ECONOMIC COUNCIL OF CANADA

Interim Report on Competition Policy

July 1969

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The Queen's Printer
Ottawa, Canada
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GLOSSARY OF TERMS

BASING-POINT PRICING. A system of product pricing adopted by an industry under which buyers are under compulsion to accept identical prices in a given market regardless of the location of the production facilities of the various suppliers.

> The delivered price to the buyer is made up of the price at a given place, known as the "basing point", plus freight to the point of delivery.... [These freight] ... charges are obtained from freight books prepared by leading companies or trade associations.... A buyer is not allowed to take delivery of the goods F.O.B. plant and transport them by any means he desires.... Under the single basing-point system, one producing center is taken as the base from which all F.O.B. prices are quoted, the delivered price of the product being this F.O.B. price plus freight from the base point to destination. Producers not located at the basing point quote the same delivered price as the firm at that place.... The multiple basing-point system is simply an extension of the single basing-point idea. A number of producing centers become basing points which quote F.O.B. prices, and the delivered price at any given destination will be the lowest combination of base price plus transportation to point of delivery....
>
> Dudley F. Pegrum, *Public Regulation of Business*, rev. ed., Homewood, Ill., Richard D. Irwin, 1965, p. 215.

CARTELS. Arrangements whereby independent business enterprises enter into agreements that have the purpose of restricting competition among them. Most cartels involve an agreement on the prices to be charged and/or a division of a market or markets. International cartels are those cartels which include the enterprises of more than one country.

CONCENTRATION. The proportion of an industry's output accounted for by a specified number of the largest firms.

CONGLOMERATE MERGER. A merger that is neither horizontal (no competitive market relationship) nor vertical (no customer-supplier relationship).

Conglomerate firm -- a firm that has diversified operations.

CONSIGNMENT SELLING. A distributor acts as an agent in selling the products of a manufacturer, with the title to the goods remaining with the manufacturer.

DIRECTED BUYING. See Exclusive Arrangements.

EXCLUSIVE ARRANGEMENTS. These undertakings serve to foreclose the part of the market covered by the agreement from the supplier's competitors. However, it should be noted that the contracts or other arrangements may serve legitimate business needs and need not involve any detriment to the public. Exclusive arrangements include:

a) *Directed Buying*. A form of exclusive dealing under which a supplier may require a distributor of his product to buy other products from a stipulated firm or firms. Directed buying will ordinarily imply a *market-access arrangement* (see below).

b) *Exclusive Dealing*. A contractual undertaking between a supplier and a purchaser under which the purchaser agrees not to handle a product or products sold by competitors of the supplier. (The contract may also obligate the supplier not to make the product available to other purchasers in the relevant market, in which case there is said to be a "bilateral exclusive agreement".) *Franchise agreements* are a form of exclusive dealing.

c) *Full-Line Forcing*. An obligation imposed on a firm wishing to distribute a particular product to handle the entire line of the supplier of that product.

d) *Market-Access Arrangement*. An agreement between a firm that controls access to a group of outlets and one or more suppliers, which gives exclusive or preferred access to the outlets in return for a commission to the firm on sales to such outlets.

e) *Reciprocal Buying*. A practice that may occur when two multiproduct firms, A and B, are in a customer-supplier relationship for some products and a supplier-customer relationship for others. Firm A may agree to obtain all or most of its requirements of product X from firm B on condition that firm B obtain all or most of its requirements of product Y from firm A. Other competitors are thus wholly or partly excluded from the markets for products X and Y.

f) *Requirements Contract*. An obligation that requires the purchaser to obtain his total requirements of a product or service from a single supplier over a given period.

g) *Tying Arrangement (Contract)*. An obligation between a supplier and a buyer that obligates the latter to buy from the supplier a product or service (tied good/tied service) in addition to the one the distributor wants to obtain (tying good/tying service).

EXCLUSIVE DEALING. See Exclusive Arrangements.

FRANCHISE AGREEMENTS. See Exclusive Arrangements -- Exclusive Dealing.

FULL-LINE FORCING. See Exclusive Arrangements.

GEOGRAPHIC MARKET EXTENSION. A term used to describe the extension by a firm (via internal expansion or merger) into geographical markets where it was not previously represented either in the production and/or distribution of its products or services.

HORIZONTAL MARKET RELATIONSHIP. A market relationship in which two firms are in direct competition with each other, such as two suppliers of a similar product or service. (This definition has been further refined in Appendix III of this Report to distinguish between "ordinary" horizontal relationships, in which two firms sell the same product in the same market, and "other" horizontal in which the area of common activity is too small for the firms to be considered as direct competitors.)

INTERLOCKING DIRECTORATES. A situation under which two or more companies have overlapping Boards of Directors.

MARKET-ACCESS arrangements. See Exclusive Arrangements.

MARKET POWER. The ability to earn profits, over a long period of time, higher than those which would have to be earned by efficient firms in order to attract and maintain sufficient capital to stay in business.

MERGER. A union of two previously separate firms through the acquisition by one of the whole or part of the assets or voting stock of the other; or the union of two or more firms through share exchange. Mergers may be described as vertical, horizontal or conglomerate.

MONOPOLY. Strictly speaking, under "monopoly", there is a sole supplier of a good or service to a market. In reality there is more likely to be a firm with virtually complete, but not wholly complete, control over the supply of the good or service to that market.

MONOPSONY. The converse to monopoly. Under monopsony, there is in theory a sole buyer of a good or service from a market. However in reality there is more likely to be a firm with virtually complete but not wholly complete control over the demand for the good or service from that market.

OLIGOPOLY. A condition under which the supply of a good or service to a market is controlled by a relatively small number of firms.

OLIGOPSONY. The converse to oligopoly. A condition under which the demand for a good or service is controlled by a relatively small number of firms.

PER SE OFFENCE. An offence subject to an unconditional ban.

PREDATORY PRACTICE. The activities of a firm or firms directed to the object of eliminating a competitor. These activities are such that they would not normally be expected to be profitable unless they had the prospect of disciplining or eliminating a competitor.

PRICE DISCRIMINATION. A pricing policy whereby products or services are offered by a manufacturer or distributor to customers at different prices not justified by cost differences; or at the same prices where there are different costs.

PRODUCT EXTENSION. A term used here to designate the entry (by internal expansion or merger) by a manufacturer into a product line that is complementary to the line he is already producing.

RECIPROCAL BUYING. See Exclusive Arrangements.

REFUSAL TO DEAL. The practice by a seller of refusing to deal with particular buyers or with a particular class of buyers.

REQUIREMENTS CONTRACT. See Exclusive Arrangements.

RESALE PRICE MAINTENANCE. An obligation imposed on a distributor to sell a product at the price (or minimum price) specified by the supplier. The practice may often result from pressure applied by the distributors on the supplier.

RESTRICTIVE AGREEMENT. See Cartels.

TYING ARRANGEMENT (CONTRACT). See Exclusive Arrangements.

VERTICAL MARKET RELATIONSHIP. *Vertical forward* integration brings a firm (via internal expansion or merger) a step closer to the final consumer -- such as a manufacturer moving into wholesaling. *Vertical backward* integration brings a firm (via internal expansion or merger) closer to its source of supply.

CHAPTER 1

INTRODUCTION

This is the Council's second Report in response to a special Reference from the federal government, dated July 22, 1966, requesting the Council,

> "In the light of the Government's long-term economic objectives, to study and advise regarding:
>
> (a) the interests of the consumer particularly as they relate to the functions of the Department of the Registrar General [now the Department of Consumer and Corporate Affairs];
>
> (b) combines, mergers, monopolies and restraint of trade;
>
> (c) patents, trade marks, copyrights and registered industrial designs."

The first part of the Reference was treated in the Council's *Interim Report on Consumer Affairs*, published in 1967. The present Report deals with the second part -- that is, with "combines, mergers, monopolies and restraint of trade" or, as we prefer to call it, competition policy. It is designated an *interim* document to indicate: (a) that further reports are to be issued, and (b) that these reports are likely to include further discussion of combines, mergers, monopolies and restraint of trade. The Council's next report will discuss patents, copyrights, trademarks and registered industrial designs. A fourth and final report will then be issued containing further observations and recommendations, notably on the subject of consumer affairs, and a general summing-up of the interrelations between the three main elements of the Reference and their place in the broader spectrum of government economic policies.

The last substantial revisions to Canadian anticombines law took place in 1960. Even more time has elapsed since the law as a whole was last subjected to thoroughgoing study -- by the MacQuarrie Committee in 1951-52. Over the intervening period, much has happened to the Canadian economy, both in terms of particular events and in terms of less dramatic but

sometimes more fundamental underlying trends. Among the events may be mentioned the following:

-- the resources boom of the mid-1950's;

-- the North American economic slowdown of the late 1950's and early 1960's;

-- the devaluation of the Canadian dollar in 1960-62 and the return to a fixed exchange rate in April 1962;

-- the defence-sharing and automobile-production arrangements with the United States;

-- a series of tariff reductions culminating in the Kennedy Round;

-- the "Great Expansion" of the economy in the 1960's.

