outstanding	494	488	483	472	467	467	458	456	443	422	470
Common Stock Outstanding	1,421	1,418	1,422	1,449	1,433	1,438	1,446	1,455	1,474	1,541	1,596
Earned Surplus and Surplus Reserves[b]	777	777	821	869	970	1,072	1,158	1,243	1,334	1,445	1,621
Equity	2,692	2,683	2,726	2,790	2,870	2,977	3,062	3,154	3,251	3,408	3,687
Net Income to Stockholders[c]	284	235	281	275	297	298	279	267	270	329	442
Per Cent Net Income to Equity	10.55	8.76	10.31	9.86	10.35	10.01	9,11	8.47	8.31	9.65	11.99

a) The tabulation includes all those companies with 1941 assets over $200,000 for which consistent reports were available from 1935 to 1947. The accounts of certain companies which were available in some or all of these years were not comparable throughout the period and had to be excluded. Since many of the companies report on a consolidated basis, the number of individual companies included in the sample is actually a good deal larger than indicated. The material is, of course, subject to all the limitations and qualifications which apply to the basic accounting statements. Fiscal year nearest to calendar years used.

b) Includes contingent and general reserves, capital surplus and the refundable portion of the Excess Profits Tax.

c) For purposes of comparability, any special capital charges made against income account in company reports have been added back as well as "contingent" and "general" reserves. Special inventory reserves, whether shown by the company in operating expenses or as an adjustment to earned surplus, have been deducted in arriving at Net Operating Profit. For the total 665 companies the special inventory reserves amount to .4, .2, 1.7, 11.1, 5.9, 2.7, 4.2, - 1.8, 2.8 and 14.9 in the years 1937 to 1947 respectively.

Source: Bank of Canada, Ottawa.

TABLE 52

PER CENT NET INCOME TO EQUITY, 665 SELECTED CANADIAN COMPANIES AND FOR 14 INDUSTRIAL GROUPS

1937 - 1947[a]

	1937	1938	1939	1940	1941	1942	1943	1944	1945	1946	1947
23 Pulp and Paper Companies	2.96	6.32	3.31	6.05	6.30	4.85	4.43	5.15	5.57	10.83	15.75
27 Electrical Machinery Companies	8.34	6.67	6.54	6.98	7.68	8.56	7.78	8.24	6.50	6.05	10.58
38 Gold Mining Companies	24.44	25.63	25.12	23.19	20.73	16.26	12.43	9.02	7.82	5.93	5.05
18 Non-Ferrous Metal Companies	23.53	15.62	18.57	17.69	18.65	17.61	16.02	13.16	12.64	14.73	20.44
49 Iron and Steel Companies	8.58	6.24	9.52	8.73	9.34	9.76	9.40	7.98	6.86	7.89	10.61
51 Machinery Companies	7.28	6.12	4.76	6.94	8.94	10.04	8.55	7.58	6.84	6.50	11.46
30 Chemical Companies	12.58	11.61	15.34	13.38	13.49	11.92	10.20	11.17	10.91	12.40	13.90
11 Petroleum Companies	15.33	14.90	13.93	11.53	10.60	9.84	10.73	10.44	10.88	11.73	12.41
64 Wholesale Trade Companies	8.50	6.15	9.16	9.23	8.97	9.10	9.09	7.99	8.87	12.19	13.12
32 Retail, Trade and Service Companies	7.26	7.07	8.42	7.73	8.89	9.27	9.28	10.33	10.59	13.86	13.86
23 Electric Utility Companies	4.11	4.02	4.00	4.12	4.37	4.88	4.87	4.56	4.63	5.12	5.15
46 Food Companies	6.76	6.72	10.93	7.89	8.35	8.80	8.41	8.41	7.48	8.23	9.91
15 Beverage Companies	13.63	10.89	11.81	9.41	12.40	13.77	12.31	14.04	15.46	21.09	16.94
27 Primary Textile Companies	5.78	4.07	9.63	8.26	9.03	9.58	7.48	9.07	7.97	7.92	10.24
Total 665 Companies	10.55	8.76	10.31	9.86	10.35	10.01	9.11	8.47	8.31	9.65	11.99

a) The tabulation includes all those companies with 1941 assets over $200,000 for which consistent reports were available from 1935 to 1947. The accounts of certain companies which were available in some or all of these years were not comparable throughout the period and had to be excluded. Since many of the companies report on a consolidated basis, the number of individual companies included in the sample is actually a good deal larger than indicated. The material is, of course, subject to all the limitations and qualifications which apply to the basic accounting statements. Fiscal year nearest to calendar years used.

Source: Bank of Canada, Ottawa.

in the past 10 years, attributable to greater volume as well as to greater unit profits. The latest figures for the primary textile companies and the statements produced before the Special Committee on Prices by some of the companies themselves, indicate a rate of return substantially higher than pre-war and a little higher than most war years.[1] One general reason for the higher rate of return in 1947 is, of course, reduced taxes on corporate profits.

TABLE 53

INCOME AND EXCESS PROFITS TAXES[a] PAID AS A PER CENT OF CORPORATE PROFITS LESS LOSSES

Year	Per Cent
1944	53
1945	53
1946	50
1947	47

a) The effective rate of tax in 1948 will be substantially lower than in 1947 because of the removal of the 15 per cent excess profits tax.
Source: Dominion Bureau of Statistics, Ottawa.

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 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. In certain cases this is also the situation with respect to manufactured goods.

Mr. H. R. MacMillan's testimony on this point is relevant:

> "Our company (H. R. MacMillan Company) felt it was not in the company's interest that the price of lumber to Canada should be advanced. We tried an experiment, and for a period of from something like two or three months, from September 15, onward, we refrained from allowing our prices to go to the level at which we were aware sales were being made by the industry at large, thinking possibly that if we sold at lower than the current prices the rise might only be temporary, and that we might have some influence on the market level, an influence in the interests of the consumers in Canada, or in those portions of Canada in which we were selling; but as has already been explained to you, I think our sales with the exception of relatively small quantities around the mill areas, that is, in Alberni, Chemainus and Vancouver, and solely to retailers and such buyers as the railroads and large industrial

[1]Evidence, Special Committee on Prices, p. 3837.

> corporations, we found that selling to the retailers at lesser prices than other mills in our producing area was having the effect of increasing the retailer's profit, without doing anybody any good, because he would buy from us for several dollars a thousand less than he was paying and ready to pay to others, and he was mixing our lumber with the lumber he bought elsewhere and selling it to consumers at the same price.
>
> Therefore after what you might call losing a sum of what we estimated to be from $75,000 to $100,000 in the pursuit of this ideal we ceased it and allowed our lumber to rise to the price level or almost to the price level—we were a little careful about that—and we allowed it to follow the price level established in the open market by hundreds of sellers and hundreds of buyers."[1]

Looking at corporate profits in general we find it difficult to say that exceptionally high profits have been a major cause of the rise in prices since the end of the war. Our examination of particular industries will be found in Volume III of this Report.

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 as Income for Spending

As was suggested earlier, profits may also affect prices through their influence on spending. They 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?

The Canadian Congress of Labour, through Mr. Eugene Forsey, argued as follows:

> "Undistributed profits, the Congress submits, are likely to have a disproportionately large inflationary effect, through their effect on the capital boom. They contribute directly to that boom; and by making their owners less dependent on the banking system, they make it harder for the banks to exert a restraining influence."[2]

The argument here, it will be noted, is not that profits have been too high, but that the retention of profits is more inflationary than their distribution as dividends. The validity of this argument which cannot be tested by the facts would seem to run as follows. 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

[1]Evidence, Royal Commission on Prices, p. 1523.
[2]Evidence, Royal Commission on Prices, p. 2119.

group, are likely at the present time to have a higher than average propensity to save and, therefore, would spend only a portion of the additional dividends they receive. Moreover, a high 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. As is pointed out in the chapter of this report dealing with the investment boom, 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.[1]

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, provided 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 of inventory profits, provide an incentive or support for labour to increase their demands for higher wages. In this way the higher profits have probably played an active part in the wage-price spiral. Even though the profits are partly fictitious, as in the case with inventory profits, this is not always taken into account and these stated profits may become the basis of demands for increased wages.

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[1]Cf. Chapter 5, The Investment Boom.

9

AGRICULTURAL PRICES

WHEN the war broke out, farm prices were low in relation to other prices, but since 1939, they have risen somewhat more than the general level of prices. The index number of wholesale prices of Canadian farm products increased about 122 per cent between the average for the year 1939, and October, 1948, while the general wholesale price index advanced 112 per cent for the same period. The largest increase in farm prices, 75 per cent, occurred between 1939 and 1945. Since then the index of farm prices has risen only 27 per cent. This is much less than the increase in most other price groups during this period. Most of the recent rise has been due to the higher prices for livestock and dairy products. The wholesale index of animal product prices has risen over 50 per cent in the last three years. On the other hand, the index of field crop prices is currently only about 10 per cent higher than it was in 1945. The more moderate rise of this group is partly due to a decline in vegetable prices, potatoes in particular. It also reflects the fact that the current market price for wheat is only partially included in the above index. If wheat were to be included at $2.05 per bushel, the current domestic and British contract price, the wholesale index of Canadian farm products for October, 1948, would be 6.6 per cent higher and the increase in farm prices shown by it since 1939, would be 137 per cent instead of 122 per cent as stated above.

The movement of farm product prices are a key factor in any inflationary period. The importance of food in our cost of living gives these prices a vital relation to the wage price spiral. Higher prices for farm products yielding higher incomes to the farmer may in turn lead to demands for higher wages on the part of the industrial worker. During the war higher prices to the farmer were paid to a substantial extent in the form of subsidies. This kept agricultural prices from being reflected on a higher cost of living at the time. But when many of these subsidies were discontinued at the end of the war the full impact of these higher returns to the farmer was passed on to the consumer.

The wide fluctuations to which farm product prices are subject make these relationships particularly important. The explanation of this lies partly in the nature of the agricultural industry and the way it adjusts to changed market conditions. The main features of Canadian agriculture and the part these have played in recent price changes are set forth below. During the past few years, the relation of the prices of farm products to the recent rise in prices has been affected by government price controls and subsidies, and by government marketing policies with respect to agriculture.

The Pattern of Canadian Agriculture

While the absolute level of agricultural production is increasing, its relative share of total production has been declining. The primary cause of this is the more rapid pace of industrial and mining development.

These trends became marked in the period between the two world wars. Since 1919, manufacturing and mining have assumed more dominant roles in the Canadian economy, especially in Ontario and Quebec. In 1919, agriculture was Canada's most important industry, contributing 44 per cent of the total net value of commodity production as compared with 33 per cent for manufacturing. By 1939, this position was almost reversed with manufacturing contributing over 40 per cent of the total as against 23 per cent for agriculture. This same trend is evident in statistics of national income. The following table shows that net farm income amounted to 17 per cent of our national income in 1926. By 1947, it had fallen to 11 per cent.

TABLE 54

RATIO OF NET INCOME OF AGRICULTURE TO NET NATIONAL INCOME AT FACTOR COST, SELECTED YEARS, 1926-1947

(millions of dollars)

Year	Net Income of Farm Operators from Current Production	Net National Income at Factor Cost	Ratio, Farm Income to Net National Income (per cent)
1926	691	4,078	17
1929	443	4,689	9
1933	98	2,387	4
1937	326	4,017	8
1939	461	4,289	11
1942	1,089	8,382	12
1945	971	9,772	10
1946	1,130	9,765	12
1947[a]	1,235	10,981	11

a) Preliminary.
Source: Dominion Bureau of Statistics, Ottawa.

In the twentieth century, agriculture has not absorbed all of the labour supply which grows up in rural areas. Because of the rapid mechanization of agriculture, particularly for field crops and the increased output per worker which has resulted from the use of more machinery, new farming methods and better varieties of grain and quality of livestock, and the relatively more rapid growth of industry, there has resulted a steady migration from rural to urban regions. This movement may be slowed up or reversed during periods of depression, but in time of high industrial employment like the present, it is resumed, sometimes becoming so rapid as to lead to complaints of a scarcity of farm labour. The movement from rural to urban areas has been accentuated by the increasing capital cost of farming operations. As agriculture becomes more mechanized, it requires more capital to start as an independent farm operator. Higher farm incomes make it somewhat easier to get started, though if the higher incomes become capitalized in higher land values, the difficulty may be enhanced.

Accompanying the decline in agriculture's relative position there has been a shift in the type of farm output. Livestock and its products have become increasingly important whereas grains have shown a relative decline. In 1926, farmers obtained one-half of their cash income from the sale of grains while sales of livestock, dairy products, poultry and eggs provided only 26 per cent of the total. By 1947, these proportions had been reversed. The marketing of grains contributed only 32 per cent of cash farm income in 1947, whereas receipts from the sale of livestock, dairy products, poultry and eggs made up 50 per cent of the total. Part of this is due to changes in relative prices. Prices of animal products have tended to increase relative to the prices of field products, chiefly because of the more rapid gains in productivity in the output of field crops. But it also reflects a shift in the type of output in response to a changing consumer demand. As incomes have risen, consumers have increased their consumption of the more expensive meats and dairy products at the expense of bread and cereals. The demand for fruits and vegetables has also risen and this is evidenced by the increased importance of fruits and vegetables as a source of farm income.

Farm prices are affected by two influences, domestic demand and export demand. With the increased importance of the industrial part of our economy, agriculture has become somewhat more dependent on industrial prosperity. Alternate periods of depression and prosperity as well as natural hazards, result in a high degree of instability in farm incomes. Net income of farm operators from current farm production fell from $693 million in 1928, to a low of only $98 million in 1933. By 1947, it was $1,235 million. These extreme fluctuations in farm incomes resulted partly from the sharp fall and rise in farm prices and partly from the variation in farm production arising from weather conditions. Crop failures and bumper crops often give a sharp year-to-year variation to the output of field crops. The resulting variation in feed supply may cause some fluctuation in the output of livestock and livestock products. But aside from this, farm production changes very slowly. Unlike industrial production the total amount of agricultural production varies little between periods of prosperity and depression, if the effects of climate are eliminated. In periods of depression industry releases many of its workers and restricts its production. At the same time, it often keeps its prices unchanged or allows them to fall only slightly. In contrast, the farmer continues to produce in the face of sharply falling prices for his product. His labour, including that of members of his family, will always yield some return. But continued farm production at a time when incomes and demands are dropping sharply in the city areas results in a severe drop in farm product prices. Since non-farm prices are much more stable the farmer finds himself forced to exchange his produce on much less favourable terms. This relationship is reversed during periods of recovery and prosperity. At such times farm prices usually rise rapidly as demand increases in urban areas. But once again, farm output may respond slowly to these increased demands and higher prices.

The instability of farm product prices not only makes farm incomes extremely variable, it also takes time for the farmer to adjust his output to changing market conditions. While in over-all terms and excepting for variations in output caused by the climate, farm production is quite stable, this is not true of any one product. Farmers may shift quickly from one type of field crop to another. Relative prices are an important guide to farmers. They help them determine which products are most urgently needed by the economy.

Canadian agriculture has long been dependent on the export market for the sale of a substantial part of its products. In 1947, the value of Canada's exports of farm products in raw or semi-finished form amounted to about 40 per cent of farmers' cash income. This represents a decline since 1929, when similar exports were 47 per cent of farmers' cash income. Of the total exports of farm products in 1947, almost 60 per cent consisted of wheat and wheat flour. In addition to wheat, dependence on the export market has been particularly marked for bacon, cheese, apples, tobacco and more recently eggs. Substantial export markets have also existed for cattle, concentrated milk, barley and beans. The export market is particularly important to the Prairie provinces, which depend so largely on the export of wheat as a source of income.