Among the trends have been the continuing industrialization and urbanization of Canada, the persisting decline in agricultural employment, the relative rise in employment in service industries to a point where they now account for more than half of total employment, and the sharp increase (though from a low starting point) in the share of manufactured goods in total exports.

Meanwhile, the external economic environment has been altering in important ways. Of the various changes that were by no means readily foreseeable in 1951-52, three in particular may be mentioned as having major long-term significance for Canadian industrial organization and structure: the successful postwar recovery and subsequent rapid growth of the economies of Western Europe as a whole and of Japan, the strong absolute and relative increase in world trade in manufactured products, and the rise of the international corporation.

The above lists are far from exhaustive; their purpose is merely to recall how different, in certain respects other than sheer size, is the Canadian economy of 1969 from the entity with which the MacQuarrie Committee was concerned. There are of course many similarities also, and not all of the changes that have

occurred since 1952 have been such as to affect greatly the appropriateness or inappropriateness of anticombines policies. Perhaps the most significant change has been less a measurable, physical one than a shift in attitudes regarding the likely future course of Canada's economic development. In the early 1950's, such a forward look would typically have laid much emphasis on the growth of primary resource-based industries and their supporting infrastructure. A similar look today would still devote a good deal of attention to these industries, but would allot a larger proportionate place than before to secondary and tertiary industry, and to certain particular matters such as the desirability of developing greater scale, specialization and export-orientation in Canadian manufacturing, with all that this would imply in the way of manpower training, technological change, and policies to smooth and promote industrial adjustment.

Enough has therefore happened, both to the Canadian economy and to attitudes regarding its future, to make timely a general reappraisal of anticombines legislation. This timeliness is reinforced by the persistence since 1952 of discussion and argument regarding various features of the legislation. No policy in this field will ever be uncontroversial, and certain basic dilemmas are bound to persist and be a continuing subject of discussion. But it is our impression that too much of the debate in Canada has settled into a stock pattern -- has involved opposing positions that have existed so long as to become almost a national tradition. Anything that could be done towards resolving some of these set-piece controversies would liberate mental energies for much-needed consideration of newer problems.

Finally, it may be noted that a reappraisal of this branch of economic policy is also rendered timely by the administrative transfer of the Combines Branch from the Department of Justice to what has since become the Department of Consumer and Corporate Affairs. Even apart from other considerations, this transfer would have made it desirable to examine the functions of the Branch and how they might best be integrated with the new Department's other responsibilities.

In its Reference to the Council, the Government made clear that the review of combines, mergers, monopolies and restraint of trade should be fundamental in character:

> Mr. Favreau further stated that the importance of this study cannot be over-estimated as a first and necessary step in the determination of a cohesive economic policy in relation to these important matters considered as a whole and in relation to each other with a view to bringing the policy in these matters into harmony with the overall economic policy of Canada and the needs of the consumer and other important segments of the economy.[1]

The sequential treatment of the three main sections of the Government's Reference of 1966 has been adopted as the best means of taking account, on the one hand, of the inherent complexity of the subject matter and, on the other, of the Government's desire to proceed to legislative proposals in certain areas without undue delay. While, therefore, some work has gone forward from the beginning on all three sections of the Reference, research resources have deliberately been concentrated on each section in turn. This research will ultimately give rise not only to reports such as the present one, but also to staff and other studies designed for a more specialized audience.

Shortly after receiving the Reference, the Economic Council advertised across Canada its readiness to receive written submissions from individuals and organizations regarding any of the areas to be studied. Nearly 40 such submissions have been received. They have proved of value in identifying problems and issues and in pointing to appropriate fields of inquiry for the Council's research program. We are grateful to those who expended time and effort on the preparation of submissions.

Notes and References

[1] Press Release of July 22, 1966, issued by the President of the Privy Council, Ottawa. See Appendix I.

CHAPTER 2

PHILOSOPHY AND PROBLEMS OF COMPETITION POLICY

This Chapter will set forth what we believe should be the basic objective of Canadian government policy relating to combines, mergers, monopolies and restraint of trade. It will place this objective in a broader context of economic goals and policies for the achievement of such goals, and indicate some of the more important problems that arise in the practical implementation of competition policy.

The Council's view, in brief, is that the objective of legislation such as the Combines Investigation Act should be the promotion of dynamic efficiency, flexibility and good all-round performance in the Canadian economy. Competition is regarded as only a means, though an important means, to this end. Conceived in this fashion, "competition policy" can be readily related to the goals for the Canadian economy elaborated by this Council in successive Annual Reviews. It can also be related to policies such as tariff policy, manpower policy, and patent policy which strongly condition how favourable or otherwise the economic environment is likely to be for the strengthening of effective competition and the achievement of high levels of efficiency.

But while the establishment of these linkages makes possible a clearer and more consistent view of the place of competition policy in the total spectrum of economic policies, there must also be discussed certain special difficulties of policy administration and enforcement. In some areas of competition policy, reliance can be placed on relatively broad prohibitions of anticompetitive behaviour, but in other areas more discretion must be exercised and more analysis of probable economic effects brought to bear on individual cases.

It is useful for some purposes to think of competition as one form (the most impersonal form) of social control of industry. Where competition is such as to promote the efficient use of manpower, capital and natural resources, it obviates or lessens the need for other forms of control such as more or less detailed public regulation or public ownership of industry.

There are of course sectors of the economy, such as the post office, telephones, and other natural monopolies, in which other forms of control are needed. This does not mean, however, that competition policy should never apply to such sectors. On the contrary, a comprehensive and broadly conceived competition policy should concern itself with promoting efficiency in *all* parts of the economy, by whatever means are most appropriate in each particular case. It should include periodic assessments of publicly owned and publicly regulated sectors to see whether the arrangements there are truly furthering the public interest in efficient economic performance. In some cases, it may be found, as it was recently in the case of the railways, that conditions are ripe for more market competition and less direct regulation.

Objectives of Competition Policy

In the past, the major objective of Canadian competition policy has usually been expressed in such terms as "the protection of the public interest in free competition". But it is necessary to go behind this and ask what the preservation of competition was intended to accomplish. One would be unwise to assume that what the legislators aimed at was a single, simple end such as economic efficiency. At least some role was likely played by considerations such as the desire to diffuse economic power (and thus, by implication, political power), sympathy for the plight of the small enterprise and entrepreneur, suspicion of big business, and concern for the fairness of competitive behaviour.

On the whole, however, competition policy in Canada appears to have been directed towards more strictly economic ends. Two such ends may be distinguished, one being concerned with the distribution of income, the other with the allocation of real resources in the economy.

Popular thinking about competition policy has tended to stress the first, or income, objective. Opposition to noncompetitive situations such as outright monopoly (to take the extreme example, although less extreme cases of imperfect competition would serve the turn as well) has traditionally centred on the transfer of income from the buyer to the monopoly seller. The abnormal monopoly profit may be regarded as an unnecessary exaction -- as a privately imposed tax. This point was

no doubt uppermost in the minds of the farm interests who were among the stronger supporters of early anticombines and antitrust legislation in Canada and the United States before the turn of the century. They, like others, wanted to recover some of the income which they believed had been transferred from themselves to the tariff-protected and in some cases quite highly concentrated manufacturing industries from which they bought. (They also had grievances against the railroads, which then dominated land transport to a far greater extent than today, but in this case the chief mode of social control adopted was public regulation.)

Professional economists, while not ignoring income distribution effects, have tended to be more concerned with the second objective of competition policy -- the resource-allocation objective. This is a less obvious objective, but a highly relevant one for broad economic goals such as productivity growth. To many economists, the greatest objection to monopoly (again using the extreme example) is that it distorts the way scarce human and physical resources are brought together and used to meet the many demands of consumers. It leads, in other words, to inefficiency. The monopolist's prices are too high, relative to other prices, and because the usual adjustment machinery is not operative, they remain so. As a result, "relative prices become unreliable as indexes of relative scarcities and relative demands ... too little will be produced and too few resources utilized in [monopolistic] industries with high margins; and too much will be produced and too many resources utilized in industries with low margins."[1] These distortions may occur primarily in final consumer markets, such as the market for some kinds of household appliances, or they may originate further back, say in the market where the appliance-maker buys his steel. They may include distortions of production methods, as for example where a high monopoly price for a certain kind of production machinery may cause the appliance-maker to use less of it than he ideally should. But wherever in the production and distribution process the distortion occurs, it will have an adverse effect on the quantities and varieties of products reaching the consumer and on the prices he pays for them.

When the statement is made that monopoly results in inefficiency, a different and broader standard

of efficiency is being applied than might well be used by an investor deciding whether or not to put his money into a company. To him, a large and growing sales volume and a consistent record of well-maintained earnings and dividends will seem conclusive evidence of efficiency. But the "efficiency" that is relevant for problems of competition and monopoly is a different, economy-wide concept. It poses the question of how well the economy is doing one of its basic jobs -- that of allocating resources between different tasks, and in this way determining what goods and services get produced, how they are produced, and for whom they are produced. Viewed in this light, the investor's hypothetical company may not look so good. The conclusion may emerge that, from the standpoint of the general public interest, and having regard to all the marketing and production opportunities and other circumstances that were present, the sales volume of the industry to which the company belongs should have grown twice as fast, with lower prices and profit margins.

It would be wrong, however, to leave the impression that the consequences for efficiency of a relative absence of competitive pressure are invariably an esoteric matter, beyond the capacity of an ordinary intelligent person to discern. As everyday observation will confirm, lack of strong competition in a company's product market increases the risk of sloppiness, poor use of productive resources, and excessive production and distribution costs. An environment is created in which both waste and a comfortable, if not necessarily spectacular, profit margin can persist, undisturbed by clear and urgent signals from the market.

This brings us to a fundamental tenet relating to competition policy. The institution and maintenance of a competition policy such as presently exists in Canada may be taken to reflect a belief that, over the greater part of the economy, competitive market forces are potentially capable of allocating resources better and more cheaply, with a less cumbersome administrative overhead, than any alternative arrangement such as wholesale public ownership and control, detailed government regulation of enterprise, or self-regulation by large industrial units within a corporate state. The function of competition policy is not to bring about a textbook regime of "perfect" competition in all the various markets making up the system, but rather to

encourage the liberation of the system's maximum competitive potential, "imperfect" though this may be. The resulting competition is valued not for itself, but for what it can accomplish in putting resources to work efficiently and effectively. Thus the market does the job, and the government's main responsibility, so far as efficiency in resource allocation is concerned, is to see that the market is free to do the best job of which it is capable. Competition is relied upon as the prime mechanism of social control:

> The legislation postulates the continuing existence of a free enterprise economy, actuated by the profit motive, in which those who wish to compete for economic gain should, to the largest extent possible, be allowed to compete free from artificial restraints imposed upon them by their competitors or other members of trade or industry. What Parliament contemplates, as expressed in this legislation, is the regulation of industry by the forces of competition rather than regulation by members of industry itself.[2]

Competition and Efficiency

It will be a recurrent theme of this Report that Canadian competition policy should aim primarily at bringing about more efficient performance by the economy as a whole. *Competition should not itself be the objective* but rather the most important single *means* by which efficiency is achieved. First, however, it is necessary to say something about the nature of competition in a modern economy and its relationship to efficiency.

As is well known, the great majority of markets do not fulfil the conditions of the economist's abstract model of "perfect" competition, wherein there are many fully informed producers and consumers, the market operates with exceptional swiftness and efficiency, and no individual seller or buyer has any significant leverage or market power. At the other end of the scale, the case of pure monopoly is also very rare in real life, especially if one is inclined to take a broad view of the possibilities of product substitution. Most markets (the North American market for automobiles is a good example) fall between these limits, in the grey zone of imperfect competition. Sellers are sometimes

relatively few, and some of them may be big and powerful. The moves made by any one seller may be much affected by his expectation of how the others will react, in which case the situation may be described as one of "oligopoly". Many variants and degrees of imperfect competition are to be found, with factors such as the amount of import competition exerting an important influence. In some cases, the imperfection of competition may partly reflect successful efforts by firms to differentiate their products -- to use product features and design, packaging and advertising, to persuade the consumer that what he is buying is significantly different from what the firm's competitors are offering.

Most markets thus being in one way or another imperfect, the model of perfect competition remains essentially an abstraction, useful for purposes of formal economic analysis because it is one end of a range, providing a point of reference and standard of comparison. (Moreover, it is not wholly without some predictive power in real-life situations.) But it cannot be and has not been a simple guide for the application of competition policy. Whatever deficiencies may be laid at the door of Canadian competition policy, any allegation that it has amounted to a systematic, if futile, attempt to impose perfect competition on the economy cannot be sustained on the evidence of reports and cases under the Combines Investigation Act.

To note the abstract quality of the perfectly competitive model, however, is very far from saying that economic analysis has little to contribute to competition policy. The nature and characteristics of imperfectly competitive markets have been extensively studied, and while this process has as yet failed to produce a satisfactory model or set of models that can be relied upon to predict what will happen in each of the many varieties of imperfectly competitive situations that are found in real life, a number of useful inferences have been drawn. Principles and concepts have been evolved that have a strong appeal to common sense and can be utilized to good effect in practical policy administration. One such principle is the desirability of keeping open for the buyer an adequate number of real options. However, what is deemed adequate in any particular case must inevitably be tempered by other considerations such as the technological conditions of production in an industry, which may make the optimal

situation one of a relatively small number of plants producing on a large scale.[3] Subject to this qualification, a buyer will generally prefer to have three or four actual or potential suppliers of an item rather than only one. A typical concern of competition policy is to look into situations where real options available to the customer are in the process of being unjustifiably reduced.

Another concept highly relevant to competition policy in a world of imperfect competition is that of the ease of entry into an industry.[4] For customers to be faced with only one or two suppliers of an item may be a tolerable situation if it would be relatively easy for other firms (including importers) to enter the business. The possibility of this occurring will tend to make the existing suppliers less tempted to exploit their customers to the point where their profit levels might attract new firms into the industry. But where it is very difficult and expensive for outsiders to break in (they might, for example, have to put very large sums into initial plant and equipment outlays and advertising), the customer is likely to be more vulnerable.

Still other concepts and principles are useful for assessing product differentiation and the many types of nonprice competition that are encountered in imperfectly competitive markets -- for example, competition in respect of product features and after-sales service. A basic principle here is that competition is to be valued according to the real net benefit it yields to the ultimate consumer. Some types and degrees of nonprice competition may pass this test while some may not. For example, the net benefit to the consumer of trading stamps and some other promotional devices has frequently been called into question. Despite such criticisms, it is still too widely assumed that *any* form of vigorous business rivalry amounts to healthy competition and is therefore good for the economy.

It must be added that imperfections of competition do not always arise primarily on the selling side of the market. Buyers, too, (supermarket and department store chains, for example) can wield substantial market power in their dealings with suppliers, as was pointed out forcefully in some of the briefs submitted to us. Assessment of such situations can

often be peculiarly difficult, not least because of the natural tendency of most people to sympathize with any underdog. But while it may seem hard, here again analysis and policy are likely to be soundest if the primary consideration continues to be the interest of the consumer rather than that of any particular producer. This means, for one thing, that relations between, say, retailers and suppliers should never be considered independently of the state of affairs in the final market where retailers meet consumers. Where that final market is characterized by vigorous competition of a type beneficial to consumers, a "squeeze" being experienced by suppliers may largely represent a normal "upstream" transmission of competitive pressures, perhaps exacerbated in some cases by the temporarily disturbing introduction of more efficient production and distribution techniques. Where, on the other hand, the final market is not notably competitive, the squeezing of suppliers may be more in the nature of an exercise of market power, possibly tending towards an eventual elimination of independent suppliers and a backward extension of noncompetitiveness through vertical integration. Even here, however, the real crux of the situation remains the noncompetitiveness of the final market. Only those policy actions that in one way or another correct this (such as by reducing barriers to the entry of new retailers) are likely to have much beneficial effect.

"Dynamic" Competition

In using economic analysis for purposes of competition policy, it is important to view competition and efficiency in dynamic rather than purely static terms. That is, they must be seen in a context of economic change over time, with new products, industries and methods of distribution constantly coming forward and old ones dying off.

This point, which over the course of a generation has come to be widely recognized by economists and administrators, was first made in a major way by the late Joseph Schumpeter. Schumpeter's study of the historical rise of capitalism led him to the belief that the central impulse of economic progress was "the perennial gale of creative destruction", incessantly revolutionizing the economic structure from within. This, in his view, necessitated the rejection of:

> ... the traditional conception of the *modus operandi* of competition. Economists are at long last emerging from the stage in which price competition was all they saw. As soon as quality competition and sales effort are admitted into the sacred precincts of theory, the price variable is ousted from its dominant position. However, it is still competition within a rigid pattern of invariant conditions, methods of production and forms of industrial organization in particular, that practically monopolizes attention. But in capitalist reality as distinguished from its textbook picture, it is not that kind of competition which counts but the competition from the new commodity, the new technology, the new source of supply, the new type of organization (the largest-scale unit of control for instance) -- competition which commands a decisive cost or quality advantage and which strikes not at the margins of the profits and the outputs of the existing firms but at their foundations and their very lives. This kind of competition is as much more effective than the other as a bombardment is in comparison with forcing a door, and so much more important that it becomes a matter of comparative indifference whether competition in the ordinary sense functions more or less promptly....[5]

Not only did Schumpeter find invention and innovation, in a very broad sense, to be the key to progress; he also made a case that some degree of monopoly and restrictive practice was necessary to "steady the ship" and provide the sort of environment in which technical progress and innovation could occur. At the same time, however, he did not conclude from his analysis that all competition policy should be discontinued. He was prepared to recognize, for example, that some restrictive business practices were less an essential safeguard for the early stages of new product development than they were an ultimately futile but temporarily disrupting effort to fight inevitable change. What he did urge was a more flexible and discriminating approach to competition policy:

> Even as now extended however, our argument does not cover all cases of restrictive or regulating strategy, many of which no doubt have that injurious effect on the long-run development of output which