TABLE 55

EXPORTS AS A PERCENTAGE OF TOTAL SUPPLY SELECTED AGRICULTURAL PRODUCTS, CANADA, 1945-1948

(per cent)

Commodity	1945-1946	1946-1947	1947-1948
Wheat[a] (exports include wheat flour)	58.6	49.5	46.5
Oats[a] (exports include oatmeal and rolled oats)	9.1	6.6	3.5
Barley[a]	2.4	3.9	22.2
Potatoes	4.9	13.1	8.9
Hay (clover, alfalfa and grain hay)	1.1	.9	
	1945	1946	1947
Butter (total)	1.4	1.2	.8
Cheese (farm and factory cheddar and whole milk cheese)	58.7	57.6	37.0
Beef (exports include fresh, canned and processed products on a fresh basis, live animals exclusive)	16.9	12.4	4.9
Pork (as above for beef)	10.5	14.3	6.1

a) Exports include export clearances and imports into United States.
Source: Data from Dominion Bureau of Statistics, Ottawa.

Canada's major export market for agricultural products traditionally has been the United Kingdom. Following in importance have been the United States and various European countries. Table 56 indicates the relative importance of these markets.

TABLE 56

EXPORTS OF AGRICULTURAL PRODUCTS[a], CANADA, SELECTED YEARS, 1929-1947

(millions of dollars)

Year	United Kingdom	United States	Other Countries	Total
1929	235	125	211	571
1939	168	124	60	352
1945	464	483	271	1,218
1946	398	213	326	937
1947	471	160	384	1,015
1948	410	357	311	1,078

a) No adjustment for non-Canadian agricultural products.
Source: Dominion Bureau of Statistics, Ottawa.

The dependence on the export market adds a further element of vulnerability to farm incomes and prices. This has been emphasized during the past year. Traditional markets have been lost, or their purchases greatly reduced because of the shortage of dollars. The United Kingdom and other European countries have restricted their purchases of our farm products on this account. In some cases, continued purchases have been made possible through Marshall plan funds. But this arrangement is precarious since purchases in Canada may be interrupted whenever a product is declared surplus in the United States. Already flax and oats have been declared surplus and cannot be purchased in Canada with Marshall plan funds. For most products, sales on the domestic market or in the United States have been sufficient to offset the loss of European markets, but the future prospects for exports are a major uncertainty in the farm picture.

Wartime Development

In 1939, the wholesale index of Canadian farm product prices on a basis 1926=100 was only 64.3 in comparison with 75.4 for the general level of prices and 78.5 for the prices of commodities and services used by farmers. The depression of the 'thirties had slowed up the movement from rural to urban regions and as a result there was a substantial number of underemployed workers on Canada's farms. The burden of farm debt was still high and the farmers' stock of machinery had not been properly maintained during the 'thirties.

Following the declaration of war, there was an upward movement in farm prices in anticipation of greater demand. But when Germany overran the continent in the summer of 1940, and markets for Canadian wheat and feed grains in the invaded countries were lost, prices of farm products declined again. The wholesale price index of field products which was 97.5 in April, 1940, fell to 78.0 by August of the same year. Livestock price indexes remained relatively steady. From then on, under the influence of rising domestic demands and special contracts with the United Kingdom, wholesale prices of farm products moved upwards. By December, 1941, when the over-all price ceiling was imposed, wholesale prices of farm products had risen almost 23 per cent, over their level in September, 1939. Field product prices rose 18.0 per cent and animal product prices about 26.7 per cent.

Because it was recognized that the relative level of farm prices was still low, the wartime price stabilization program did not result in a freezing of prices received by farmers.[1] Price ceilings were applied to manufactured or processed farm products, but prices for most farm products were free to fluctuate within the limits allowed by this ceiling. Wheat was treated as a special case.[2] In this way the farmer was given the benefit of any trading advantage which might arise without increasing prices to the ultimate consumer. Administratively, it would have proven extremely difficult to establish ceilings on farm products. This policy also allowed supplies to flow freely from farmer to processor. Ceiling prices were applied in the case of farmers selling products directly to consumers through market stalls or by other methods. Farmers were considered to be retailers in such instances and could not sell products directly to consumers at prices any higher than the ceiling established for that district. Further upward adjustments were made at various stages throughout the war period.

With the disappearance of continental sources of supply for livestock and livestock products in 1940, and with the intensification of submarine warfare it became necessary for Canada to concentrate on farm products that were high in protein value relative to volume. Livestock and dairy products were given a high priority. At the same time, with the loss of several export markets for grains and as a result of two large crops the carry-over reached the point where storage space was filled to capacity. This situation made necessary sharp changes in the pattern of Canadian agriculture. Increased production of cattle and hogs was encouraged by the payment of a quality premium on hogs and an upward adjustment of the ceiling price on beef. Freight assistance on the shipment of feed grains to British Columbia and eastern Canada and the Wheat Acreage Reduction Act had similar effects. Under this latter act farmers, between 1941 and 1943, were given an incentive to increase their output of coarse grains and forage crops and reduce their output of wheat. Other programs fostered an increase in the output of flax, soybeans, fruits and vegetables, and dried beans and peas. For dairy products payment of subsidies on milk for fluid milk, for cheese, for concentrated products and for butter encouraged larger output and helped offset higher feed costs. Measures were also taken to keep farm costs from rising. Special subsidies on gasoline and the removal of custom duties from farm machinery allowed only a moderate increase in the prices of these commodities. Subsidy payments also kept feed cost at fairly constant levels after April, 1942, and kept fertilizer prices unchanged.

The result of this program was a large increase in the output of urgently needed livestock and livestock products. An unusually favourable crop of coarse grains in 1942, provided the feed required for a sharp expansion in

[1] See Chapter 8, Vol. II, Price Control and Rationing.
[2] See Chapter 2, Vol. III, Bread.

output. The increased output was needed to meet both the requirements of the United Kingdom and a greatly expanded domestic demand. The increase in production and exports of a number of major farm products are set forth in the following table.

TABLE 57

PRODUCTION AND EXPORTS OF SOME IMPORTANT FARM PRODUCTS, CANADA, WAR AND PRE-WAR YEARS

(millions)

		Average 1935-1939	1942	1943	1944	1945
Wheat[a]						
Production	bushel	312	557	284	417	319
Export[b]	bushel	181	215	344	343	343
Oats[a]						
Production	bushel	338	652	482	500	382
Exports	bushel	14	63	75	86	44
Barley[a]						
Production	bushel	89	259	216	195	158
Exports	bushel	14	34	36	39	4
Apples						
Production	bushel	15	13	13	18	8
Exports[c]	bushel	7	3	3	4	3
Pork						
Production	pounds	625	1,189	1,396	1,505	1,113
Exports[d]	pounds	184	538	589	719	463
Beef						
Production	pounds	704	823	893	961	1,156
Exports[d]	pounds	88	78	15	109	198
Eggs						
Production	dozen	220	281	316	361	374
Exports[e]	dozen	1	29	41	57	115
Cheese						
Production	pounds	120	207	166	182	186
Exports	pounds	80	142	130	131	135
Butter (Creamery)						
Production	pounds	255	285	312	299	294
Exports	pounds	7	2	9	5	6
Concentrated Milk						
Production	pounds	136	261	260	278	300
Exports	pounds	30	67	46	47	104
Fluid Milk						
Sales	pounds	2,880	3,388	3,706	3,912	4,008

a) Crop years beginning August 1.
b) Includes wheat as flour.
c) Includes fresh fruit equivalent of canned and dried apples.
d) Includes estimated dressed weight of animals exported alive.
e) Includes exports of dried eggs converted to fresh egg equivalent.
Source: Dominion Bureau of Statistics, Ottawa.

At annual conferences representatives of the Dominion, the provinces, and the farmers themselves, met and agreed on objectives for agricultural production during the coming year. To some extent the announcements of

these conferences were a mixture of objectives and forecasts, and prices were not always known at the time the objectives were determined. Farmers were encouraged to meet these objectives by means of educational campaigns, by price increases and by subsidy payments rather than by any direct regulations.

For a number of products the Dominion government negotiated long term contracts with the United Kingdom under which the United Kingdom contracted to take definite minimum amounts at agreed upon prices. Contracts for bacon, cheese, evaporated milk, eggs, flax fibres and a few other products were first negotiated early in the war. Successive agreements covering these products were maintained throughout the entire period and in many instances continue. In 1939, agreements were also reached covering the shipment of beef, mutton and lamb and in the post-war period contracts covering the shipment of wheat, fruits, vegetables and a number of other products were arranged. The prices under these agreements frequently became the effective domestic prices and were set with a view to encouraging the necessary expansion in production in Canada. Since costs, with the exception, perhaps of labour, were relatively stable, the farmer was able to plan his production more easily than he normally could under free market conditions with sharply fluctuating prices. This undoubtedly facilitated the achievement of Canada's wartime agricultural objectives.

Prices received by farmers moved upward throughout the war period. The index of prices received by farmers advanced 20 per cent between 1941 and 1942, increased a further 19 per cent by 1943 and nine per cent more by 1944. By the middle of 1943, this advance had restored a relationship to other prices similar to that enjoyed by farmers during the latter part of the 'twenties, a condition of prices which the Canadian Federation of Agriculture, in their evidence before us, considered favourable.[1] At the same time, the extensive use of subsidies kept most of these increases from being reflected in higher food prices to the consumer. Retail food prices increased only about 10 per cent between December, 1941, and August, 1945.

Aided by higher prices and increased output the financial position of Canadian farmers improved substantially during the war. Cash farm income increased from $722 million in 1939 to $1,695 million in 1945. Net farm income for the same period increased from $484 million to $981 million. This higher income led to a substantial reduction in farm debt. It is estimated that in the years between 1939 and 1944 farmers reduced their total indebtedness by approximately $326 million or by about 32 per cent. Each of the provinces showed a substantial reduction with the greatest decrease occurring in the prairies. Both the wartime gains in income and the reduction of indebtedness have continued in the post-war period. Though supplies were limited during the war, farmers were able to make additions to their machinery and equipment. Between 1939 and 1945 farmers bought well over $300 million worth of farm equipment and substantial additions have occurred during the post-war years. A further effect of the improved

[1]Evidence, Royal Commission on Prices, p. 2186.

financial position of farmers has been a rise in land values. In 1947, the average value of farm land was estimated at $35 per acre, an increase of approximately 40 per cent over 1939.

Post-War Development

When the war ended the demand for agricultural products was strong. The removal of the dangers to shipping, the re-opening of the continent and the loans extended to the United Kingdom and to other European countries by the Canadian government provided markets for Canadian farm products. Agricultural production in Europe and other parts of the world had been severely reduced because of the lack of machinery and fertilizers and the liquidation of livestock herds. At the same time the population had continued to increase and the food shortage in many areas was acute. Canadian exports of farm products were limited only by the supplies available and our willingness to restrict our own consumption.

Domestic demands were also high because of the increase in Canada's population of about eight per cent between 1939 and 1945 and because of high levels of income. Per capita incomes in the hands of the consumer had increased from $338 in the 1935-1939 period to $686 in 1945. While consumers in 1945 were spending about the same proportion of their income on food as they had in 1939, with the higher income levels prevailing this meant a substantial increase in the volume of food consumption. Data on per capita food consumption show that by 1945, the average Canadian was eating a good deal more meat, fresh fruits and vegetables and was using more fluid milk and cream. On the other hand, he was eating less cereals and about the same amount of potatoes. Consumption of both butter and sugar had been reduced below pre-war levels by rationing.

TABLE 58

SUMMARY OF PER CAPITA SUPPLIES MOVING INTO CIVILIAN CONSUMPTION IN CANADA, PRE-WAR AVERAGE, ANNUAL TOTALS, 1945-1947, ESTIMATE FOR 1948

(pounds per capita per annum)

Commodity	Pre-war	1945	1946	1947	Estimate 1948
Cereals, total (excluding starch)	206.0	200.2	219.2	165.9	183.1
Potatoes, white	192.3	186.3	198.5	161.6	175.4
Fruit, total (excluding non-citrus juices)	138.7	163.4	174.6	172.0	146.8
Vegetables, total	78.4	78.5	83.8	75.8	68.2
Milk, total milk and cheese	390.8[a]	523.0	519.0	510.5	500.7
fluid milk (sold and consumed)	3[illegible]7.3[a]	479.1	478.2	457.8	447.4
Meat, total[b]	136.8	167.6	167.3	166.1	164.5

a) Figures represent total of number of pounds of fluid milk and number of pounds of fluid cream (25 per cent butterfat). Data for subsequent years are weight of total fluid milk.
b) Estimated dressed weight.
Source: Combined Food Board, Washington, D.C. and the Dominion Bureau of Statistics, Ottawa.

Though the demand for farm products seemed assured for a year or two at least, there was little certainty beyond that time. The severe winter in Europe in 1946-1947 followed by a dry summer gave a sharp set back to the recovery of European agricultural production and prolonged the period of food shortages and high prices. Only now in late 1948 are there signs that world food stocks are beginning to approach more normal levels, even yet a crop failure in some major producing area such as the United States could further delay the end of serious food shortages.

Food contracts with the United Kingdom, similar to those first developed during the war, were negotiated in 1945 for the purchase of a major portion of Canada's export supply of bacon, beef, wheat and other products. It was hoped that the effect of these contracts would be to retain the stability of agricultural prices which had prevailed during the war.

On the supply side, when the war ended, Canadian agriculture had achieved a better balance than ever before. A big livestock and dairy industry had been built up which provided some hedge against the extreme dependence on wheat which proved so disastrous for agriculture in the 'thirties. The following table shows the increases among important agricultural commodities since 1941.

TABLE 59

INDEXES OF TOTAL SUPPLY OF SELECTED AGRICULTURAL COMMODITIES, 1945-1948

(1941 = 100)

Commodity	1945-1946	1946-1947	1947-1948
Wheat[a]	72.7	61.3	53.7
Oats[b]	136.6	127.7	99.1
Barley	153.7	147.2	140.4
Potatoes	103.4	122.6	114.9
Hay[c]	134.4	111.9	d
Sugar Beets	86.9	103.1	d
	1945	1946	1947
Butter[e]	97.0	90.5	98.8
Cheese[f]	129.2	103.6	84.2
Beef[g]	151.6	144.0	130.7
Pork[g]	103.4	91.5	90.6

a) Wheat flour included.
b) Oatmeal and rolled oats included.
c) Hay and clover, alfalfa and grain hay.
d) Data not yet available.
e) Creamery, dairy and whey butter.
f) Cheddar, farm and factory produced, whole milk cheese and other than cheddar.
g) Exports of live animals not taken into account in these calculations.
Source: Data from Dominion Bureau of Statistics, Ottawa.

A movement out of livestock production was already underway in 1945. The decline in the following years was particularly sharp in the prairies where much of the wartime expansion had taken place. Farmers, finding wheat production more profitable, shifted back rapidly to their former pattern of output. By the middle of 1948, the number of hogs on farms had fallen almost to the level in 1939, and was only a little more than half of the number on farms in June, 1943. Farm stocks of sheep and lambs had fallen below 1939 levels, though stocks of cattle were still about

13 per cent higher. Less favourable ratios between feed and livestock prices and smaller coarse grain crops undoubtedly played an important part in this decline, but the higher income that could be earned in producing wheat was also a factor.