> is uncritically attributed to all of them. And even in the cases our argument does cover, the net effect is a question of the circumstances and of the way in which and the degree to which industry regulates itself in each individual case. It is certainly as conceivable that an all-pervading cartel system might sabotage all progress as it is that it might realize, with smaller social and private costs, all that perfect competition is supposed to realize. This is why our argument does not amount to a case against state regulation. It does show that there is no general case for indiscriminate "trust-busting" or for the prosecution of everything that qualifies as a restraint of trade.[6]

The Schumpeter hypothesis, which was originally developed on a basis of extensive but relatively crude empirical observation, has remained a rich source of controversy and a spur to further economic research and testing up to the present day. It has, for example, been a major stimulus to the large volume of factual investigation, either completed or under way, into relationships between research and innovative activity on the one hand and the size and other characteristics of companies on the other -- a matter touched on in Chapter 5 of this Report. This and other evidence have been variously interpreted, and the present state of the argument is difficult to summarize. It is not necessarily inconsistent to feel that, while certain degrees of corporate bigness and associated phenomena are appropriate in some industries as a means of helping to bring about socially desirable levels of research, invention and innovation, too *little* competition would remove one of the most important spurs to these types of activity. One American authority, Richard Caves, has reached the conclusion that "some degree of concentration is needed to promote research and innovation, but whether existing structures provide too much or too little remains debatable".[7] Another, Jesse W. Markham, suggests that Schumpeter's theory ought to be treated as a "threshold theory", which states that "some departure from a state of perfect competition (or the presence of some monopoly) is a necessary concomitant of innovation, but it does not follow that twice this volume of departures, somehow measured, should lead to twice the volume of innovations". He goes on to say that the intensive statistical analysis

of invention that has occurred since Schumpeter "provides no basis for either condemning or beating the drums for bigness or for concentration on the grounds that they either stifle or promote technical progress ... corporate size and market power in excess of Schumpeterian threshold levels appear to be with us, and for this and other reasons are still legitimate concerns of public policy."[8]

Where there would probably be a wide measure of agreement would be on the proposition that competition must be seen in its dynamic dimension. To the greatest extent possible, competition policy should be administered in such a way that due account is taken of the competitive impact of, and the desire for, new products and new methods of production and distribution.

The New Industrial State

A much more recent work than Schumpeter's, dealing with matters of industrial organization, is J. K. Galbraith's *The New Industrial State*. This book has already been widely read and discussed, and for this reason should be mentioned at least briefly here. It covers, of course, a considerably wider territory than competition policy. It is nothing less than an attempt to discern, on the basis of developments observable in certain sectors of the U.S. economy, some central tendencies of modern industrial societies. Walter Adams, at the outset of what later becomes a distinctly critical article, summarizes Galbraith's main argument thus:

> He finds that the giant corporation has achieved such dominance of American industry that it can control its environment and immunize itself from the discipline of all exogenous control mechanisms -- especially the competitive market. Through separation of ownership from management, it has emancipated itself from the control of stockholders. By reinvestment of profits (internal financing), it has eliminated the influence of the financier and the capital market. By brainwashing its clientele, it has insulated itself from consumer sovereignty. By possession of market power, it has come to dominate both suppliers and customers. By judicious identification with and manipulation of the state, it has achieved autonomy. Whatever

> it cannot do for itself to assure survival and growth, a compliant government does on its behalf -- assuring the maintenance of full employment, eliminating the risk of and subsidizing the investment in research and development, and assuring the supply of scientific and technical skills required by the modern technostructure. In return for this privileged autonomy, the industrial giant performs society's planning function. And this, according to Galbraith, is not only inevitable (because technological imperatives dictate it); it is also good. To be sure, Galbraith recognizes that the industrial state poses a grave problem for the esthetic and other non-economic values of our civilization. But this is simply a matter for future negotiation between our intellectuals and the technostructure. So far as the economic system is concerned, the only remaining task, it seems, is to recognize the trend, to accept it as inexorable necessity, and, presumably, not to stand in its way.[9]

So far as competition policy is concerned, the essential issue raised by Galbraith is whether the U.S. economy has gone, or soon will have gone, so far along the lines he describes that any attempt to strengthen competition and market forces would be largely an exercise in futility. He concedes that antitrust policy still has a marginal usefulness in some areas, but for the most part he appears to regard it as a piece of harmless deception. In the sectors of the economy with which he is principally concerned, he sees no value in it:

> It follows that the antitrust laws, in seeking to preserve the market, are an anachronism in the larger world of industrial planning.[10]

It is clearly apparent that, as in some of his previous works, Galbraith in *The New Industrial State* deliberately set out to be provocative. It is equally apparent that he has been successful. Economists, in particular, have taken up the challenge in respect of several of the major arguments. A recurring criticism is that of excessive generalization. There seems little doubt that the tendencies described in the book may be found in certain parts of the U.S. economy. The vital question for public policy is how pervasive these

tendencies are -- how representative they are of what is going on or soon will be going on in the American economy as a whole. Many critics believe them to be a great deal more special and less representative than does Galbraith.

What of the relevance of the book for Canada? Is market competition in Canada dying and beyond resuscitation? Bits and pieces of evidence relating to this matter are available -- for example, the industrial concentration data referred to in Chapter 5. There are, however, large gaps, and answers to the questions posed above must be in part impressionistic. On this basis, it would be our conclusion that, over the greater part of the Canadian economy, and provided they are supported by adequate competition policy and other appropriate policies, competitive market forces can be an important factor making for efficient economic performance. We would note in passing that a substantial proportion of the American industrial landscape painted by Galbraith appears to involve industries much of whose output flows into defence and space programs. It is not really surprising if in such industries the managerial role of the "technostructure" is very significant, relations with government are close, and the role of market forces is attenuated. Somewhat similar situations are to be found in Canada, but as might be expected from the relatively smaller size and complexity of Canadian defence and space programs, they bulk less large in the economy.

The above is not meant to be an out-of-hand dismissal of the importance for Canada of *The New Industrial State*. On the contrary, the issues raised by Galbraith are worthy of consideration in all industrialized countries. One issue suggested by the book is the general role of the corporation (particularly the large corporation) in a democratic state. What is the chief goal of large corporations? Is it still, in the final analysis, some kind of profit-maximization (perhaps on a very long-run basis); or has it, as Galbraith suggests, become something decidedly different? Is it desirable, in the interests of society as a whole, that large corporate organizations should concentrate their resources and energies primarily on the achievement of their own business goals? How far should they go into what might be described as "extracurricular activities" -- assuming community leadership, setting

up foundations, contributing to educational and charitable causes, and in other ways endeavouring to live up to codes of good corporate citizenship? These are not idle speculations, for, unlike most individuals, many "corporate citizens", in both their main and their subsidiary activities, determine the use of very large amounts of resources. How well these resources are used, from the point of view of the total society, is of much significance. So too, therefore, are the social responsibilities of corporations and the locus of decision-making power within them.

We earlier characterized competition as a means of social control of the economy, contrasting it with alternative means such as public ownership and public-utility-type regulation. A further question suggested by a reading of *The New Industrial State* is whether, in cases where competition was seen to be no longer effective as a means of social control, inexorable pressure would not fairly soon develop for the institution of other means. Even the most intelligent policies for the preservation and encouragement of competition are bound to be seen by businessmen subject to them as something of a nuisance and a harassment. But this view should be tempered by considering the other policy options that might well be exercised in the absence of effective competition.

In the case of an oligopolistic and product-differentiating industry selling directly to consumers, one policy option that may need to be exercised, even if matters have not yet reached the stage where major alternative means of social control are being considered, is a heightened emphasis on consumer protection and consumer information. Policies in these areas may, to some extent, remedy a lack of competitiveness (particularly price competitiveness) in a market. For example, better product information from an unbiased source may enable the consumer to form a lower and more realistic estimate of how much a particular piece of product differentiation is really worth to him. Acting on this estimate, he may bring about a shift in the market towards a more even confrontation of products and sharper price competition.

Competition Policy and Economic Goals

The discussion to this point of the objectives of competition policy may be recapitulated as follows:

-- the main objective of competition policy should be that of obtaining the most efficient possible performance from the economy;

-- at any given moment, the economy should be using the resources available to it in ways that most contribute to raising total output in accordance with consumer demands;

-- the efficiency of resource use must, however, be seen in dynamic as well as static terms, which implies among other things the recognition of the importance of research, invention and innovation;

-- but the dynamic view also implies that as demands change and technology advances, resources should move freely into new and better patterns of use, and it is important therefore that monopoly and restrictive practices should not be allowed to get in the way of this process and prevent the economy from deploying its resources to better advantage in a changing world.

Essentially, we are advocating the adoption of a single objective for competition policy: the improvement of economic efficiency and the avoidance of economic waste, with a view to enhancing the well-being of Canadians. In conjunction with other policies, competition policy should seek to develop an economic environment in which beneficial change will be initiated and carried through, and in which real income will be maximized.