Prices of farm products are determined in a competitive market and there is little that the individual farmer can do either to increase the price of the product he sells during a depression or to hold its price down in a period such as the present. Because of this, in the face of a strong export and domestic demand for food, the prices of farm products moved rapidly upward during the post-war period. The major factors affecting this movement were the rapid advance of prices in export markets, Dominion and provincial marketing legislation and the government program of price decontrol and subsidy removal. The effects of export prices were considerably modified by means of the export controls maintained and the food contracts negotiated with the United Kingdom. These are discussed in some detail below. The removal of subsidies and price controls affecting the prices of farm products was substantially completed during 1947, although some controls have been reimposed since that time.[1] The impact of this on Canadian price levels has also been assessed.

In considering both these factors it is necessary to keep in mind the conflict that exists between allowing higher farm prices and farm incomes and maintaining low food prices to the consumer. The conflict is not absolute. Some increases in farm income without a rise in domestic prices can be attained through controls which prevent domestic prices from rising to the higher levels on the export market.

The Food Contracts with the United Kingdom

The United Kingdom food contracts have been particularly important for livestock and dairy products. The minimum amount called for under the contracts and the actual shipments and prices for a number of important products are set forth in the following table.

As we have pointed out in our discussion on meats,[2] the domestic price for beef and pork has been largely determined during recent years by the price obtained in Canada's contracts with the United Kingdom. This is also substantially true for other farm products such as eggs and cheese. During the war years when Canadian production of most livestock and dairy products reached high levels, Canada succeeded in supplying the minimum amounts called for under the contracts, in some instances exceeding them. But with the decline in production at the end of the war, Canada frequently fell far short of supplying the amounts specified. In this situation, the contract prices have acted both as a ceiling and a floor on domestic prices. Any increase in domestic demand or reduction in domestic supply merely reduced the quantities shipped under the contracts. Because of this, prices could not rise above the contract prices. Nor could they fall below them as

[1] See Chapter 8, Vol. II, Price Control and Rationing.
[2] Cf. Chapter 4, Vol. III, Meat.

TABLE 60

CANADA — UNITED KINGDOM FOOD AGREEMENTS, BACON, BEEF, CHEESE, EGGS AND EVAPORATED MILK

Bacon		Nov. '39 Oct. '40	Nov. '40 Oct. '41	Oct. '41 Nov. '42	Nov. '42 Dec. '43	Jan. '44 Dec. '44	Jan. '45 Dec. '45	Jan. '46 Dec. '46	Jan. '47 Dec. '47	Jan. '48 Dec. '48
Contract	millions of pounds	291	426	600	675	900[a]		450	350	225
Shipments	millions of pounds	331	426	600	675	660	450	273	226	176
Price	dollars per cwt.	18.01	15.82	19.77	21.75	22.50	22.50	25.00[b]	27.00[c]	36.00
Beef						Jan. '44 Dec. '45		Jan. '46 Dec. '46	Jan. '47 Dec. '47	Jan. '48 Sept. '48[d]
Contract	millions of pounds					100		60	120	50
Shipments	millions of pounds					349		120	41	17
Price	dollars per cwt.					22.75		22.75	24.25	27.50
Eggs			April '41 Dec. '41	Jan. '42 Dec. '42	Jan. '43 Dec. '43	Jan. '44 Dec. '44	Jan. '45 Dec. '45	Jan. '46 Dec. '46	Feb. '47 Jan. '48	Feb. '48 Jan. '49
Contract	million dozen		13.8	38.1	57.0	50.4	50.4	83.0	83.0	74.0[d]
Shipments	shell dozen			4.1			42.0	54.2	58.1	36.3
	dried dozen		15.3	33.4	33.6	79.9	47.7	14.1	30.6	27.0[h]
Price	spring, cents per dozen		{24.4[e]}	28.8	35.0	35.5	39.0	{41.5[e]}	42.5[f]	47.5
	fall, fresh, cents per dozen			32.1			44.0		50.8[g]	54.2
Cheese		May '40 Nov. '40	April '41 Mar. '42	April '42 Mar. '43	April '43 Mar. '44	April '44 Mar. '45	April '45 Mar. '46	April '46 Mar. '47	April '47 Mar. '48	April '48 Mar. '49
Contract	millions of pounds	78	112	125	150	125	125	125	125	50
Shipments	millions of pounds	93	115	142	116	123	127	92	56	32.3
Price	cents per pound	14.	14.4	20.	20.	20.	20.	20.	25.	30.
Evaporated Milk		July '40 Mar. '41	April '41 Mar. '42	April '42 Mar. '43	April '43 Mar. '44	April '44 Mar. '45	April '45 Mar. '46	April '46 Mar. '47	April '47 Mar. '48	
Contract	thousand cases	1,050	658	668	300	300	300	600	600	
Shipments	thousand cases	709	644	668	301	300	704	611	600	
Price	cents per case	3.75	4.13[j]	4.45	4.75	4.81	4.81	4.95	5.85	

a) Two year contract.
b) Raised from 22.50 April 1, 1946, and in effect until Jan. 11, 1947.
c) Raised to 29.00 Sept. 1, 1947.
d) In September, 1948, the beef contract was cancelled and the egg contract was revised downwards from 83,000,000 dozen.
e) Flat price.
f) 41.0 cents from Feb. 1–May 4, 1947, and 42.5 cents from May 5.
g) 47.8 cents from Feb. 1–May 4, 1947, and 50.8 cents from May 5.
h) Dried and frozen.
j) Eastern ports.

Source: Dominion Department of Agriculture, Economics Division, Ottawa.

long as supplies were not sufficient to fill the contracts. Canadian producers could always sell to the United Kingdom any supplies which were not absorbed by the Canadian market. Although the rise in contract prices was responsible for the increase in domestic prices of many farm products, there is reason to believe that domestic prices might have gone much higher if sales on the export market had been completely free. Prices for most farm products in the United States market remained appreciably above Canadian prices from the termination of price controls in the United States in July, 1946, until very recently. The comparative levels of prices in Canada and the United States for a number of major products are indicated in the following table.

TABLE 61

PRICES OF IMPORTANT FARM PRODUCTS, CANADA AND THE UNITED STATES, SELECTED DATES

(dollars)

		August, 1939	August, 1945	January, 1947	January, 1948	August, 1948	December, 1948
CANADA							
Wheat, No. 1 Northern, Lakehead							
Commercial export	bushel		1.55	2.276	3.258	2.423	2.413
United Kingdom contract	bushel		1.55	1.550	1.585	2.035	2.05
Domestic to Millers	bushel	.549	1.25	1.250	1.585	2.05	2.05
Initial Payment to Producers	bushel	.70	1.25	1.35	1.35	1.55	1.55
Barley No. 1 Feed Lakehead	bushel	.323	.648	.648	1.285	1.075	1.075
Oats No. 2 C. W. "	bushel	.273	.515	.515	.966	.779	.795
Rye No. 2. C. W. "	bushel	.376	1.538	2.583	4.150	1.595	1.541
Flax No. 1 C. W. "	bushel	1.299	2.750	2.750	5.000	4.836	4.000
Steers, Yard, Toronto	cwt.	6.27	11.70	13.36	15.21	22.42	21.30
Hogs, B 1, Dressed, Toronto	cwt.	7.85	18.70	21.71	28.10	33.28	30.70
Eggs A-Large, Montreal	dozen	.318	.499	.423	.479	.661	.503
Cheese No. 1, "	pound	.130	.206	.275	.413	.383	.373
Butter, No. 1, "	pound	.228	.367	.420	.695	.705	.705
Fluid Milk, Toronto	cwt.	2.098	2.80	3.45	4.00	4.05	4.05
UNITED STATES[a]							November, 1948
Wheat No. 1, Dark Northern Spring, Minneapolis	bushel	.72	1.877	2.168	2.999	2.198	2.346
Barley No. 2 Malting, Minneapolis	bushel	.368	1.412	1.839	2.754	1.518	1.601
Oats No. 3 White, Minneapolis	bushel	.310	.634	.781	1.331	.672	.790
Rye No. 2, Minneapolis	bushel	.455	1.634	2.841	2.774	1.568	1.722
Flax		(not available)					
Steers, good to choice, Chicago	cwt.	9.307	18.923	26.531	34.188	34.450	34.30[b]
Hogs, heavy butcher good, Detroit	cwt.	5.777	16.299	22.894	26.500	28.525	23.185
Eggs, 1 and 2 large boxed, Boston	dozen	.175	.503	.470	.512	.573	.658
Cheese, whole milk, f.o.b. Chicago	pound	.135	.278	.410	.453	.466	.359
Butter, creamery 92 score, Chicago	pound	.236	.453	.657	.836	.748	.630
Fluid milk, f.o.b. country, Chicago	cwt.	1.638	3.626	4.567	4.962	5.261	4.377

a) Converted to Canadian dollars.
b) Average of good and choice.
Source: Dominion Bureau of Statistics, Ottawa.

Throughout most of the post-war period Canadian prices were prevented by means of export restrictions from rising to the levels prevailing in the United States. The embargo on exports of beef and cattle was removed in August, 1948, and this was immediately followed by a substantial advance in cattle and beef prices in Canada. Even before the removal of the embargo, prices had moved upward in anticipation of such a step. Within the last few months the disparity between Canadian and American prices for farm products has begun to disappear and prices across the line are now lower than in Canada for pork and a few other farm products.

The wheat contract with the United Kingdom covering the period 1945 to 1949, provided that the United Kingdom should purchase a minimum of 160 million bushels in each of the first two years at a price of $1.55 per bushel, and a minimum of 140 million bushels in each of the two final years. In the last two years of the agreement, prices were to be reached by negotiation but floor prices of $1.25 and $1.00 per bushel were guaranteed. The price actually reached in the final two years was $2.00 per bushel. In addition provision was made for some readjustment if the contract price in the first two years was substantially below the market price. As we pointed out above at the time this contract was reached, it was expected that the post-war food shortage and period of high farm product prices would be comparatively short. As a result, Canada has been selling wheat under this contract at prices substantially below world levels throughout most of its duration.

Sales of wheat in the domestic market have also been at a price substantially below the commercial export price. The price up to February 17, 1947, was $1.25, thereafter it was $1.55 until August 1, 1948, when it was raised to $2.00 per bushel. The most recent increase was absorbed on the domestic market by a subsidy of 45 cents per bushel, instituted to prevent a rise in bread prices. The lower prices for wheat provided under the United Kingdom contract did not directly affect prices on the domestic market. Indirectly it is possible there may have been some effects. A higher price for wheat throughout this period might easily have caused a greater transfer from the production of oats and barley to production of wheat. With less oats and barley for livestock feed there would have been more upward pressure on the prices of these products and in turn on all livestock and dairy products.

Wheat Marketing Arrangements

Since 1943, wheat marketed in western Canada has been handled by the Canadian Wheat Board. Before that, farmers had the option of delivering their wheat to the Board or selling it on the open market. Farmers are paid an initial payment when the wheat is delivered and in addition receive a participation certificate which entitles them to participate in proportion to their deliveries in any further earnings of the Board. Any losses incurred by the Board are absorbed by the Dominion government and become in effect a subsidy to wheat farmers. Until 1945, in the determination of these earnings or losses, deliveries and sales for each crop year were kept separate. Beginning in 1945, and for the period of the wheat contract with the United Kingdom from 1945 to 1949, deliveries and sales for this four year period have been pooled and earnings or losses will be calculated on the period as a whole. In the early years of the war many of the crop accounts incurred substantial losses and the Dominion government paid subsidies to western wheat farmers amounting to about $12 millions. However, since 1941-1942, the selling price has substantially exceeded the initial delivery price.

Under arrangement covering the period 1945 to 1949 the Canadian Wheat Board has twice raised the initial delivery price, first from $1.25 per bushel to $1.35 per bushel and then to $1.55 per bushel. This increase was made retroactive for all deliveries up to that time and as a consequence substantial additional payments were made to the farmer. Throughout the period of the current contract the Canadian Wheat Board has been accumulating substantial earnings which ultimately will be paid to the farmer. It would appear that $160 millions of undistributed earnings were accumulated during the three years 1945 to 1947 and a further accumulation has occurred during 1948.

Provincial Marketing Legislation

Most of the nine provinces in Canada have marketing legislation authorizing the establishment of marketing boards with power to regulate the movement and the minimum prices of the majority of farm products. The provinces of Ontario, British Columbia and Nova Scotia are most active in this respect and dairy products, fruits and vegetables have been the chief products affected.

Fluid milk control agencies have been set up in all provinces of Canada and, while the type of control differs in the various provinces, the method of operation and the powers of the agencies are very similar. All provincial agencies have the power, under their control legislation, to inquire into all matters pertaining to the fluid milk industry. Milk control operates in those areas defined by the provincial boards and while all boards have the authority to bring any area in a province under control, in most provinces the controlled areas are confined to the larger urban centres in the provinces. Prices for milk in these areas may be established at both the consumer and producer levels.

The marketing arrangements for most other products vary as to coverage of commodities, scope and responsibility. Because Ontario is the most active province in the field of provincial marketing boards, we will briefly outline its program. The Farm Products Marketing Act of that province provides authority for the Minister of Agriculture to approve the operation of the marketing projects and a Board is appointed to supervise them.

Marketing plans are the legally constituted means for collective bargaining and regulating the sale of designated farm products. Each scheme must provide a definite program of marketing activities and must be supported by a vote by ballot showing that a fairly representative number of growers concerned are in favour of the arrangement.

Each scheme is administered by a local board of growers. Subject to approval, each local board is empowered to negotiate and conclude agreements respecting minimum price, premiums, discounts, forms of contracts and conditions of sale for the product or products subject to regulation under the scheme. The minimum prices and terms of contract established each year are floors, below which no processor may go in purchasing his supplies.

Decontrol and Subsidy Removal

For farm products most price ceilings and subsidies were removed during 1947. The first important foods to be decontrolled were fresh fruits and vegetables which, with the exception of apples, were released from control on January 13, 1947. Ceiling prices were lifted on shell eggs on April 2, 1947, to help stimulate production to meet export commitments. At the same time price controls were removed from turkeys, geese and ducks, followed in June by dairy products, fresh apples, chickens, some of the less important canned fruits and vegetables and most jams and jellies. On July 1, tea, coffee and bakery products were decontrolled. Then on September 15, ceiling prices were lifted on flour, bread, prepared cereal products, rice, corn and corn products, beans, peas, canned pork and beans, the remaining jams and jellies and most of the remaining canned fruits and vegetables. Decontrol of meats and feed grains followed on October 22. By that time, the only products of agricultural origin still under control were sugar, molasses, the principal oil-producing crops such as flax seed, sunflower seed and rapeseed and the more important oils and fats.

In most instances, the removal of ceiling prices was preceded or accompanied by the termination of the subsidy payments affecting various foods. The major subsidies removed during 1947, were those on wheat used for milling, on butterfat for creamery butter, and on milk used for cheddar cheese.

Subsidies in the form of freight assistance on feed grain shipped to eastern Canada and British Columbia, hog premiums and assistance in the transportation of lime were continued into 1948.

Events in late 1947 and early 1948 led to the restoration of some price controls and subsidies. In other instances further decontrol occurred. Sharp fluctuations in the prices of fruits and vegetables following the imposition of import restrictions applied in November, 1947, as part of the foreign exchange conservation measures, led to the reimposition of ceiling prices on the more important canned fruits and vegetables, and mark-up control on canned citrus fruit juices, citrus fruits, grapes, cabbages, carrots and imported new potatoes. Butter also was brought back under price control in January, 1948, as were wheat, flour and bread much later in the year. As was pointed out above, a subsidy of 45 cents a bushel on wheat sold to the millers for domestic use was instituted in August, 1948, to offset an increase of that amount in the domestic price. On the other hand, lard, shortening, soap, and oils and fats used in their production were decontrolled at the end of July.

The process of decontrol may be said to have facilitated rather than to have caused the increase in prices during this period. With the removal of subsidies, an upward price adjustment was inevitable. It could have been avoided only by a reduction in the return to the farmer. There was instead some increase in prices received by the farmers which, coupled with the removal of subsidies, led to a sharp advance in food prices. Retail food prices advanced over 22 per cent during 1947, and increased a further 14 per cent in 1948. For many products the prices established during this period were the result of the adjustment of demand and supply in a free market. However, as was indicated above, for a number of important products the prices established in export contracts with the United Kingdom and the limitation imposed on exports to the United States were important determining factors. Even yet for such important products as butter, flour and bread, prices in Canada have been kept below the levels that would have prevailed in a completely free market.

Both in the United States and Canada there is a large body of opinion in favour of moderating the cyclical swings in agricultural prices. It may not be entirely wise to allow the prices of farm products to be determined completely by the play of a free market. As we have noted above farm prices tend to fluctuate more than the prices of any other products over the business cycle. Many farmers and farm groups believe that the farmer's position would be improved by the introduction of more stability into farm prices.[1] Under the Agricultural Prices Support Act, prices of farm products may be supported through the Agricultural Prices Support Board. The Act, which applies to all farm products except wheat, sets forth the following broad principle for the guidance of the Board in making its recommendations regarding price levels.

> "In prescribing prices . . . the Board shall endeavour to ensure adequate and stable returns for agriculture by promoting orderly adjustment from war to peace conditions and shall endeavour to secure a fair relationship between the returns from agriculture and those from other occupations."

Under the Act the Board may buy agricultural products at defined prices and sell them again. If the Board sustains operating losses in supporting the prices of farm products these losses can be made up by annual votes of Parliament. If the Board makes operating profits these will be paid over annually to the Receiver General, to be added to government revenue. Thus far the only farm products whose prices have been supported under the Act are potatoes and apples.

[1]This attitude was expressed in the address of the President to the annual meeting of the Canadian Federation of Agriculture in Brockville in 1948. "Canadian farmers have never been advocates of high 'prices' and are not so today. Their policy has been one of farm prices in a proper balance with those of other major groups in the nation and preferably on a moderate level. This has been the policy of the Canadian Federation of Agriculture. Moreover, last May at the farmers' conference in The Hague, it was adopted unanimously as to the policy of the farmers of the world organized internationally. They declared themselves in favour of prices in world trade which are fair to producers and consumers alike. And their first consideration was to find and support the best possible method of stabilizing prices of staple food products entering extensively into world trade within a range which would prevent them from dropping so low as to ruin producers in exporting nations or of rising out of reach of consumers in importing nations."

In judging the effects which the post-war course of farm product prices has had on the relative income position of the farmer it is common practice to make a comparison between the prices of the goods and services the farmer buys and the prices of the products he sells. In a brief presented before us by the Canadian Federation of Agriculture, it was suggested that the period 1925 to 1929 was one in which our economy was pretty well in balance and that this period should be taken as a base of reference for comparing these two sets of prices. It is then suggested that if prices of farm products have increased more, or decreased less, since 1925-1929 than the prices of the goods and services that farmers buy, the farmers' position has improved. If the reverse is true the farmers' position has deteriorated in relation to his position in 1925-1929. The ratio between these two sets of prices is often called a parity price level.

Although we recognize that there should be an equitable relationship between the income of the farmer and the return to other groups in equivalent positions in the economy, it is our opinion that caution must be observed in dealing with the principle of a parity price level. The circumstances under which a parity price is established can easily change. Any price should reflect the cost or efficiency with which a commodity is produced. If there are marked improvements in the efficiency with which a commodity is produced and if the benefits of these improvements are passed on to the consumer through competition there will be a fall in the price of the commodity. An improvement of this type seems to have taken place in the production of rayon yarn and wholesale price of this product is now only 63.6 per cent of its level in 1926, even though the general index of wholesale prices has increased by almost 60 per cent over this period. But this has not meant any deterioration in the position of producers of rayon yarn. The same is true of farm products. Where improvements in farming methods or new varieties of grain make it possible to produce certain farm products more cheaply than formerly this benefit can be passed on to the consumer in the form of a lower price without any deterioration in the farmers' income. In general, improvements in the efficiency of production over the past 20 years seem to have been greater for field products than they have for animal products. The disparity between these two indexes has become progressively greater since 1926. Yet no one would suggest that because of this, livestock and dairy farmers have been much better off than farmers who raised field crops.

Whether improvements in techniques will cause an index of all farm products to fall more or less over a period of years than an index of the prices of goods and services purchased by farmers is difficult to predict. But there is no reason to suppose that the two indexes will be equally affected. For this reason it is difficult to see how this comparison over a long term of time can offer any valid measure of the changing fortunes of the farmers.

Over short periods of time changes in productivity are unlikely to be important and the relative movement of these two indexes provides some measure of the change that has occurred in the farmers' relative position.

Since 1939, the farmers' price position has improved substantially. By late 1948, prices received by farmers had increased 174 per cent since 1939, whereas the cost of goods and services farmers buy had risen only 90 per cent. Some of this improvement is undoubtedly due to the depressed level of farm prices in 1939. Since 1945, prices of farm products have increased slightly more than the prices of commodities and services purchased by farmers. The first index went up about 39 per cent, the second a little less than 35 per cent.

The amount of income received provides another basis for judging the relative position of the farmer. During 1947 Canadian farmers received an average of $1,870 from their current farm production. This was just slightly less than the average salary and wage income of $1,910 received by paid workers in both agricultural and non-agricultural employment. As a result of the sharp rise in farm prices during the current year farm incomes in 1948 will be substantially higher than this. While data indicate that the average farmer is receiving very modest returns this does not mean that many farmers are not making very high returns. In the 1941 census of agriculture, 28 per cent of our full time farms, classed as subsistence or combination of subsistence farms, produced only eight per cent of the total commercial product sold off all farms. If this group of farms could be excluded, the average for the remaining farms would be much higher.

Summary and Conclusions

What part then can we say that agriculture has played in causing the recent rise in prices? Prices of farm products have risen less since 1945 than the prices of most other groups in the wholesale index. Yet because the cost of food is of such vital concern to almost every Canadian the recent rise in farm prices has received a good deal of attention. In part, this arose from the sudden removal of subsidies which kept food prices down during the war. Because of this the advance in retail food prices has been greater than the rise in farm product prices since the end of the war.

In general we have found that farm prices moved upward in response to the acute world shortage of food, a shortage that was an inevitable aftermath of the war. Canadian farmers themselves could do little either to avoid or moderate this rise. But to some extent the rise was moderated by the food contracts negotiated with the United Kingdom by the Canadian government. Both these agreements and the restrictions that were placed on the export of farm products to the United States 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. If Canadian food prices had risen to higher levels it seems likely that industrial workers would have sought and obtained higher wages to compensate for the greater rise in the cost of living.

To the farmer the higher prices for his product have meant higher incomes both gross and net. When the war broke out farm product prices were unusually low and the farmer's position was relatively unfavourable. Since that time, farm incomes have improved considerably.

10

MARK-UPS AND MARGINS

THE primary purpose of this chapter is to analyze the effect of mark-ups and margins in the distributive trades on prices paid by consumers in a period of rising prices. Throughout our inquiry we paid particular attention to the problem of margins and mark-ups and many references to this important topic appear throughout the evidence.[1]

It ought, perhaps, to be mentioned at the outset that the statistical information available to us on the subject was not very complete. Therefore, apart from our own evidence and that of the Special Committee the statistics appearing in this chapter are not as current as we would have wished.

It is in the price he has to pay that the average consumer comes in contact with the system of distribution; the spread between the cost of production and the retail price of consumer goods is thus a matter of some significance to him. It is important to note, however, that the price spreads represent more than simply the distributors' profits and that a small spread does not necessarily indicate efficiency in distribution. "In many lines of trade, 30 or 40 per cent of the price received by the retailer is paid out for wages, salaries, rent and other operating expenses; and most of the remainder represents the cost of goods sold, so that the retailer retains as profit only a few cents out of what the consumer pays."[2] However, our chief concern is with the effect on the retail price paid by consumers of changes in the "dollar and cent" spread following changes in the prices paid by retailers for merchandise they sell; and, in particular, in a period of rising prices. In brief, we are not so much interested in the reasons for the spread as we are in changes in the spread and the reasons or justifications for these changes.

As a preliminary to the analysis of this problem, we must first give precise definitions of a few terms that are used in the manufacturing and distributive trades and these are set out in the following paragraphs.

The majority of terms used in this survey are common to every day business activity and only a few warrant formal definition.

Some Definitions

In the distributive trade the term "mark-up" means the amount which is added to the cost price to determine the selling price. The mark-up is usually expressed as a percentage of the cost or of the selling price.

Frequently a wholesaler or retailer is unable to sell his merchandise at the original selling price, and in order to move the merchandise, he is forced to reduce the price. The amount of the reduction that he makes is called a "mark-down" and is commonly expressed as a percentage of the selling price.

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[1]See general discussion in Report of the Distribution Costs Commission, Union of South Africa (The Government Printer: Pretoria, 1947), p. 3.
[2]"Does Distribution Cost Too Much?" The Twentieth Century Fund (New York, 1939), p. 23.

The rate of stock-turn is the number of times the average inventory is sold during a given period, usually one year. The stock-turn rate may be computed under conditions of fairly uniform prices, by dividing the average inventory at selling price into the net sales. The resulting figure perhaps might be distorted in periods of changing prices.

Obviously the mark-up placed on goods is influenced by the distributor's opinion of the stock turnover he can expect when various prices are asked. There is a definite relationship then between the mark-up and the rate of stock turnover.

For purposes of our treatment of margins and mark-ups, net sales will be accepted and used throughout as the base, or 100 per cent, in order to relate all factors to this one common base, net sales.

Some Considerations on Mark-ups

In actual practice, the retailer or wholesaler does not add the same mark-up to all his goods. There are several reasons why varying mark-ups are used. In the first place, the competition on some items may be too strong to allow the retailer to get his desired average mark-up. Again, some goods, such as style goods, are so subject to mark-downs that they are unprofitable unless the initial mark-up is very high. Moreover, it costs more to sell some goods than it does others; they may require more display, more of the sales person's time, and more advertising. A mark-up higher than the average is needed to offset this higher cost. Hence, the actual price established for any article of merchandise may vary considerably from that indicated by the application of an average mark-up percentage.

The retailer, or wholesaler, endeavours to set up some average mark-up as the goal for his total operations but he tries to adjust his mark-ups on various items of merchandise so as to maximize his total net income. The result is that mark-ups on specific items may be in a process of constant adjustment in an effort to reach this goal.

One of the most common fallacies connected with distribution is to compare the mark-ups, or margins, taken on different goods and to assume that in those cases where the mark-up is relatively low the distribution is more efficient; or, to put the matter another way, to assume that in those cases where the mark-up is relatively high that it is "too high". For example, the margin on fresh fruits is considerably higher than the margin on sugar. However, the special circumstances attached to the distribution of fresh fruits, for example perishability, are absent in the case of sugar and necessitate the taking of a higher margin on fruits.

The Marketing Structure in Canada

The cost of distribution accounts for the "spread" between the price the producer receives and the price the consumer ultimately pays. For this reason, we will give a brief description of the marketing institutions in the various channels of distribution in Canada and examine the functions they perform.

First, let us ask: What is distribution? Distribution includes all the intermediate steps such as transportation, storage, merchandising, financing and advertising involved in getting the goods from the manufacturer's factory door to the ultimate consumer. For our purposes we will adopt this definition of distribution but we shall concentrate our attention more on the specific spreads between manufacturer and wholesaler and between wholesaler and retailer.

Distribution, like production, has been undergoing marked changes in recent years with the result that the distributive methods of today are considerably different than they were, say, at the outbreak of World War I. It is not our concern here to discuss these changes but we might note in passing that the principal changes have centred around the growth of large-scale merchandising outlets such as department stores, chain stores, supermarkets and the growth of direct selling to retailers by manufacturers. Both of these developments have tended to bring about a decline in the relative importance of the wholesaler and to reduce the volume of business of the so-called independent retailer.

Wholesaling in Canada

The limits of the wholesale field are not easily defined because manufacturers perform many of the functions usually attributed to wholesalers and there is considerable interchanging of the marketing functions among the various other organizations in the marketing structure.

It is, however, more convenient to consider the services performed by the wholesaler as twofold: (i) services to the retailer and (ii) services to the manufacturer. The services performed by the wholesaler were explained in part by Mr. J. V. R. Porteous, the president of Greenshields-Hodgson-Racine Limited:

> "It, (wholesaling) reduces the effort the retailer has to spend on buying and leaves him free to look after the other ends of his business.
>
> "In order to give you an example of what that actually means, I should like to go back to my own business for a moment. We analysed for our own satisfaction certain shipments that were going out of our warehouse. I have one shipment that amounted to $610. In that shipment we had the products of fifty-three manufacturers. That averaged $11 per manufacturer. I think that more or less explains itself. If you care to break that down and figure how much time you would have to spend to interview the representatives of fifty-three manufacturers, buy an average of $11 a piece and then have fifty-three shipments coming in, then have fifty-three drafts through the bank and so on and so forth, you realize that it would be an impossible burden on some of the smaller retailers. They simply would not be able to cope with it. That is one shipment."[1]

[1]Evidence, Royal Commission on Prices, p. 902.

For the retailer the wholesaler acts as "buying agent", anticipates retailers' demands, maintains effective contacts with sources of supply, performs the storage function and aids materially in financing by giving direct aid to the retailer or by offering quick delivery so that the retailer may keep a smaller inventory on hand. In turn, the wholesaler acts as the "selling agent" for the manufacturer and performs many of the essential functions in the marketing process.

Although there is a great variation among the classifications of wholesalers as to the functions performed, it is the performance of these essential services which justifies the spread, or margin, to give the wholesaler a profit after meeting the expenses incurred.

Operating Expenses of Wholesale Establishments

As noted, the operating expenses of wholesale establishments are largely dependent upon the extent of services performed. Table 62 indicates the operating expenses of wholesale establishments as reported to the Census of Merchandising and Service Establishments at the time of the 1941 Census.

TABLE 62

OPERATING EXPENSES OF SELECTED WHOLESALE ESTABLISHMENTS BY TYPE OF OPERATION, CANADA, 1941

Type of Operation	Operating Expenses (per cent of sales)		
	Total	Salaries and Wages	Other Expenses
Wholesale Merchants	11.28	5.65	5.63
Voluntary Group Wholesalers	10.24	4.73	5.51
Export Merchants	3.48	1.31	2.17
Import Merchants	11.72	5.58	6.14
Drop Shippers and Desk Jobbers	3.01	1.11	1.90
Wagon Distributors	12.32	4.23	8.09
Manufacturers' Sales Branches (with stocks)	8.99	4.02	4.97

Source: Census of Canada, 1941: Volume XI, p. 184.