This concentration on one objective is not meant to imply any necessary disparagement of other objectives, such as more equitable distribution of income and the diffusion of economic power, which have been entertained for competition policy in the past. It is simply that we believe:

(1) that a competition policy concentrated on the efficiency objective is likely to be applied more consistently and effectively; and

(2) that there exist more comprehensive and faster-working instruments, particularly the tax system and the structure of transfer payments, for accomplishing the deliberate redistribution of income and the diffusion of economic power, to whatever extent these are thought to be desirable.

On the point of consistency, it may be explained by way of example that a competition policy that assigned equal importance to maximizing economic efficiency and diffusing economic power would be likely on occasion to run into a conflict of goals. It is a stern reality of a competitive market system that from time to time some competitors go to the wall. If this occurs mainly because of predatory or exclusionary tactics practised by other competitors, there may well be a good case for competition policy to intervene. But if the squeezing out of competitors appears to be part of a process likely to produce increased efficiency and lower costs and prices (if, for instance, a number of small corner stores are being forced out of business by the entry of new, low-cost, mass distributors) then a dilemma is faced. The economic efficiency goal might well suggest letting the process work itself out; the goal of diffusing economic power would call for intervention. By recommending that efficiency be the sole objective of competition policy, we are in effect saying that no individual competitor, corporate or otherwise, has an inherent right to stay in business.

It must not be thought, however, that the single-minded pursuit of efficiency would invariably work against the diffusion of economic power, or indeed against the achievement of more equal income distribution. Most of the time, action to promote efficiency would also result in some progress towards the other goals mentioned. For example, while we do not believe that an efficiency-oriented competition policy would necessarily be concerned to guarantee the survival of already-established enterprises in an industry, we do strongly believe that such a policy would be very much concerned with eliminating barriers to the entry of new enterprises, some of which would often be relatively small enterprises.

If, then, the objective of competition policy can be taken to be the promotion of economic efficiency and the reduction of economic waste, how may this be related to the five economic goals for Canada elaborated by the Economic Council in successive Annual Reviews? These goals, it will be recalled, are full employment, a high rate of economic growth, reasonable stability of prices, a viable balance of international payments, and an equitable distribution of rising incomes.

Some economic policies are capable, at least upon occasion, of facilitating the attainment of more than one goal. At the same time, however, policies tend to be specialized in their application, and to be more relevant for one goal than for others (hence the need for a skilful blending of policies in order to work towards all goals simultaneously). This is clearly true of competition policy which, though it has at least some bearing on all five goals, is most relevant for the goal of rapid economic growth. To the extent that the policy works as it should, it opens the way for market forces to operate more freely at all stages of the productive process and improves the prospects of rapid productivity growth. A specific example will illustrate this. As has already been mentioned, one of the typical preoccupations of competition policy is to lower unnecessary barriers to the entry of new firms into industries. In other words, there should be no unneeded roadblocks in the way of the person who thinks that he can come in and do the job better and cheaper. Thus an important element in the 1951 decision to ban resale price maintenance in Canada was the view that there should be nothing to prevent a retailer from trying to operate on a basis of high volume and low mark-up. It is just such a basis of operation that has made possible the retailing revolution of the last 40 years and the increase in productivity that has accompanied it.

The liberation of market forces, which competition policy seeks to achieve, helps to produce a pattern of output more closely related to consumer needs. This point was made in the Council's *Interim Report on Consumer Affairs:*

> High standards of performance in the Canadian economy -- including particularly the maintenance of high employment, strong productivity growth and

> reasonable price stability -- will provide a basis for achieving important and continuing improvements in consumer welfare and real living standards. However, these improvements will only be realized fully and effectively if adequate attention is paid to the process of relating productive efforts as closely as possible to the needs and aspirations of consumers. To a large extent this can be achieved by the operation of flexible markets sensitive to changing consumer preferences.[11]

A competition policy aiming at economic efficiency can be fairly readily related to a second major goal of the Canadian economy, that of a viable balance of international payments. In general, a policy that strives to maintain an adequate degree of competition in the domestic market will tend to harden the economy's muscles and render it better able to meet the tests of international competition. From time to time, however, certain conflicts may occur -- for example, where conditions in foreign markets make it appropriate for exporting enterprises to form consortia or other types of intercompany association. It may be difficult to prevent these consortia from impinging back upon the domestic market and running afoul of competition policy there. The Webb-Pomerene Act in the United States and some of the 1960 amendments to the Canadian Combines Investigation Act were attempts to resolve this type of conflict.

There is also some relationship between competition policy and the goal of reasonable price stability. Under postwar conditions, a virtually universal problem of industrial countries has been to keep the general level of prices from rising, even at times of substantial unemployment.[12] On balance, over a succession of relatively soft and relatively buoyant phases of economic activity, an effective competition policy helps to slow the longer-term upward price rise. To the extent that opportunities for the exercise of market power are reduced, the ability to pass cost increases on into price increases is diminished, with the result that a greater incentive is created to seek efficiencies and ways of keeping costs and prices down. This in turn eases the task of the monetary authorities, who are less likely to have their hand forced by situations where monetary action can only decelerate the rise in the general price level by bringing about an unacceptably high level of unemployment.

Turning now to the goal of full employment, there is no direct and obvious relationship between this and competition policy. The prime requisite for full employment is an adequate level of aggregate demand, and the "big levers" of fiscal and monetary policy can in principle provide this equally well under monopolistic or competitive conditions. As has been suggested, however, there is an indirect relationship. If full employment is to be well sustained, there must be good performance in respect of other goals, notably that of reasonable price stability and of the productivity component of rapid economic growth. To the extent that competition policy assists the attainment of these other goals, it contributes indirectly to the attainment of full employment. For example, in so far as competition policy makes stability in the general price level any easier to achieve, it mitigates the policy problem of the "trade-off" between the goals of full employment and reasonable price stability, thus making it possible to press more vigorously towards the attainment of full employment.

The fifth of the Council's goals is an equitable distribution of rising incomes. The desire to prevent or lessen the income transfer that occurs between buyer and monopoly seller has provided one of the reasons for instituting competition policy in the past. The position has already been taken, however, that deliberate changes in the distribution of income are best brought about by relying mainly on policies other than competition policy.

We are left, then, with the proposition that while there is some relationship between competition policy and all five of the goals, the main link is by way of the encouragement of efficiency and rapid economic growth. This leads to a further proposition, to the effect that the most significant relationships between competition policy and other economic policies are with those policies (usually of a somewhat longer-term nature) that have a major bearing on the efficiency and productivity of the Canadian economy, and on the state of competition within it. This group includes tariff policy and other commercial policies, policies such as manpower mobility programs designed to facilitate the transfer of resources in the economy, and other policies aiming at restructuring the Canadian economy -- for example, in the direction of greater scale and specialization of production.

It is important to appreciate both the potentialities and the limitations of competition policy. How much it can accomplish in the way of improving economic efficiency is heavily conditioned by the setting of other economic policies and other aspects of the general economic environment. In Canada, the intensity of import competition in domestic markets is crucial. To a considerable degree, Canadian competition policy has represented an attempt to provide a partial substitute for the greater intensity of competition that would have prevailed in the absence of tariffs.

The future effectiveness of competition policy in Canada will depend very much on how well it can be co-ordinated with other economic policies. The present situation in this respect could be greatly improved. Agreement on policy objectives will be a first essential. If the objective of maximizing economic efficiency can be kept well to the fore in respect both of competition policy and of other policies to which it is closely related, it should be possible to put an end to the unhealthy situation whereby, despite the stepped-up informational efforts of its administrators, competition policy is still too frequently regarded as a highly specialized and esoteric activity whose ultimate goals are wrapped in legal enigmas. While there will always be certain legal complexities to be faced, there is no reason that we can see why competition policy should not take its place as part of an interrelated structure of policies directed towards common economic ends.

Problems in Applying Competition Policy

Even where there was a consensus on the objectives of competition policy, however, the practical application of the policy would pose some special problems. If economic efficiency is taken as the basic objective, the policy should in principle be applied in such a way as to take account of all the important factors that bear upon efficiency in each individual case. Yet the law should be clear, give fair warning, and lend itself to reasonably speedy application. These principles are not always easy to reconcile in practice, and much criticism of competition policy reflects this underlying dilemma.

Why, it is frequently asked, should there be, in the application of competition policy, so much

Preoccupation with competition as such? We stated above that the ultimate objective should be economic efficiency rather than competition for its own sake. Why then should public policy in this area be concentrated on removing impediments to competition -- on restraining certain types of market *conduct* such as collusive price-fixing, or on trying to prevent the emergence of certain types of market *structure* such as monopoly? Why not by-pass all this, go to the heart of the matter, and focus directly on the efficiency of business *performance?*[13] If the consumer is obtaining efficient and otherwise satisfactory performance from industry, why should it matter what structures and patterns of business conduct, what conditions of competition, lie behind that performance?