The data in Table 62 indicate that the operating expense ratios vary from 3.01 per cent to 12.32 per cent according to the variation in the marketing functions performed by the wholesalers.

Table 63 shows the operating expenses of wholesale merchants for some selected trades.

The percentage of operating expenses to sales for the selected trades shown in this table varied from a low of 7.45 to a high of 40.31 per cent. Wholesalers handling staple goods such as tobacco, groceries, and food products tended to have the lowest operating expense ratios. On the other hand, high operating expenses were reported for wholesalers dealing in optical goods, paint, glass and wallpaper, and leather goods.

TABLE 63

OPERATING EXPENSES OF WHOLESALE MERCHANTS FOR SELECTED KINDS OF BUSINESS, CANADA, 1941

Kind of Business	Operating Expenses (per cent of sales)
Drugs and Drug Sundries (general line)	11.16
Clothing and/or Furnishings (general line)	13.56
Dry Goods (general line)	14.18
Fruits and Vegetables	9.71
China, Glassware, Pottery	26.47
Groceries (general line)	7.69
Hardware (general line)	14.52
Leather Goods	22.84
Paint, Glass and Wallpaper	26.61
Tobacco and Confectionery	7.45
Optical Goods	40.31

Source: Census of Canada, 1941: Volume XI, p. 180.

Operating Expenses and Mark-ups

The relation between operating expenses and mark-ups is obvious. In actual practice the wholesaler does not mark up each article he sells at a uniform mark-up but he will endeavour to obtain an average mark-up that will yield him the desired profit. In determining the mark-up operating expenses will be an important factor.

Retail Trade in Canada

Of the $3,668 million of retail trade transacted in Canada in 1941 Census year, $3,441 million was transacted through retail stores. These retail outlets are broken down into 10 broad classifications and their relative importance is shown in Table 64.

TABLE 64

DISTRIBUTION OF TOTAL RETAIL STORE SALES BY KIND-OF-BUSINESS GROUP, 1941

Group	Sales (thousands of dollars)	Per Cent of Total
Food Group	786,247	22.9
Country General Stores	214,748	6.2
General Merchandise Group	525,971	15.3
Automotive Group	594,720	17.3
Apparel Group	295,212	8.6
Building Materials Group (including Hardware)	174,203	5.1
Furniture, Household, Radio Group	118,357	3.4
Restaurant Group	131,181	3.8
Other Retail Stores	589,193	17.1
Second-hand Group	11,070	0.3
Total	3,440,902	100.0

Source: Census of Canada, 1941: Volume X, p. xix.

In common with many other countries, large scale merchandising in Canada has followed two main lines of development, the large individual establishments, particularly the department store type, and the "horizontal integration" development involving the growth of multiple organizations of which the chain stores are the outstanding example. In spite of the important part played by these developments, the independent stores still conduct the bulk of the trade, approximately 70 per cent in 1941, yet there is a marked concentration of retail sales in Canada in the larger stores. For example, according to the Census of Merchandising 43,292 stores with annual sales of less than $5,000 constituted 31.6 per cent of all retail outlets yet only accounted for 2.9 per cent of the total retail sales. On the other hand, there were 413 stores each with annual sales of $500,000 or more and while constituting only 0.3 per cent of the total of retail outlets these transacted 19 per cent of the total retail trade.

Operating Expenses of Independent Stores

The Census of Merchandising obtained at the time of the Census the operating expenses of independent stores. These operating expenses include the following items: (i) the value of proprietor services; (ii) salaries and wages paid to employees; (iii) rentals of property used for business purposes; and (iv) a total figure for all other operating expenses. The cost of merchandise purchased, however, was not obtained by the Census; hence, the data do not permit a computation of the gross margin obtained or the net profit or loss. Nevertheless, the operating ratios are useful as a guide in showing the variations in these items for the different types of independent retail stores.

TABLE 65

OPERATING EXPENSES OF INDEPENDENT STORES FOR SELECTED KINDS OF BUSINESS, 1941

Kind of Business	Operating Expenses (per cent of sales)
Millinery Stores	45.2
Restaurants and Cafeterias	43.7
Jewellery Stores	35.9
Paint, Glass and Wallpaper Stores	34.9
Children's Wear Stores	29.4
Household Appliance Stores	29.0
Women's Ready-to-Wear Stores	27.9
Department Stores	27.9
Furniture Stores	27.2
Variety Stores	26.6
Family Shoe Stores	26.5
Drug Stores (without soda fountain)	26.3
Men's Furnishings Stores	25.8
Hardware Stores	23.7
Lumber and Building Materials Stores	22.7
Fruit and Vegetable Stores	21.3
Grocery Stores (without fresh meats)	17.9
Combination Stores (groceries and meats)	16.7
Country General Stores	15.0

Source: Census of Canada, 1941: Volume X, p. 433.

From Table 65 we see that grocery stores, combination stores and country general stores have relatively low operating expenses. The low expense ratios in these stores are explained by the following factors: rapid turnover of stock, the stability of demand for staple food products, the small selling effort required, and moderate rentals. On the other hand, the highest expense ratios were reported in millinery stores and restaurants in which alterations, processing or manufacturing play an important part. The operating expenses of other stores shown in Table 65 fall in varying degrees between these extremes.

There is, moreover, a variation in the operating expenses in relation to sales as the size of the business increases. Generally speaking, the expenses as a percentage of sales decrease up to a point as the size of the business increases.

Store expense ratios generally continue to decline with increases in sales until a level of maximum efficiency has been reached. It is simply a case of "spreading the overhead" over a larger sales volume. There are certain expense items which are quite inflexible, for example rent, depreciation, insurance, taxes, heat, etc., and as the volume of sales increases the operating ratios decline. However, after the level of maximum efficiency has been reached the expense ratio may rise with further expansion of sales.

Effect of Different Mark-up Practices on Prices to Consumers in a Period of Rising Prices

In this section we shall trace the effect on prices paid by consumers of two major mark-up policies, or practices: (i) a constant percentage mark-up, and (ii) a constant dollar and cent mark-up. The effect on prices of these two practices can best be illustrated by means of a hypothetical example.

Let us assume that the laid-down cost to a retailer of an item of merchandise is $10 and that he takes a mark-up of 50 per cent of selling price. The article will then be marked to sell at $20. Let us assume further that his expenses amount to eight dollars or 40 per cent of selling price. He will then realize a net profit of two dollars or 10 per cent of selling price. This operation we will refer to as the "base period" operation.

Now let us assume that the laid-down cost to the retailer of this item of merchandise increases from $10 to $12 and that he maintains the same percentage mark-up, that is, 50 per cent of selling price. In this case, the article will be marked to sell at $24. Assuming that the retailer's expenses remain the same, eight dollars, his net profit will now be four dollars, or 16.6 per cent of selling price.

If, however, he had maintained the same dollar and cent mark-up as in the base period the article would have been marked to sell at $22. In this case the mark-up percentage would be 45.4 per cent and, assuming as before the same expenses, the retailer would have made the same profit as in the base period, that is two dollars or 9.1 per cent of sales.

Thus it can be seen that when the retailer uses a constant percentage mark-up when the cost of his goods increases, the price paid by the consumer is higher than when he uses a constant dollar and cent mark-up. Of course, if a constant percentage mark-up is used by the manufacturer and/or wholesaler in the prices at which they sell to retailers an initial price increase at the manufacturing level is magnified considerably by the time the consumer is reached.

It appears to be a fairly general practice among wholesalers and retailers to take a nearly constant percentage mark-up rather than a fixed dollar and cent mark-up. This fact was substantiated many times in the evidence; for example, Mr. Norman MacGregor, of the MacGregor Shirt Company Limited, when asked if the definite percentage mark-up was prevalent replied, "I could say that we assume that it is the practice. It has been a fairly well established custom".[1]

There are several reasons given for using the constant percentage mark-up, particularly in a period of rising prices.

(i) Most retailers maintain that, when the prices of the merchandise they handle are rising, their costs are also rising and that it is, therefore, necessary for them to take a larger dollar and cent mark-up such as is given by using a fixed percentage mark-up. That is to say, in the hypothetical example given above, if the retailer's cost had risen from eight dollars to 10 dollars he would have received the same net profit as in the base period. On the other hand, if he had used the constant dollar and cent mark-up his profit would have been wiped out. There is, however, a general tendency for retailers' expenses to lag behind rising prices.

We note that there is no definite relationship between increased dollar sales, on the one hand, and lower expense rates and higher profits on the other. It depends to a certain extent on the manner in which the increased sales have been achieved and this varies from store to store; that is, some stores experience a relatively moderate increase in the number of transactions but quite a marked increase in the size of the average sales while others have a substantial rise in the number of transactions and only a moderate increase in the size of the average sales. In the latter group the expense ratios will not decline as much as in the former group.

However, as the volume of sales increases, any subsequent decline in the expense ratio depends on the previous level of the store's productivity of personnel and of space.

> "If these have been low in the period preceding the sales increase, the advance in sales volume will have a more marked effect in scoring expense reduction and profit increases; but if the store has been operating at high costs of personnel and space productivity just prior to the sales increase, necessary additions of personnel and additions or rearrangement of space may counteract in some part the beneficial effect of the step-up in sales."[2]

For these and other reasons there is no clear-cut pattern between rates of sales increase, on the one hand, and decline in expenses and improve-

[1]Evidence, Royal Commission on Prices, p. 1044.
[2]Operating Results of Department and Specialty Stores in 1944, Harvard University Bureau of Business Research, Cambridge, 1945), p. 21.

ments of profits, on the other. The circumstances surrounding each individual case have to be investigated to discover this relationship.

It should be clearly understood that the above discussion applies to the change in expense ratios, that is, expenses expressed as a percentage of net sales and not to the dollar amounts of expenses. There have been sharp increases in the dollar amounts of certain operating expenses, particularly in payroll costs.

(ii) It was argued by Mr. G. S. Hougham, General Manager of the Canadian Retail Federation, that even though the actual dollar profit may increase as a result of a constant percentage mark-up in a period of rising prices, "the retailer can look to the accumulation of a fund which will, to some extent protect him against such contingencies, price declines." Mr. Hougham went on to explain that the "purchasing power" of the profits will be less and consequently in real terms they may be lower than previously.[1]

With respect to the former it is maintained that if there is a decline in the wholesale prices of merchandise, a retailer feels that his competitors who bought later will be able to place orders at lower prices; consequently they may set lower prices on their goods and this will force those who bought earlier to take mark-downs.

(iii) It has even been maintained that in periods of rising prices the retailer should take a higher-than-usual mark-up, or else his working capital will decrease.

> "Whenever a retailer discovers that he cannot replace his present stock except at higher prices, he should not hesitate to advance his prices. Otherwise, he will find that he does not achieve the inventory gain which is needed to offset the inventory loss which will come when prices fall."[2]

Some Comments on Pricing Policies and Practices

The pricing policies and practices of manufacturers and distributors form a rather complex pattern showing considerable variation from industry to industry and from firm to firm within the same industry. These variations are produced by different firms placing different emphasis on such factors as: long-run point of view and effect of price on sales, charging what the traffic will bear, price leadership, meeting competition, underselling competition, price lines, customary prices, odd prices, and so forth. For our purposes it is not necessary to examine in detail the many pricing policies and practices in actual use by manufacturers and distributors. Our main purpose is to appraise certain pricing practices and policies as they effect mark-ups and margins and the prices paid by consumers.

Some authorities maintain that, in spite of the apparent diversity in practice, many manufacturers and distributors follow a rather conventional pattern. For example, Mr. S. H. Imrie, of Tooke Bros. Limited, testified that "It has been an established practice as far as I can recall in the business

[1]Evidence, Royal Commission on Prices, p. 2092.
[2]Duncan and Phillips, Retailing (Chicago, 1948), p. 353.

that a retailer requires around 35 per cent to 36 per cent or 37 per cent to operate on."[1] Within the limitations imposed by the factors mentioned above, it appears to be a common practice of manufacturers to apply uniform percentage mark-ups to cover all expenses and profits except direct factory costs. It should be noted that an indiscriminate application of this practice on the part of both manufacturers and distributors results in an apparent variation in costs of distribution for articles of merchandise produced at different costs.

Tooke Bros. Limited, turns out a medium-priced shirt to sell at retail for $3.75 and a higher-priced shirt to sell at retail for $6.00. The manufacturing cost, that is the material and labour cost, of the $3.75 shirt is $1.79, and for the $6.00 shirt the manufacturing cost is $2.73. The manufacturer's selling price to the retailer is $2.21 for the lower-priced shirt and $3.54 for the higher-priced shirt. These represent a 19 per cent and a 23 per cent mark-up respectively on the two types of shirts on the manufacturers' selling price. For the retailer the spread is 41 per cent on both types. The dollar and cent spread between the manufacturer's cost and the retailer's price is $1.96 for the cheaper shirt and $3.27 for the more expensive one. Under this conventional mark-up system it costs much more, presumably, to sell the more expensive shirt.[2] The standard defence of manufacturers and retailers of this practice is that the expenses of selling the better shirt are actually greater because the turnover on this class of merchandise is smaller and expenses chargeable to service and return goods are greater.

The conventional mark-up system has become more or less a tradition, without any consideration of the effects of prices on volume of sales. Time and again the evidence before us indicated that manufacturers and retailers seemed so firmly entrenched in their policy of fixed margins that they were unable to consider any other method justifiable.

Resale Price Maintenance

One pricing policy that is quite widely used and which has a definite relation to mark-ups and margins is the policy known as resale price maintenance. Resale price maintenance may be described as that price policy under which the manufacturer of a branded product establishes the price or at least the minimum price at which the product shall be sold to the consumer. This subject is discussed in some detail in Chapter 11.

In practice, the manufacturer who uses resale price maintenance has control of the mark-up or margin that the distributor may use on his product. Thus when a manufacturer states the price at which goods may be sold by a wholesaler or a retailer he in effect fixes the margins that these distributors may obtain. Hence, under this pricing policy, control of mark-ups and margins is taken out of the hands of the distributors.

[1]Evidence, Royal Commission on Prices, p. 869.
[2]Ibid., p. 875.

It should be noted that maintained prices have the effect of placing all dealers on the same price basis. Probably the most important criticism that can be levelled at the practice of resale price maintenance from the consumer's point of view is that, under this practice, it is impossible for the low-cost merchants to sell at the prices their lower expenses warrant. If the low-cost, efficient retailers are forced to sell at the same prices as the high-cost inefficient merchants, the consumer is denied the advantages of efficiency. Further, the efficient retailers are likely to turn more heavily to various forms of non-price competition such as advertising and services which the consumer might be glad to forgo for lower prices.

> "It seems unreasonable that dealers whose costs are lower, either because of reduced services or of greater efficiency, should be denied the use of price appeal, and that the consumer should not receive the price advantage which results".[1]

There appears to be some variation between manufacturers with respect to the margins permitted to wholesalers and retailers in a period of rising prices. In some cases it appears that approximately the same dollar and cent margin has been applied while in others the same percentage mark-up has been used. Some tobacco companies we are informed have generally kept to the same dollar and cent mark-up when prices have risen. Apparently there has been little objection from the trade to this practice simply because of the great increase in the volume of sales which has permitted dealers to make a larger dollar profit with the same absolute mark-up. In most cases, however, it appears that the manufacturers have permitted the same percentage mark-up when the prices of the goods they sell rise, as was shown in evidence given before us by certain shirt manufacturers.[2] A thorough investigation of the number of articles to which resale price maintenance applies in Canada would be required to determine whether the over-all margins in the distributive trades have increased as much, or more or less, than those commodities which are not sold under resale price maintenance.

Actual Results of Distributors' Operations to 1946

The results of distributors' operations which we now examine are derived from two main sources, published data chiefly from the Dominion Bureau of Statistics and data obtained from the evidence given before us. Further references will be made to various chapters of Volume III as each chapter contains pertinent information on the margins and mark-ups prevailing in specific industries.

Operating Results of Retail Food Stores

Table 66 shows information regarding operations for each of five types of food stores for the years 1944-1946.

[1]Clark & Clark, Principles of Marketing (New York, 1942), p. 702.
[2]Evidence, Royal Commission on Prices, p. 850.

TABLE 66

OPERATING RESULTS OF RETAIL FOOD STORES, 1944, 1945, 1946

(items expressed as percentage of net sales)

	Year	Grocery Stores	Combination Stores	Meat Markets	Fruit and Vegetable Stores	Confectionery Stores
Average Net Sales per Store	1946	$35,075	$62,280	$52,581	$39,568	$19,735
	1945	32,356	56,956	46,403	39,958	18,582
	1944	27,233	43,268	42,103	37,183	16,307
Gross Margin	1946	14.3	15.1	17.2	16.1	18.9
	1945	14.1	14.9	16.9	16.0	20.7
	1944	14.2	15.2	17.1	16.4	19.5
Total Operating Expenses	1946	8.3	10.3	11.4	9.6	10.1
	1945	8.0	9.9	10.9	9.4	10.6
	1944	7.9	9.4	11.1	9.8	9.9
Net Profits[a]	1946	6.0	4.8	5.8	6.5	8.8
	1945	6.1	5.0	6.0	6.6	10.1
	1944	6.3	5.8	6.0	6.6	9.6

a) Net profits before deduction of proprietors' salaries and income tax.
Source: Operating Results of Retail Food Stores, 1946, Dominion Bureau of Statistics, Ottawa.

From this table the following conclusions may be drawn: (i) With the single exception of confectionery stores, the gross margins in food stores were slightly higher in 1946 than in 1945. (ii) The total operating expenses were higher in 1946 than in the preceding year again with the exception of confectionery stores. The report of the Bureau shows that this increase was largely due to increased payroll. (iii) The net profits as a percentage of net sales were down slightly from both 1945 and 1944 for each type of food business but the dollar value of net profits per store showed marked gains. The improvement in dollar profits was due to the greater dollar volume of sales.

TABLE 67

GROSS MARGINS AND NET PROFITS IN RETAIL FOOD STORES FOR SELECTED YEARS, 1938-1946

(items expressed as percentage of net sales)

Year	Grocery Stores		Combination Stores		Meat Markets	
	Gross Margin	Net Profit	Gross Margin	Net Profit	Gross Margin	Net Profit
1938	16.0	4.5	17.4	4.1	22.4	5.6
1941	15.2	5.7	16.9	5.2	[a]	[a]
1944	14.2	6.3	15.2	5.8	17.1	6.0
1945	14.1	6.1				
1946	14.3	6.0	15.1	4.8	17.2	5.8

a) Data not available.
Source: Ibid.

It is useful also to compare the gross margin and net profit for food stores for earlier years with the corresponding figures for recent years. Table 67 shows the gross margins and net profits for certain years from 1938 to 1946 for combination stores, grocery stores and meat markets.

From this table we see that the gross margin for each type of food store declined between the year 1938 and 1941 and continued to decline through 1944 and 1945. This decline in gross margin no doubt reflects the influence of the over-all price ceiling which came into effect on December 1, 1941.[1] In order to meet the difficulty of rising costs, one of the methods adopted by the Wartime Prices and Trade Board was known as "sharing the squeeze". "To the extent to which the cost of replacing an article had risen beyond the level on which the retail price ceiling was based, steps were taken to get the producers and distributors to share the increased costs between them."[2]

We note, however, that the net profit as a percentage of sales increased in 1941 over 1938 and was still higher in 1944 and 1945. This appears to be due in large measure to the reduction in services under the Board's "simplification" program which resulted in the curtailment of certain services and the elimination of "frills". The operating results for 1946 reveal a trend of return to the higher gross margins and lower net profits of the pre-war period. The lower net profit in 1946 was due to

TABLE 68

BEGINNING AND ENDING INVENTORIES AND STOCK TURNOVER, 1938, 1941, 1945, 1946

Year	Grocery			Combination			Meat		
	Beginning Inventory (dollars)	Ending Inventory (dollars)	Stock turnover[a]	Beginning Inventory (dollars)	Ending Inventory (dollars)	Stock turnover[a]	Beginning Inventory (dollars)	Ending Inventory (dollars)	Stock turnover[a]
1938	2,570	2,472	9.9	2,275	2,265	13.0	732	723	31.0
1941	2,636	2,979	7.9	2,046	2,324	13.0	(not available)		
1945	2,382	2,468	11.5	3,084	3,176	15.5	882	972	41.6
1946	2,442	2,843	11.4	3,231	3,846	14.9	1,054	1,284	37.2

Year	Fruit and Vegetable			Confectionery		
	Beginning Inventory (dollars)	Ending Inventory (dollars)	Stock Turnover[a]	Beginning Inventory (dollars)	Ending Inventory (dollars)	Stock Turnover[a]
1945	1,212	1,283	26.2	970	1,030	15.3
1946	1,278	1,418	24.6	1,117	1,352	13.0

a) Times per year.
Source: Operating Results of Retail Food Stores, 1946, Dominion Bureau of Statistics, Ottawa.

[1]Under the "Maximum Price Regulations" the retail prices of goods were fixed at the highest level at which they sold during the period from September 15 to October 11, 1941, known as the basic period.
[2]Report of the Wartime Prices and Trade Board, Ottawa, 1943, p. 21.

higher operating expenses as shown in Table 66, largely accounted for by increased wages and salaries. The tendency, however, to restore the services rendered in the pre-war period is also forcing up operating expenses and widening gross margins. This inclination was not as marked among food merchants in 1946 as in other lines but it will likely grow as competitive conditions return.

The increased rate of stock turnover as shown in Table 68 during the later war years was a factor tending to reduce the operating expenses.

From the table we note that the rate of stock turnover per year declined for every type of food store in 1946 over 1945. All stores carried inventories greater in dollar volume at the end of 1946 than at the beginning of the year.

In summary, the data given in this report of the Bureau of Statistics show a return in 1946 to larger gross margins and lower net profits as a percentage of sales. The increased dollar volume of the sales has resulted, however, in increased dollar profits. It is interesting to note, moreover, the relative constancy of the gross margins, particularly in grocery and combination stores, for the period 1938-1946. In view of the increased volume of sales and the increased rate of stock turnover[1] in this period, the gross margins display a rather remarkable constancy for food stores as a whole.

Operating Results of Retail Clothing Stores

The operating results of retail clothing stores are based on a survey by the Dominion Bureau of Statistics of a sample of firms throughout the country which covers four types of stores: men's clothing, women's clothing, family clothing, and family shoe stores. The sample includes both unincorporated and incorporated independent stores, but excludes chain stores.

The realized gross margins and net profits as a percentage of net sales for these stores are summarized for selected years in Table 69.

TABLE 69

GROSS MARGINS AND NET PROFITS OF RETAIL CLOTHING STORES FOR SELECTED YEARS 1938-1946

(items expressed as a percentage of net sales)

Year	Men's[a] Clothing		Women's[a] Clothing		Family Clothing		Shoe Stores	
	Gross Margin	Net Profit	Gross Margin	Net Profit	Gross Margin	Net Profit	Gross Margin	Net Profit
1938	28.7	7.0	29.7	4.6	27.1	4.4	29.8	6.6
1941	27.7	15.3	27.5	9.4	b	b	26.3	9.3
1944	27.2	12.3	27.9	11.8	24.3	11.1	27.6	12.6
1945	27.5	13.5	27.7	11.5	24.8	11.5	27.3	13.9
1946	26.9	13.7	27.1	16.9	23.8	10.7	26.8	12.5

a) The data shown in this table are averages for unincorporated clothing stores only. Incorporated firms were not included in operating cost surveys prior to 1946.
b) Data not available.
Source: Operating Results of Retail Clothing Stores, 194?, Dominion Bureau of Statistics, Ottawa.

[1]Cf. Table 68.

The following conclusions may be drawn from this table: (i) In the period 1941-1945 there was a decline in the gross margin from the year 1938 in all four types of clothing stores. This decline continued into 1946, all four types of stores obtaining slightly lower gross margins than in 1945. (ii) The net profit ratio for each of the four types of stores increased considerably since 1938 For example, in the men's clothing stores the net profit ratio practically doubled between 1938 and 1946, from seven per cent in 1938 to 13.7 per cent in 1946. With the exception of men's clothing stores there was, however, a slight decrease in the net profit ratio between 1945 and 1946. The increased dollar sales volume would, of course, more than offset this decline in the profit ratio.

The marked increase in the net profit ratio between 1938 and the later years is largely accounted for by the higher rate of stock turnover in all types of stores; for example, the rate of stock turnover in men's clothing and in family clothing stores was almost double the 1938 rate.[1] This increase in rate of stock turnover resulted in a considerable decline in the expense ratio similar to the retail food stores.

Again, it is interesting to see that the gross margins throughout the years shown in this table display a notable constancy.

This discussion of the operating results of certain retail stores as reported by the Dominion Bureau of Statistics, could have been expanded to include other types of retail outlets but, with minor variations, the pattern of behaviour of gross margins, net profits and operating expenses is quite similar to that indicated above and we did not feel any useful purpose would be achieved in extending the analysis further. By way of summary, however, the following highlights may be stated.

(i) There has been a tendency in most retail businesses for the gross margin to decline between 1938 and 1946. The movement, however, has been somewhat irregular as between the different kinds of businesses and between different sizes of business classification within each kind of business. This narrowing of the gross margins in the war years probably reflects the "squeeze" imposed on margins by the Wartime Prices and Trade Board during the over-all price control period.

During the first full post-war year, 1946, the change in gross margins does not conform to any definite pattern. For example, an analysis by the Dominion Bureau of Statistics of the average gross margins of independent retail stores in 21 different kinds of businesses reveals that nine had a slight increase in gross margins in 1946 over 1945, 11 had a slight decrease, and one experienced no change.

The lower gross margins in 1946 in some lines ~~may be accounted for by one or all of the following factors~~:

(a) Although there may have been no change, or a very slight change, in the initial mark-up percentages there was some reappearance of low-price, low-margin merchandise.

[1]Dominion Bureau of Statistics, Ottawa.

(b) There was a slight tendency for retail reductions to be higher, reflecting in part, the desire of some retailers to avoid the accumulation of any sizeable stocks of inferior wartime goods.

(c) The method of import pricing used by the Wartime Prices and Trade Board was basically changed during 1946. In July that year the principle of "cost plus" pricing was applied, with a few exceptions, to imports from all countries. The mark-ups permitted were usually somewhat restricted. "In general the aim was to establish percentage mark-ups which were roughly equivalent to the dollar and cent margins which had prevailed prior to the war."[1] With the considerable increase in imports, especially from the United States, during 1946, this factor of restricted mark-up may have reduced the gross margin in certain lines.

(d) In the case of some articles, for example certain types of furniture, the Wartime Prices and Trade Board permitted increases in the manufacturers' ceiling prices but distributors were required to accept a restricted mark-up so that the percentage increase in cost to the consumer was somewhat less than the amount of the adjustment at the manufacturing level.[2]

In any case, the change in gross margins was, in most cases, relatively slight as "adjustment" and decontrol were partially effected during 1946. As mentioned previously, there was a surprising degree of uniformity in the gross margins throughout the period 1938-1946.

(ii) Although there was a considerable absolute increase in certain operating expenses in the retail trade, particularly in salaries and wages, the expense ratio in most lines decreased from that existing in pre-war years. In several businesses the expense ratio rose in 1946 as compared with 1945. This resulted in a lower net profit ratio. But the increased sales volume and the higher rate of stock turnover which was manifest in practically all lines resulted in augmented dollar profits.

Results of Distributors' Operations, 1947-1948

The purpose of this section is to relate the variations in mark-up policies during the recent period of rising prices, as shown in evidence given before the Special Committee on Prices and ourselves, to the practices which have been usual in the Canadian economy in the past.

In the period of decontrol when the ceilings were removed, there was bound to be a certain amount of readjustment involving a return to former margins. Moreover, a tendency towards a widening of mark-ups and margins would be particularly evident in a sellers' market.

A general pattern of the policies of manufacturers, wholesalers and retailers with respect to margins and mark-ups may be derived from the evidence presented before us. Certain conclusions will be qualified by data obtained from our investigations into the various manufacturers and distributors.

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[1]Report of Wartime Prices and Trade Board, Ottawa, 1947, p. 45.
[2]Ibid.

That the practice of maintaining a fixed percentage mark-up prevails very generally was established by the evidence given by manufacturers and distributors of bread, meat, fruits and vegetables, shoes, men's fine shirts and many other commodities. In general, this practice appears to be much more rigorously adhered to in the distributive trades than among manufacturers although in certain trades it is evident even at the manufacturing level.

In the case of men's fine shirts, for example, manufacturing costs have risen greatly since 1939 and the distributors maintain the same percentage mark-up even in view of greatly expanded sales.[1]

The effect, of course, is a pyramiding of prices to the consumer and a very comfortably enhanced profit in dollars and cents for the distributors.

The shoe retailers exhibit the same characteristics.[2] Mr. H. R. Pollock of Pollock's Shoes Limited, a retail chain of stores operating in Toronto, testified that his company endeavoured to maintain price lines for shoes and that manufacturers, on his instructions would make shoes to suit his particular price lines.

Mr. Pollock stated that his company arrived at an average mark-up of 50 per cent on cost. Looking at a specific model of shoe, work boots No. 278, we see that Pollock's obtained the margins over cost shown in Table 70.

TABLE 70

SELLING PRICES AND FACTORY DOOR COSTS IN DOLLARS, WORK BOOTS No. 278

Date	Selling Price per pair	Cost per pair	Margin in dollars	Margin Per Cent of Cost
July 1, 1939	3.45	2.48	0.97	39
July 1, 1942	3.45	2.48	0.97	39
July 1, 1946	3.95	2.59	1.36	52
July 1, 1947	4.95	3.20	1.75	55
July 1, 1948	6.50	4.38	2.12	49

Source: Evidence, Royal Commission on Prices, p. 609.

In this particular company the increased volume of sales coupled with the higher realized mark-up, resulted in an increase in net profit from $10,373 in 1939 to $84,168 in 1948.[3]

During the winter of 1947-1948 there was a notable widening of margins in the fruit and vegetable distributive trades, especially in the imported lines. The provisions of the Emergency Exchange Conservation Act curtailed supplies to a large extent.[4] This was an example of how restriction of supply can lead to increased margins and mark-ups and greatly enhanced prices to consumers. Evidence showed that the increased margins "were more than necessary to compensate for the loss in volume, with the result

[1] Cf. Chapter 10, Vol. III, Secondary Textiles.
[2] Cf. Chapter 9, Vol. III, Leather Footwear.
[3] For fiscal year ending February 28.
[4] Cf. Chapter 8, Price Control and Rationing.

that higher than normal profit was earned during the winter months of 1947 and 1948."[1]

The net operating profit, before taxes on income, earned by six fruit and vegetable wholesalers for the months of November to March increased from $80,904 in 1946-1947 to $165,539 in 1947-1948.[2]

The retail meat business shows the established trend of a customary or prevailing margin.[3] Between the removal of the price ceiling in October, 1947, and April, 1948, several sharp increases took place. Actually the margin on meat as a percentage of sales declined but once again due to the increased sales the margin in dollars increased.