These questions have been posed, not only by businessmen, but also by some economists. The general notion of replacing the complex legal trappings of competition policy by something more in the nature of an expert review panel that would simply address itself to the question of whether an industry's or firm's performance was generally progressive and efficient is an eternally seductive one. The great difficulties involved only become apparent when one gets down to the details of turning it into practical public policy:

> What will be lacking is any basis for deciding whether the firm's performance was good or bad in light of its opportunities. The record may reveal that output has grown ten times in the period under study; it will not reveal whether or not output could have grown fifteen times if price policy had been different or if more vigorous efforts had been made in product development, in foreign marketing, or in cost reduction. The record may show that expenditures of money and of the time of trained men on research and development were large and continuous, and that the decrease of inputs per unit of output as well as the flow of new and improved products were great; it will not in general show whether returns per dollars or per professional man-hour were high or low, or would have been higher or lower had the situation or conduct of the firm been different than it in fact was. True, there may be exceptional situations in which the spectacular quality of the results overwhelms question, or in which the almost total

> lack of effort speaks for itself. Yet even in such cases the problem is not completely solved. Would a big research effort in the poorly performing industry pay for itself? Could the excellent performer have bettered even its own spectacular record if it had operated under different market conditions?[14]

There is also the problem that good performance in the past gives no necessary assurance of similar performance in the future. To be really meaningful, enforcement of the policy would have to be continuous, with a large bureaucracy to second-guess all important managerial decisions. Such a system would be virtually indistinguishable from detailed public regulation of industry.

As against this, a competition policy more or less like Canada's present one, which places emphasis on market conduct and to a lesser degree on market structure, can be seen to have important advantages of simplicity and low overhead. In principle, at any rate, it should only be necessary to ensure that market conduct and market structure are such as to provide an acceptable degree of competition. The attainment of efficient industrial performance can then be left to market forces, without any need for vast supervisory efforts and detailed bureaucratic surveillance.

There are important choices and "trade-offs" to be made in the application of competition policy. To obtain certain advantages, it is sometimes necessary to make certain sacrifices. Thus it may be thought desirable to apply the policy in such a way as to examine in some depth the economics of individual cases, with much attention being devoted to past business performance and likely future performance. But this will tend to slow up proceedings and to render their outcome less predictable. If, by contrast, a high value is placed on speed and certainty, it may be decided to go another route and to promulgate clear bans on specific kinds of business conduct, with the courts not required to engage in comprehensive economic analysis of individual cases.

Between these two extremes, there are of course many intermediate positions. Also, the application of competition policy need not be all of a piece. In

one sector, such as merger policy, there may be a leaning towards a discretionary approach, with speed and certainty being sacrificed in favour of greater economic analysis of individual cases. In another sector, such as policy towards collusive price-fixing, detailed depth-analysis of individual cases may be judged less necessary, with the result that the law can be given more the form of an outright prohibition. The policy recommendations to be made later in this Report embody just such a varied approach.

Notes and References

[1] T. Scitovsky, "Economic Theory and the Measurement of Concentration", *Business Concentration and Price Policy*, New York, National Bureau of Economic Research, 1955, p. 104.

[2] D. H. W. Henry, Q.C. (Director of Investigation and Research under the Combines Investigation Act), Address to the New York State Bar Association, Antitrust Law Section, New York, January 30, 1964 (mimeo.).

[3] In a Preface to a selection of readings on combines policy, one Canadian authority on industrial organization and competition policy states, "Perhaps the most useful approach is the eclectic one which, while recognizing that large size and 'fewness' are concomitants of modern industrial organization, emphasizes the importance of the availability of adequate alternatives to buyers and sellers, whatever may be the source of the economic pressures accounting for the provision of such alternatives." L. A. Skeoch, *Restrictive Trade Practices in Canada*, Toronto, McClelland and Stewart, 1966, p. x.

[4] Joe S. Bain's *Barriers to New Competition*, Cambridge, Mass., Harvard University Press, 1956, is a standard reference on this topic.

[5] Joseph A. Schumpeter, *Capitalism, Socialism and Democracy*, 3rd edition, New York, Harper & Row, 1942, p. 84.

[6] *Ibid.*, p. 91.

[7] Richard Caves, *American Industry: Structure, Conduct, Performance,* Second Edition, Englewood Cliffs, N.J., Prentice-Hall, 1967, p. 104.

[8] Jesse W. Markham, "Market Structure, Business Conduct, and Innovation", *American Economic Review,* vol. 55, no. 2, May 1965, pp. 325,331-332.

[9] Walter Adams, "A Blueprint for Technocracy", *Science,* vol. 157, August 4, 1967, p. 532. Two other important critiques of the Galbraith work are J. E. Meade's "Is the New Industrial State Inevitable?", *Economic Journal,* June 1968, p. 372; and Scott Gordon's, "The Close of the Galbraithian System", *The Journal of Political Economy,* July-August 1968, p. 635.

[10] John Kenneth Galbraith, *The New Industrial State,* Boston, Houghton Mifflin, 1967, p. 197.

[11] Economic Council of Canada, *Interim Report -- Consumer Affairs and the Department of the Registrar General,* Ottawa, Queen's Printer, July 1967, p. 19.

[12] This problem was extensively discussed in the Economic Council of Canada's *Third Annual Review,* Ottawa, Queen's Printer, 1966, pp. 33-193.

[13] Market *conduct* may be defined as how a firm behaves (e.g. how it reacts to moves made by its rivals) in all the markets in which it deals, whether these be the product markets where it sells its output or the factor markets from which it draws materials, labour and other inputs. Market *structure* consists of the significant features of a market that affect the behaviour of firms buying and selling in that market. It includes such things as the degree of monopoly or concentration, product differentiation, barriers to the entry of new firms, and the growth rate of market demand. Market *performance* embraces the ultimate outcome of market activity and how that outcome relates to broad economic goals such as rapid economic growth.

[14] Carl Kaysen and Donald F. Turner, *Antitrust Policy, An Economic and Legal Analysis,* Cambridge, Mass., Harvard University Press, 1959, pp. 53-54.

CHAPTER 3

COMPETITION POLICY IN EUROPE AND THE UNITED STATES

Most of the world's major industrial countries now have significant competition policies, although both the vigour of the policies and the degree of emphasis with which they address themselves to particular business practices and situations vary considerably from one country to another. In most European countries the long-standing tradition of acceptance of restrictive agreements or cartels has, since the Second World War, given way to increasing recognition of the merits of a competitive economy. U.S. competition policy, or antitrust policy as it is more familiarly known, remains, however, unique in the comprehensiveness of its coverage, in the energy given to its enforcement and in the widespread public acceptance of its underlying presumptions regarding the intrinsic virtues of a competitive private-enterprise economy.

Over the years there has grown up around the subject of U.S. antitrust policy and its administration a truly formidable literature addressed to both the economic and legal aspects. In Europe, by contrast, the veins of commentary available for exploration are not as rich or extensive, since much of the European legislation in this field has either been introduced for the first time or substantially amended in the 1950's or 1960's. For this reason, we commissioned a thorough study of competition policy in five European countries (France, Sweden, Denmark, the Federal German Republic and Britain), a report on which will be published in the near future.[1] Only a summary condensation of those aspects of foreign competition policies that are particularly relevant for Canada will be attempted here; the reader interested in pursuing the subject of foreign experience further should refer to the study and to the short list of major works on U.S. antitrust given in Appendix II.

The discussion here will focus on four principal areas of interest for competition policy: restrictive agreements, dominant firms, mergers, and certain business practices. Rather than spell out in detail all the circumstances in which particular business practices and situations may be called into question, the discussion will emphasize national attitudes with regard to each

of these areas -- attitudes that are reflected in policy approaches, in the wording of legislation, and (particularly in the United States) in the judicial interpretation of legislation. The concluding section will examine the administrative framework through which foreign competition policy is enforced, and the remedies that are available to bring about any desirable changes in business practices.

Restrictive Agreements

Concern about agreements in restraint of trade among competitors has always been one of the prime reasons for introducing competition policy; yet this area, perhaps more than any other, is illustrative of the range of choices facing policy-makers. On the one hand, there is the American approach whereby restrictive agreements are condemned as criminal offences; on the other hand, there is the European practice of specifying the circumstances under which restrictive agreements may be permitted. However, it must be quickly added that in terms of effects, the two approaches are not as far apart as the above overly simplified statement might suggest. While it is true that in all five of the European countries studied agreements in restraint of trade may be approved and operated, in all of them there is an underlying element of prohibition. With only a few exceptions, the general tendency over the last few years has been to tighten up exemptions and to define more narrowly the circumstances under which restrictive agreements may be operated.

Within the five European countries, however, the treatment of restrictive agreements in relation to the public interest varies considerably. At one end of the scale is Britain, where there is a general presumption that such agreements are not in the public interest, and where those seeking to gain approval of agreements must justify their continuation by passing them through one of the exemption "gateways" specified in the Restrictive Trade Practices Act. These gateways permit a restriction to be defended on the following grounds: protecting consumers against injury, counteracting restrictive measures taken by others, enabling the negotiation of fair terms with a preponderant supplier or customer, preventing a serious and persistent adverse effect on employment, or preventing a reduction in the volume or earnings of export business. However,

the most important gateway in practice is the one that allows an agreement to proceed on proof "that the removal of the restriction would deny to the public as purchasers, consumers or users of any goods ... specific and substantial benefits or advantages enjoyed or likely to be enjoyed ... by virtue of the restriction". All gateways give rise to difficulties in interpretation, but none more than this "benefits and advantages" gateway. If an agreement is allowed through a gateway, a balancing test remains: the Restrictive Trade Practices Court must be satisfied that the agreement is, on balance, not contrary to the public interest. This assessment involves the Court in the task of weighing conflicting interests and competing economic analysis and, generally, in making policy decisions.