An interesting point here is the fact that retailers took a slightly lower margin on meats after April, 1948 in the face of very strong consumer resistance. But still the general tendency was to cling to the fixed percentage mark-up.

The examples cited above from the evidence, were selected more or less at random for purposes of illustration and do not by any means cover the complete list of commodities investigated. However, as far as marks-ups and margins are concerned, an examination of the evidence taken on the remaining commodities indicates that with a few exceptions the same general pattern exists. This pattern shows in the majority of cases that manufacturers, wholesalers, and retailers, follow the percentage system of mark-ups and margins and use, in each trade, an established or customary mark-up or margin.

The effect of this practice is to magnify considerably an initial increase in cost of production by the time the commodity reaches the consumer. In other words, the cumulative effect of the percentage mark-up results in a pyramiding of every increase in cost through all the stages of distribution. The evidence submitted indicates that the percentage system of mark-ups and margins is a firmly established practice, so firmly established in fact that most witnesses were unable to think in any other terms or to offer explanations as to why they should continue the practice in a period of rapidly rising prices.

Summary and Conclusions

In general, we can say that two broad practices with respect to mark-ups and margins in the distributive trades are possible in a period of rising prices:

(i) to maintain the same percentage mark-ups on merchandise when the laid-down cost to the wholesaler or retailer rises; or

(ii) to maintain the same dollar and cent mark-up.

By and large the evidence before the Special Committee on Prices and ourselves indicates that the former practice is much the more prevalent in the distributive trades.

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[1] Evidence, Special Committee on Prices, p. 3941.
[2] Ibid., p. 3942, and see Chapter 5, Vol. III, Fruits and Vegetables.
[3] See Chapter 4, Vol. III, Meat.

Here is what Mr. J. W. Ford, Executive Secretary of the T. Eaton Company Limited, says in justification of the system of the fixed percentage mark-up system as opposed to the fixed dollar and cent mark-up on each and every separate item:

> "It would be almost a physical impossibility, to begin with, to record and keep a fixed dollar mark-up for each article in the large number that the average retailer carries. For instance, we were not able to give you the number of pairs of shoes we sold because we do not keep the number of shoes we sell. We are simply interested in the total dollar volume of business and we gave you a substitute figure. We simply cannot keep all the records that would be necessary to establish and maintain a fixed dollar mark-up on each and every separate item".[1]

Some firms, however, in a period of rising prices appear to strike a course lying somewhere between the rigid application of either of these practices; that is, they take slightly lower percentage mark-ups when the cost of their merchandise rises but, on the whole, achieve a larger dollar and cent mark-up. The increased rate of stock-turnover in most lines in recent years has permitted many firms to take a lower mark-up and yet realize larger net profits in dollar terms.

Whether or not the system is justified from a practical business standpoint, the net effect of maintaining relatively constant percentage mark-ups or margins in the distributive trades in a period of rising prices is to magnify the effect of a price rise at the manufacturing, or producer level in the price paid by the ultimate consumer. If, on the other hand, a constant dollar and cent mark-up were used in the distributive trades the increase in the price paid by the consumer would reflect only the initial rise in price at the manufacturing, or producer, level.

Naturally then which of these two methods is used is a matter of vital concern to the consumer. However, we have left out of consideration any reference to possible changes in the wholesaler's or retailer's operating expenses. Hence the basic question is: has the price to the consumer increased above the level justified by increased costs? As mentioned previously, this question can only be answered by an analysis of individual cases.

The evidence referred to previously indicates that costs in absolute terms in the distributive trades have increased, particularly salaries and wages, during the price rises of recent years. The same evidence suggests, however, that the costs as a percentage of net sales have increased only moderately, and in many cases have actually decreased, with the result that dollar profits have been augmented. In a sense then the basic problem is to decide whether or not the increased dollar profits in the distributive trades are justified.

Evidence presented before us showed in many instances that return on the shareholders' equity had greatly increased over the period under

[1]Evidence, Royal Commission on Prices, p. 628.

discussion. For example, Mr. S. B. Nitikman, Secretary Treasurer of the Western Glove Works Limited, stated that his company made 50 cents per share in 1937, whereas in 1947, the net profit per share was $90.[1] Ayer's Limited, woollen manufacturers, reported to the Special Committee on Prices, that its percentage of profit to capital was 8.7 in 1937, and 16.5 in 1947.[2] We find it difficult to justify the maintenance of a fixed percentage mark-up throughout the marketing process when net profits show greatly increased returns on the shareholders' equity.

The issues with respect to mark-ups and margins seem to fall naturally into two major categories.

(i) Are present profits in the distributive trades too high? If this question is answered in the affirmative then some appropriate course of action, or policy, should be recommended that would effect a reduction in these profits to a level that is considered "reasonable".

If, however, this question is answered in the negative, that is, that by and large, profits in the distributive trades are not considered to be too high in relation to other incomes in the economy, then consideration must be given principally to methods of reducing the prices that are paid initially by distributors for the merchandise they sell.

(ii) Whether or not it is felt that profits in the distributive trades are too high, it might be felt that under present circumstances the overall costs of distribution are too high. It should be noted that, even in a period of low prices, there is considerable agitation to reduce distribution costs; in other words, this is a problem that is not peculiar to periods of high prices.

Any attempt to answer the questions that have been raised here must take the following factors into consideration.

(i) Generally speaking, profits in the distributive trades are not large. This statement is particularly true if we consider profits in distribution over the course of the business cycle. Yet many people believe that it is the profits of middle men that are largely responsible for the high cost of distribution. It is, of course, true that some distributing organizations, particularly those in the newer and more successful branches of retail distribution, have been conspicuously profitable but these are the exceptions rather than the rule.

As yet, we do not have adequate data on costs of distribution in Canada nor are the data fully satisfactory in the United States. However, a study[3] made in the United States in 1939 reveals that distributors' profits do not constitute a very large proportion of the total cost of distribution. Moreover, a study made by the Harvard Bureau of Business Research of operating results of several hundred department stores over the course of the business cycle from 1929 to 1936 showed that the only years in which profits were made by the group as a whole were 1929, with 1.2 per

[1]Evidence, Royal Commission on Prices, p. 1143.
[2]Evidence, Special Committee on Prices, p. 3746.
[3]*Does Distribution Cost Too Much?* The Twentieth Century Fund (New York, 1939).

cent on sales, and 1936, with 1.6 per cent. Losses rose as high as 6.4 per cent of sales in 1932.[1]

If we refer to the Canadian data quoted above we can see that, for example, in 1938 only 4.5 cents out of the consumer's dollar spent in independent grocery stores went on the average to the grocer as profits. In 1946, the corresponding figure was six cents. In 1938, out of the consumer's dollar spent in independent women's clothing stores only 4.6 cents went to the retailer as profit. By 1946 this figure had risen to 10.9 cents. This represents, of course, a considerable increase in the profit ratio but if it were averaged out with the fluctuations of the business cycle, the result would be considerably lower than this figure.

In brief, the complete elimination of the distributors' net profit from the cost of distribution would not significantly affect the average prices paid by consumers.

(ii) Even though distributors' profits constitute only a relatively small fraction of the total cost of distribution, this does not necessarily imply that distribution costs are not "too high". However, it would seem that substantial economies in the field of distribution "must be sought chiefly in reduction of operating expenses, either through elimination of services or by performing distribution services more efficiently and economically".[2]

The greater portion of the distributor's gross margin is absorbed by his operating expenses. These costs include salaries, wages, rent, interest, and so forth. Since some of these costs are relatively fixed, at least in the short run, the operating expenses as a proportion of sales tend to decrease as sales volume increases. It is probably in the long run reduction of these operating expenses that the greatest hope lies for the reduction of mark-ups and gross margins.

It must be borne in mind, however, in this connection that

> "the consumer himself can properly be charged with a part of the responsibility for the higher distribution costs which have resulted from competition for his favor. The buyer expects, or has been led to expect, from the distributor a multitude of costly privileges and services which cannot be dispensed with until the buyer's attitude itself has been changed."[3]

Moreover, it is important to note that in many types of operation, both in retailing and wholesaling, operating expenses are taking a smaller percentage of the consumer's retail sales dollar than they did in pre-war years. In spite of this fact, however, there still remains widespread public misunderstanding of retailers' and wholesalers' costs of doing business. The case has been well stated as follows:

> "The persistent public ignorance and misunderstanding of distribution costs is commonly thought to be related in some part to the rather intangible character of those costs. It is quite true that no

[1] Operating Results of Department and Specialty Stores in 1936. Harvard Bureau of Business Research (Cambridge, 1937).
[2] Twentieth Century Fund, op. cit., p. 336.
[3] Ibid., p. 339.

one can wear a pair of shoes which is one of a case lot in in a manufacturer's warehouse, or sleep under blankets that are packed in cartons on the dry goods wholesaler's shelves. But these utilities of time, place, dispersal and combination are not anything than can be seen, felt, or tasted. They make no alterations in the form or appearance of an article. Hence they do not seem to be 'real', even though they are just as much part of the cost of producing the final utilities to the consumer as are the costs of raw materials and manufacturing processes."[1]

Finally, we fail to see the necessity of adhering to a fixed percentage mark-up system over the years, in the face of changes in the volume of business transacted. When the rate of stock-turn increases substantially there tends to be a reduction in operating expenses, and we cannot seem to justify the augmented dollar profits made by the distributor who invariably maintains the same percentage mark-up as when his rate of stock-turn was lower.

[1]Operating Results of Department and Specialty Stores in 1944, Harvard University, Bureau of Business Research (Cambridge, 1945).

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RESTRICTIVE BUSINESS PRACTICES

THE rapid increase of Canadian commodity prices since the war has been attributed by a considerable body of opinion to restrictive practices on the part of monopolistic businesses.[1] This view in many ways is not an unnatural one; a study of the evidence given before both the Special Committee on Prices and ourselves reveals at least a suspicion that some important articles of every day use were not subject to price competition. Accordingly, in our examination of the evidence and our study of the problems of selected industries, we endeavoured to find the extent of monopolistic practices and to determine if they have been an important factor in the post-war rise in prices.

In spite of the increasing responsibility placed on governments in economic matters, business in Canada remains essentially subject to private direction and control. This system is referred to as one of private enterprise, in which competition is an important regulating force. The evidence makes clear that this competition takes many forms, that only in rare instances does it approximate perfect competition as defined by economists, and that there have been tendencies in certain industries in the direction of monopolistic competition. The experiences and influences of the war period have, if anything, hastened the process by consolidating the position of large corporations, and creating conditions conducive to the spread of patterns of behaviour from which active price competition is excluded.

Effect of Wartime Controls

The effective organization of industry for war purposes required concerted rather than competitive efforts in many aspects of business activity. Reductions in the variety of products manufactured and in delivery and other services were among the more apparent restrictions which were effected through government co-operation with the business groups concerned. Trade associations in many instances proved effective agencies through which the need and details of wartime controls could be explained to business firms. Existing trade organizations were strengthened and new associations[2] were formed under the stimulus of war needs. Their prestige became enhanced as they acted as intermediaries between government agencies and business in the adoption and application of various measures of control. At the same time business men learned to work more closely together and to accept, as a matter of common practice, the discussion of aspects of their business which, under peacetime conditions, might have been regarded as matters for individual decision in the light

[1]Evidence, Royal Commission on Prices, p. 2112.
[2]Thirteenth Report on Organization in Industry, Commerce and the Professions in Canada, 1947. Dept. of Labour, Canada.

of the prevailing competition. The possibility that the establishment of such patterns of behaviour might lead to less rather than more enterprise was referred to in the following terms by the Commissioner of the Combines Investigation Act when he appeared before the Special Committee on Prices:[1]

> "Throughout the war years concerted action on the part of producers and distributors was encouraged rather than discouraged by government agencies, and quite properly. Under a direct control system, quicker and more effective action can be secured if the one controlling agency can deal with a single organization representing a whole section of a trade or industry rather than with a multitude of independent units. These groups played an important and highly useful part in the wartime control of their respective industries; but, the last word, the ultimate control, lay not with them but with government. We may well be concerned, however, lest the restrictionist philosophy which is inherent in these emergency controls should motivate such strongly organized groups to certain types of action that are not at all appropriate to a system of competitive enterprise. Perhaps it is only natural to expect that some industries might be tempted, once the State discontinues the fixing of maximum prices in the public interest, to substitute fixing of minimum prices in their own interest."

Another factor of considerable importance, carried over from the period of wartime control, is that the pricing policies of individual business men have been affected substantially by the forms in which price regulations were cast. It is a danger in all price regulation that the established maximum prices tend to become minimum prices and that any price established by government order, as long as it does not put a "squeeze" on sellers, is accepted by them, regardless of their individual circumstances, as a "reasonable" price even though it must of necessity be established on an arbitrary basis so as to be of general application. This tendency has a marked influence while maximum prices are in effect, but what we think of more lasting significance and what turned up in the evidence before us repeatedly, is the persistence of such an attitude after price regulations have been withdrawn. Mark-up controls, for example, were established under wartime regulations for each stage of distribution, but the margins they provided were intended to be, as the regulations clearly stated, the maximum margins which could be charged. Continuance of such mark-up controls, not by government but by business groups themselves, and designed to fix minimum rather than maximum margins, appears to be favoured in many lines of trade. Manufacturers as well as distributors have come to regard such methods of determining prices as established trade practices which were approved by government authorities during the war period and which they should be entitled to maintain by common action in the industry after the lapse of wartime orders. One example of several

[1]Evidence, Special Committee on Prices, p. 158.

illustrating this was afforded to us by some testimony during our inquiry into shirts. When asked whether the objective in setting the retail price is to give the retailer 37½ per cent on sales a witness replied

> "That is not our objective at all. We estimate what a shirt can be sold at and then we try to fit that into the price so that it comes into the category of that retail price arrangement that the Wartime Prices and Trade Board put through."[1]

The maximum mark-ups established in price control orders were continued into the period of decontrol as the minimum margins which should be recognized in the trade. If there is any general demand on the part of distributors for a higher margin, the tendency often is to accept this in itself as justification for such a move. The widespread acceptance of such practices could result in a pattern of behaviour which may be as effective in maintaining or increasing prices as formal agreements.

Because of the absence of effective action to ensure competition in price in our system of private enterprise, such habits may persist beyond the period of inflation and can become even more significant when conditions of supply would be expected to lead to reductions in price. In a period of rapidly rising prices, such as we have experienced, it is natural for the public to become concerned over the possibility of exploitation by combinations of suppliers or monopolistic groups. The absence of competition, under easier conditions of supply, may have effects even more serious and less likely to be noticed.