At the other end of the scale is the position on restrictive agreements taken in Sweden, where there is no general presumption as to whether or not agreements in restraint of trade are in the public interest, and where the key question is whether the agreements produce harmful effects. To be deemed harmful, an agreement between Swedish firms must be one that "unduly affects the formation of prices, restrains productivity in business, or impedes, or prevents the trade of others".

In the United States, restrictive agreements are condemned as a criminal offence under Section 1 of the Sherman Act of 1890. The wording of the Act affords no opportunity for evasion. The courts are only concerned with establishing that an agreement does or does not exist, and have always refused to consider whether the objectives of the agreement or the resultant prices or profits have been "reasonable". The vigorous enforcement of this Section has effectively prevented the appearance in the American economy of the cartelization experienced by numerous European countries, especially in pre-Second-World-War years when there was virtually no competition policy in Europe. The illegality of conspiracy to restrain trade is a firmly established feature of the environment within which U.S. business operates, and business conduct is powerfully influenced by the "relatively large probability that offences in this category will be prosecuted and punished with the full backing of public opinion".[2]

Experience in the five European countries and in the United States indicates that two types of

restrictive agreements have usually been accorded favourable treatment. In all of the countries studied, export agreements may be granted exemption from the general prohibition on agreements in restraint of trade. In the United States, the Webb-Pomerene Export Trade Act of 1918 exempts from a ruling of illegality under the Sherman Act agreements between American exporters in respect of matters such as price and market-sharing, provided the agreement does not affect domestic prices of the product in question or otherwise lessen competition, and provided further that the existence of the agreement does not damage exporters of the same product who are not parties to the agreement. Most European countries grant approval to production rationalization agreements; the German legislation spells out in some detail the circumstances under which such approval may be granted, while in France the conditions necessary to obtain approval for a rationalization agreement are left to the discretion of the administrative tribunal. In Britain, agreements designed to promote officially approved productivity or price stability objectives may be removed from the reach of the 1956 Restrictive Trade Practices Act on the authority of a designated government department.

Dominant Firms

In addition to concern with agreements and practices in restraint of competition, the legislation of the five European countries reflects an awareness of the special public interest in the conduct of "dominant firms". The definition of a dominant firm is expressed in the legislation in such imprecise phrases as a firm that possesses the ability to exert "a substantial influence on price, production, distribution or transport conditions" (Denmark), one that has no competitors or is not exposed to "any substantial competition" (Germany), or one that occupies a position characterized by a "monopoly situation or the manifest concentration of economic power" (France). Obviously the impact of public policy based on such vaguely expressed concepts will depend on their interpretation and application to individual cases. Only in Britain is the method of determining market dominance expressly spelled out. The section of the 1948 Monopolies and Restrictive Practices (Inquiry and Control) Act relating to dominant firms applies when "at least one-third of all the goods of that description which are supplied in the United Kingdom or any substantial part thereof are supplied by or to any one person".

In all of the countries but Britain and the United States, there is no power to prevent the emergence of market dominance, such as by a prohibition of mergers, or to destroy an established position of dominance by requiring the splitting-up of large market-dominating firms. Instead, such firms are subject to supervision or regulation, an approach sometimes described as preventing the "abuse of dominant positions". In Denmark, for example, a dominant firm may be requested to register with the Monopolies Control Authority. If the Authority finds "unreasonable prices or business conditions, unreasonable restraint ... unreasonable discrimination", it will attempt, by negotiation, to obtain a satisfactory change in the dominant firm's policies; if negotiations fail, the Authority has the power to issue orders to the dominant firm, including an order to make supplies available to firms whose freedom of trade has been unreasonably restrained by the dominant firm's refusal to sell. Most important of all, a registered dominant firm must obtain permission to increase its prices from the Monopolies Control Authority, unless special exemption is granted. Given the restriction on the firm's freedom of action, it is not surprising that appeals from a finding of market dominance are frequent.

In France and Germany, little use has yet been made of the dominant-firm provisions. The French legislation in this field is of relatively recent date, while the original German legislation, which contained a relatively limited concept of abuse of a position of market dominance, confining it to matters relating to prices, terms of sale and tying arrangements, was amended only in 1966 to a more general concept which allows action to be taken against any firm "not exposed to any substantial competition" if the Cartel Authority believes it is abusing or exploiting its position of market power.

In Britain, the Board of Trade is authorized to refer to the Monopolies Commission situations in which the "one-third of the market" criterion applies. The guidelines given to the Commission for its assessment of whether or not the public interest is adversely affected by the monopoly itself or by practices associated with it are extremely general. Account is to be taken of all relevant matters, including economical production and distribution, efficient organization of industry,

encouragement of new enterprise, effective distribution of labour, materials and capacity, technical improvements and market expansion. The Commission's findings, and the recommendations it may make to remedy any adverse effects on the public interest, are published. The Commission's role is an advisory one. The responsible Ministry (normally the Board of Trade) decides what, if any, action to take on the strength of the report. Although the power to issue binding orders is present, the Board of Trade has usually preferred to obtain an assurance from the firms in question that the practices complained of will be discontinued or modified.

The British approach to the dominant firm is thus essentially ad hoc, in contrast to that of the other countries studied. There are no regulations applying to dominant firms as such. Whether a dominant firm is, or is not, subject to some sort of supervision will depend on whether or not it has been the subject of a reference to the Monopolies Commission, a situation that has led to criticisms on the grounds of discrimination. The overall effect of the system depends on the initiative of the Board of Trade in referring cases to the Commission, on the determination with which the Commission's recommendations are pressed, and on the Commission's skill in making its public interest assessment.

The most explicit part of U.S. policy regarding dominant firms is to be found in Section 2 of the Sherman Act and in the body of case law under it. Section 2 states that "every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several states, or with foreign nations, shall be deemed guilty of a misdemeanor". Since what is prohibited is the act of *monopolizing*, but not the existence of *monopoly* as a type of economic structure, this Section raises the very complex issue of what sort of conduct constitutes an illegal act. The decisions in some of the earlier court cases, such as United States Steel in 1920, established that neither the existence, attainment nor maintenance of a monopoly position was an offence in the absence of coercive or predatory conduct. However, the conviction of the Aluminum Company of America in 1945 of a Section 2 offence dramatically altered this position. Alcoa's monopoly position had not been achieved by overtly

predatory conduct, nor had it been thrust upon it. Rather, practices admittedly normal and prudent, such as building capacity ahead of demand, were found to have had a monopolizing effect and were so condemned. Thus, although the possession of a monopoly position was not, in and of itself, an offence, the Alcoa conviction went "very far in the direction of making large relative size illegal".[3]

The concept of the dominant firm plays some implicit role in other areas of U.S. antitrust policy, in the sense that certain practices such as exclusive-dealing and tying arrangements are, on the whole, more likely to be condemned when they are carried on by a dominant firm. Furthermore, dominance would appear to be a significant criterion in scanning individual mergers, particularly in the light of court decisions and the recent Merger Guidelines issued by the U.S. Justice Department.

Mergers

Only in the United States, Britain and, to a lesser extent, in the Federal German Republic does competition policy deal in a meaningful way with mergers. In Germany, a 1966 amendment expanded the definition of mergers that must be reported to the Cartel Authority but did not affect the basic principle of the German approach to mergers: that mergers need not be expressly granted prior approval, nor should mergers be liable to dissolution.

Merger policy in the United States is principally incorporated in the Clayton Act, passed in 1914 in an attempt to supplement effective antitrust enforcement with mechanisms by which certain business practices likely to promote monopoly may be dealt with in their incipiency, at a stage early enough to prevent the emergence of the monopoly. Unlike the Sherman Act, the Clayton Act is not criminal but civil law. The Act condemns certain business practices employed by individual firms only when their use may "substantially lessen competition or tend to create a monopoly". In other circumstances, the same practices may be considered acceptable. The effect of the legislation clearly depends on the interpretation of certain terms such as "substantially lessen competition", preceded by the equally important "incipiency" doctrine implicit in the term "may be".

Competition Policy

Modern U.S. merger policy effectively dates from the 1950 Celler-Kefauver amendment to Section 7 of the Clayton Act. Prior to 1950, Section 7 was thought to be applicable only to horizontal mergers in which one company acquired the stock or other share capital of one of its competitors.[4] Mergers involving the acquisition of the actual physical assets of a company could and did proceed freely, impeded neither by Section 7 of the Clayton Act, nor by the Sherman Act which had proven ineffective in this role. The 1950 amendment extended the application of Section 7 to nonhorizontal mergers (i.e. to mergers of firms not in a directly competitive relationship to one another) and to mergers carried out via transfer of physical assets. The amendment instructed the courts to strike down all mergers where "in any line of commerce in any section of the country the effect of such acquisition may be to substantially lessen competition, or to create a monopoly".