> "Much more frequent, and much more insidious, is a state of affairs where profits are far from exorbitant, simply because high prices are matched by high cost; where monopoly produces its effects indirectly, through actual penalties on enterprise, and through the barring of entry to the promising newcomer with a good idea. It is on a dynamic view of economic affairs that monopoly and near-monopoly stand condemned . . ."[2]

In the period between the two World Wars and particularly during the depression, some headway was made by organizations and individuals who advocated various forms of what was frequently referred to as "self-government of industry". Some favoured assigning to the government a general supervisory role; others considered that the power of government should be used to secure the adherence of firms which might wish to pursue an independent course. Still others advocated a more complete form of industrial self-government which envisaged nothing in the way of either state interference or state support. The experience under the National Recovery Act codes in the United States did much to explode the theory that stability and business progress could be secured by using the authority of the state to enforce restrictive business agreements. The difficulties of administering wartime controls have served to emphasize the limitations which exist in measures for government supervision or regulation.

[1]Evidence, Royal Commission on Prices, p. 824.
[2]The Economist, London, March 20, 1948.

Legal Restraints

Since 1889 there has been in Canada some statute law against combinations in restraint of trade. It was embodied in the Criminal Code in 1892 and was supplemented by the Combines Investigation Act of 1910. The latter Act was replaced by the Combines and Fair Prices Act, 1919, which, after declaration of its constitutional invalidity by the Judicial Committee of the Privy Council, was replaced by the present Combines Investigation Act in 1923. The provisions of section 498 of the Criminal Code and of the Combines Investigation Act are much the same with respect to the definition of unlawful combination in restraint of trade. Section 498 makes it an offence for two or more persons to conspire, combine, agree or arrange to lessen competition unduly. Under the Combines Investigation Act the offence is described as that of preventing competition to the detriment or against the interest of the public. Courts have held that the latter has the same meaning as "unduly" in section 498.

The Combines Investigation Act also condemns monopolies, trusts and mergers which operate to the detriment of the public. A significant difference between the two statutes is that the Combines Act provides for the investigation of alleged offences and for the publication of the reports of such investigations. Since the end of the war reports have been published as a result of investigations into international cartels and the dental supply, optical, bread baking and flour-milling industries. The adoption of emergency controls, embracing practically all branches of trade and industry as World War II reached its climax, led to the virtual suspension of activities under the Combines Act. Legislative policy was reaffirmed by Parliament in 1946 when amendments were adopted to permit more effective administration. These now make it possible for the Commissioner under the Act to investigate complaints of practices alleged to be offences under section 498 of the Criminal Code, and also under section 498A which relates to offences of price discrimination resulting in the curtailment of competition. The amending Act of 1946 restored a provision similar to that which had been in the Act from 1923 to 1937, whereby the Commissioner could proceed on his own initiative with an inquiry to determine whether a combine exists or is being formed. As the Act now stands, preliminary inquiries may be made as a result of complaints from the public, on direction of the Minister of Justice or on the initiative of the Commissioner. If such inquiries disclose evidence to warrant more extensive proceedings, a formal investigation is made.

Once the public becomes aware that the policy embodied in Canadian legislation against undue restraint of trade is being applied effectively and consistently, much wider effects should result than those directly related to particular investigations or prosecutions. Not only will there be desirable clarification of the law but business will be aroused to take stock of practices similar in character or effect to those condemned by the courts. As one writer has put it, there is need "to jolt business out of the habits or regimentation and self-government appropriate to the regulated war economy, into the free enterprise, non-collusive habits required in the absence of direct control".[1]

Publicity, which was stressed in the recommendations of the Special Committee on Prices, is one of the most effective means of safeguarding the public from harmful trade practices. The publication of the reports of investigations under the Combines Investigation Act has been a basic principle in the legislation since the first act was passed in 1910.

A competitive market has been defined as one possessing, at least, the following characteristics:

(a) alternative sources of supply;
(b) alternatives in business policy with respect to price, production, or the kinds of goods or services offered;
(c) flexibility in business policies with respect to prices and other important terms of sale;
(d) freedom of entry into the industry or trade.

One writer has summed up these characteristics by stating that "workable competition implies the availability to both buyer and seller of an adequate number of alternative courses of action." He goes on to say:

> "It is clearly not enough that buyers have a number of sellers from whom to choose or that sellers have a number of customers to whom they can sell. There must be on the part of buyers and sellers an independent probing of the possibilities in the situation."[2]

It is this independence of business activity which legislation against undue restraint of trade is intended to preserve as an essential condition of free enterprise. Such independence disappears when all or the principal firms in an industry or trade agree on common pricing policies or other vital conditions of sale or distribution. The buyer, in such circumstances, no longer has available to him "an adequate number of alternative courses of action." He finds wherever he turns that the same price is demanded, the same conditions for acceptance as a customer, the same terms of sale and so on. The defence of such common practices has always been that they are "reasonable", but when the regulating effect of competition is removed other checks on "reasonable" conduct cannot be relied upon as adequate public safeguards. The ever-present dangers in such circumstances are suggested by the following:

> "What, for instance, is a fair price? What is a reasonable gross margin? A few years ago the Select Committee on National Expenditure suggested "there has not yet been evolved a tech-

[1] V. W. Bladen, "The Combines Investigation Commission and Post-war Reconstruction", Canadian Journal of Economics and Political Science, Vol. No. 10, Number 13, August, 1944, p. 343.

[2] E. S. Mason, "Competition, Price Policy and High Level Stability", in symposium, Economic Institute on Pricing Problems and the Stabilization of Prosperity, Chamber of Commerce of the United States, September 18, 1947, p. 19.

> nique which solves satisfactorily the essential problem of how, in the absence of free competition, to settle the "right price" to be paid for a particular article."[1]

In applying Canadian legislation our courts have consistently declined to assume the responsibility of determining what is a reasonable price when the issue is one of restraint of trade. Instead they have endeavored to determine that there has been undue interference with the free course of trade, and American courts have apparently followed the same line of reasoning.

In many fields of Canadian industry, because of the size of the market or for other reasons, the number of producers is relatively small and the alternative sources of supply in the domestic field consequently limited. In such circumstances freedom of entry into a particular field of distribution or use of the products made by a limited number of producers is restricted if the suppliers follow a policy of selling only to "recognized" customers. This danger is lessened when similar products are freely available from foreign countries on terms which permit the new firm to compete successfully with those already established.

Recognition of the importance of such outside competition appears to have been one of the reasons for an amendment made to the Customs Tariff Act in 1948 which provides that the dumping duty is not to be applied on

> "goods which, though of a class or kind made or produced in Canada, are not offered for sale to the ordinary agencies of wholesale or retail distribution or are not offered to all purchasers on equal terms under like conditions, having regard to the custom and usage of trade."

The extension of this principle to provide not only for the lifting of the dumping duties in such circumstances, but also for a positive reduction in the tariff, might, we think, do much to facilitate freedom of entry. Customs duties may now be reduced or removed, under Section 17 of the Customs Tariff Act, in the event of producers taking advantage of any duty to maintain prices at levels higher than should prevail. If reductions of customs duty were made possible also where producers take advantage of the tariff to thwart freedom of entry by selling only to already established wholesale or retail outlets, a generally more competitive condition would, we think, result. If new entrants are prevented from trading in Canadian goods and the customs tariff prevents them from selling similar imported goods at competitive prices, some redress such as tariff reductions might, we think be salutary.

Resale Price Maintenance

Resale price maintenance has been referred to frequently both in this report and in the evidence as a practice which is responsible for

[1] Corwin D. Edwards, "Can the Anti-Trust Laws Preserve Competition", American Economic Review, March, 1940.

increasing costs of distribution. This term which is described in Chapter 10, is applied where the manufacturer of a branded product imposes as a condition of sale, a fixed price at which the retailer must sell the product to the public. The interest of consumers in this question was expressed by the Canadian Association of Consumers and the National Council of Women in their joint brief, which referred to the growing practice of resale price maintenance as a matter of grave concern to consumers. A few firms represented at our hearings admitted establishing resale prices on such products as shirts[1] and shoes.[2] Certain eastern bakers stated that they suggested resale prices on their bread, but did not insist upon the retail stores observing them.[3] The recently published report of the Combines Investigation Commission on the bread baking industry in western Canada states, however, that certain western bakers have declined to sell bread to merchants who sell at prices lower than those fixed in furtherance of a general plan of resale price maintenance which the Special Commissioner found to be one feature of the activities of an alleged combine. It is evident that the practice is growing and is having a significant effect on the prices which the public has to pay for goods in a number of lines of trade. It becomes a matter of special public concern when dealer competition is eliminated by the fixing of resale prices of certain foods, and particularly such an essential food product as bread.

In the United States the Miller-Tydings Enabling Act has legalized resale price maintenance in interstate commerce. We consider it would be unfortunate for Canadian consumers if any such proposal were to receive legislative sanction or encouragement in this country. Indeed positive action to discourage the practice or at least to remove its undesirable features would, we think, be more in the public interest.

Representatives of several manufacturers presented to us various reasons for the growth of the practice of suggesting or requiring the observance of fixed resale prices. It seemed evident that in certain instances the policy was adopted by the manufacturer to meet the wishes of distributors and to avoid what was termed "confusion in the trade". This "confusion" may have been what was described by another witness as "competition that exists among retailers" when resale prices are not set by the supplier. In other instances, it was suggested that resale price maintenance was introduced to protect the small retailer from special sales by large distributors and to enable him to make a profit which would keep him in business and encourage him to promote the sale of the price-maintained goods. The Commissioner of the Combines Investigation Act, when he appeared before the Special Committee on Prices, made the following comment in his reference to resale price maintenance:

> "One cannot deal with the problem of resale price maintenance without recognizing that some manufacturers may have some jurisdiction in seeking to protect the prestige of their product by maintaining

[1]Evidence, Royal Commission on Prices, pp. 823, 869, 986.
[2]Ibid., p. 595.
[3]Evidence, Special Committee on Prices, p. 1051.

some supervision over the conditions under which it is sold to the public. The protection of good-will, however, may often be the cultivation of the dealer so that he will push the manufacturer's product rather than the maintenance of prestige in the mind of the public. One can understand also the motive of dealers who are genuine in their desire to remove the evil of predatory price-cutting and that alone. The motive of most dealers, however, who are pressing for resale price maintenance seems to be not only to eliminate such forms of unfair competition, but all price competition in the particular products. If this is not their motive it would seem to be the effect of their proposals. In seeking by means of private trade sanctions to prevent the occurrence of predatory price-cutting, the dealers deprive the public of the safeguard of reasonable price competition at the distributive level. Experience in other countries tends to show that the adoption of this form of private price control leads to further demands for the control over new entrants to the trade so that the advantage may not be dissipated by having to be shared with others who are attracted by the guaranteed margins."[1]

Resale price maintenance has been dealt with in a number of investigations under the Combines Investigation Act, but usually in conjunction with other restrictive practices. It was the sole issue in one inquiry, that into the Proprietary Articles Trade Association. Two reports were published, in 1926 and 1927, in which conclusions were expressed that the public interest was detrimentally affected. The Proprietary Articles Trade Association was disbanded shortly after the final report was published. The same conclusion was reached in the following investigations which dealt with certain aspects of the problem: tobacco, 1938, dental supplies, 1947, optical goods, 1948, and bread in western Canada, 1948.

Our examination of the problem of resale price maintenance has necessarily not been complete enough to permit a conclusion as to all the circumstances in which the practice should be declared to be against the public interest. From the examples we have examined, it appears that as a whole the disadvantages to the buying public greatly exceed any possible advantages. In certain circumstances, as, for example, a combination of dealers arranging with a manufacturer to adopt resale price maintenance, or where several manufacturers jointly agree upon such a policy, the Combines Investigation Act in its present form would appear to provide a remedy for undue restriction. A different situation arises where a single manufacturer, acting independently of other manufacturers and without pressure from dealers, requires all dealers to maintain the minimum resale prices which he establishes. Price competition amongst dealers in the sale of these particular goods is thereby seriously limited if not eliminated. In dealing with such a case, the effect on the public would be determined by consideration of many factors, including the volume of the

[1]Evidence, Special Committee on Prices, p. 161.

manufacturers' sales of these goods in relation to the total sales of goods of the same class and kind, the availability of other similar goods which are not subject to such restriction, and the extent to which the customs tariff may permit or prevent imported goods from competing with the price-protected lines. Similar considerations would apply where the practice takes a less definite form and is one of suggestion rather than of insistence.

Monopolistic Prices in an Inflationary Situation

So far we have been dealing only with the growth of monopolistic practices during wartime and thereafter, the legal restrictions to monopoly operation, and the means by which such restrictions could be enlarged. We have not until now discussed monopoly operation as an inflationary factor.

Generally speaking, we have not found that monopolistic practice in any of its forms has been a major factor in the general rise in prices, though in some of its aspects it has been a contributing factor. Nearly all monopolistic businesses are subject to a degree of legal and social restraint. Public utilities boards and other rate-making bodies exercise some control of the price policy of the so-called "perfect monopolist" and all of them, even those borderline cases where monopolistic practice is not clearly and positively indicated are subject to inquiry at any time by the Combines Investigation Commission. Perhaps of even greater effect however, are the social restraints, the concern of the monopolistic firm for good public relations. Thus the firm engaging in monopolistic practice will carefully weigh the possible reaction of labour to any attempt to increase prices beyond a point which can plainly be justified. In short such a firm is subject to the constant pressure of opinion and to the suspicion of a public which is not unready to lay at its door responsibility for a good many of our economic ills.

A further influence which we believe has affected to an important extent the pricing policies of monopolistic firms is the desire to achieve long-run price stability. Thus we think the firm which is operating under any of the various forms of monopoly is principally interested in eliminating the vagaries of the business cycle by securing for itself a stable price structure over a period of time. Hence, while prices under these conditions as we have said, tend to be set on the whole not as high as they probably could be in an inflationary situation, they are maintained at a higher level than competitive conditions would indicate in a deflationary situation.

The net result in our opinion is that over a period of time the elimination by the monopolist of the "peaks and valleys" tends to place the average price of his goods above what would be the competitive level. As the Royal Commission on Price Spreads said, "price no longer automatically adjusts itself to supply and demand, and no longer reacts quickly to changed economic conditions. The dominant producers fix the price they deem most profitable and attempt to adjust their production to sales at that determined price."[1]

[1]Report of the Royal Commission on Price Spreads, 1935.

Summary and Conclusions

We have examined at some length the tendency we have found during the course of our own inquiry as well as that of the Special Committee towards the growth of monopolistic practices. We have shown that the wartime stabilization program by its very nature tended to restrict the competitive forces in the economy and was conducive to the formation of habits of price and commodity standardization in industry. These tendencies have become perpetuated to some extent in the post-war situation.

On the question of resale price maintenance, a recommendation appears in Volume I. We conclude that the advantages to the public claimed for this practice are greatly outweighed by the disadvantages. Resale price maintenance, like other forms of restrictive practices, does offer what appears to the manufacturer and distributor, 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.

Finally, on the basis of the evidence before us, we have concluded that although the concentration of economic power reduces the "competitive spur of efficiency", and although we regard it as undesirable socially and economically, it has not been one of the major or underlying factors in the present rise in the cost of living. We feel that the degree of sheer price exploitation engendered by monopolistic practice is much less in inflationary than in deflationary periods. Or, as one writer has put it:

> "All this need not alter our social and economic evaluation of the evils of monopoly. But to blame monopolistic price policies for the 'exorbitant' increases in the price level during the last years is to turn the real picture topsy-turvy".[1]

[1] Fritz Machlup, Review of Economics and Statistics, February, 1948.