As interpreted by the Supreme Court, the amended Section 7 has been a powerful instrument in inhibiting mergers. Of overriding importance has been the Supreme Court's view of the nature of the competition and the competitive process Congress desired to protect, especially the part to be played by small independent enterprises. Successful attacks have been conducted against all three types of mergers: horizontal, vertical and conglomerate. The incipiency doctrine has been crucial, with the probable economic consequences of the attacked merger the focus of court concern.

After almost 20 years of experience with Section 7 there now exists a considerable degree of certainty in the United States as to the circumstances in which a merger is likely to run afoul of competition policy. The accumulation of experience in the courts led the Department of Justice in May 1968 to issue its *Merger Guidelines* in which it indicated the type of mergers it intends to challenge in future. The Guidelines set forth percentage shares of markets controlled by the parties proposing to merge: if the actual market shares are at or above these figures, a challenge will likely be issued. There is some variability in the guiding percentages; thus, in the case of a horizontal merger, the market share standards become stricter the higher the degree of concentration in the industry generally. In addition, a horizontal acquisition that

swallows up an unusually effective competitor, or even a firm with unusual competitive *potential*, will likely be challenged. Vertical mergers, between firms in a supplier-customer relationship, will be challenged if they significantly raise barriers to the entry of new firms into either market, or if they allow the merged firm to use its access to raw materials or other supplies it controls in such a manner that other firms requiring these supplies are hurt, competition is lessened, and it becomes harder for new firms to enter industries where access to the kind of supplies in question is essential.

The Guidelines are less precise in the case of conglomerate mergers, although the market share holdings of a merger involving a *potential* competitor (i.e. a firm that *might*, left to itself, have entered one of the markets where its merging partner was active) are spelled out, and a merger designed to prevent the entry of a potentially "disruptive" firm will be opposed. Conglomerate mergers that significantly increase the danger of reciprocal buying will be challenged, as may mergers that increase the market power of a leading firm in a relatively concentrated or rapidly concentrating market.[5]

In Britain, the decision to bring mergers within reach of the law dates from 1965 when the Monopolies and Mergers Act introduced the principle that certain mergers should be liable to examination and, in the light of the public interest, either permitted, prohibited, or, if already consummated, dissolved. This gave recognition to the fact that the confines of the 1956 Act, which had created the Restrictive Practices Court to deal with restrictive agreements between separate firms, needed to be widened to encompass mergers between previously separate firms that could produce results very similar to those brought about by restrictive agreements.

The assessment of the implications of the merger for the public interest is made by the Monopolies Commission to whom the Board of Trade is authorized to submit mergers that exceed either a certain absolute size or a certain share of the market. The importance of the Board's role in determining how many of the mergers eligible for reference are actually referred to the Commission is evident from the fact that the

Commission may only examine those mergers which the Board, at its discretion, refers to it. At least one merger proposal which the parties realized might be difficult to justify in terms of the public interest was abandoned when the Board indicated that it planned to submit the matter to the Commission.

In assessing the public interest implications of the merger, the Monopolies Commission will, on the one hand, estimate the possible efficiency benefits to be gained and, on the other hand, make a judgment as to the consequences of the merger for competition. It may, on its own initiative or at the direction of the Board of Trade, examine other matters as well. There is no presumption that mergers referred to the Commission are against the public interest, nor is there any onus on those proposing to merge to convince the Commission that an exemption is justified. The Commission publishes a report stating the reasons for its findings and its recommendations. The Board, while not obligated to follow the Commission's recommendations, has done so in the first seven merger references.

An appreciation of mergers policy in Britain must also take account of two other Acts. The 1966 Industrial Reorganization Corporation Act embodies a positive philosophy of encouraging mergers and other structural changes in sectors of the economy where market forces are considered inadequate to produce those reorganizations thought to be required in order to increase productivity. The concern of the 1966 Act, it seems fair to say, is with industries in which firms are found to be too small to meet international competition. The Industrial Expansion Act of 1968 allows the government to provide financial support to specific projects, industries or sectors of industries to stimulate industrial change (including change coming about by merger) with a view to promoting "efficiency and productive capacity for industry and its technological advance". Thus British policy provides the means by which mergers may be actively encouraged in some areas of the economy and effectively blocked in industries where effects detrimental to the public interest are likely to ensue.

Resale Price Maintenance

The one major exception to the general rule that U.S. competition policy tends to be "tougher" than its European counterpart is to be found in the field of resale price maintenance. Here it is the European law which is more or less prohibitory, while the American is permissive.

Both Denmark and Sweden have prohibited resale price maintenance, in sharp contrast to their negotiatory approach to other restrictive practices. Although exemption from the Scandinavian ban on resale price maintenance is possible and although the wording of the exemption clauses gives substantial discretion to the Swedish Board and to the Danish Control Authority, both have in fact granted exemption sparingly and both have revoked exemptions when the original justification no longer appeared valid. In France, too, where one of the major objectives of competition policy is to encourage the modernization of the distribution sector of the economy, the approach to resale price maintenance is quite strongly prohibitory, with little scope for exemptions.

In Britain, the passage of the Resale Price Act in 1964 marked a dramatic change from the permissive approach of the 1956 Restrictive Trade Practices Act which, while declaring the *collective* enforcement of resale price maintenance to be unlawful, allowed enforcement by *individual* firms. The 1964 Act established a more general prohibition with exemption "gateways". To claim exemption, a seller must come before the Restrictive Practices Court, and a provisional exemption applies until the Court has ruled on the application. The exemption gateways are expressed in terms of the interests of consumers in relation to quality, number of retail establishments, retail prices, health, and post-sale service. If a product passes through a gateway, a balancing public interest test remains. Many products with a long history of resale price maintenance have not been registered for provisional exemption and others have not been defended when the opportunity to do so arose. The Court's refusal to grant the requested permission to practise resale price maintenance, in the first two cases to come before it, strengthened still further the reluctance of firms practising resale price maintenance to seek the Court's

approval. It seems likely that in the near future, resale price maintenance will be employed only in the case of a few products possessing sufficiently peculiar characteristics that the Restrictive Practices Court sees its way clear to granting an exemption from the general ban.

In all of the countries studied, advocacy of resale price maintenance appears to come mainly from two quarters: from manufacturers of branded merchandise, who voice their fears that their heavily advertised products will be used as "loss leaders", and from small businesses fearful of the price-cutting tactics of their larger competitors. National policy in Germany and the United States can be said to reflect the influence of these two concerns. In Germany, the law condemns resale price maintenance in general, but the significance of this condemnation has been substantially reduced by the permission granted to producers of "branded articles which are competing in price with similar goods of other producers or dealers" to practise resale price maintenance. Publishing firms are also exempt from the ban. This permission may be withdrawn by the Cartel Authority if the practice is abused. A recent amendment strengthened the abuse provisions by stating that certain practices would henceforth be taken as presumptive evidence that abuses had occurred. The abuses in question were: the causing of an "increase in the prices of the goods affected" or "preventing a lowering of their prices" or "restricting their production or their distribution" in a "manner not justified by general economic conditions", as well as the disappearance of competition with similar goods.

U.S. policy in this field reflects the American tendency sometimes to protect small business even at the expense of economic efficiency -- in this case, primarily, the economic efficiency of the distribution system. This tendency has been a long-standing feature of the "fair-trade" laws passed in the early 1930's by many of the state legislatures under which resale price maintenance could be practised. However where interstate commerce was affected, resale price maintenance could still run afoul of the federal Sherman Act. To prevent such a conflict the Millar-Tydings amendment to the Sherman Act was passed in 1937. This amendment provided that nothing in that Act should render resale price maintenance illegal when agreements of that description

are lawful when applied to intrastate transactions. In 1951, however, one of the most controversial features of fair-trade laws was ruled by the Supreme Court to constitute an offence under the Sherman Act. This was the so-called "non-signer" clause, which provided that once a manufacturer's resale price had been prescribed by contracts with one distributor, no other distributor could knowingly undercut that price. To overrule this decision of the Supreme Court, Congress passed the McGuire Act amendment to the Federal Trade Commission Act, clarifying the legality of resale price maintenance. Continued opposition to the enforcement of the non-signer provision and to fair-trade laws in general is reflected in action taken in many of the state Supreme Courts to rule such legislation unconstitutional, as well as in the 1955 Report of the Attorney General's National Committee to Study the Antitrust Laws, which recommended the repeal of both the Millar-Tydings Act and the McGuire Act.

Price Discrimination

Concern for the preservation of small business also figured in the thinking which led, in the United States, to the passage of the Robinson-Patman amendment to the Clayton Act in 1936. Prior to this amendment, Section 2 of the Clayton Act had branded as illegal the use of discriminatory pricing policies as a predatory tactic designed to eliminate competitors. To a considerable extent, the Robinson-Patman amendment was a response to certain retailing developments in the depression years. Large retail chain stores, particularly in the food trade, were putting increasing competitive pressure on small outlets. There was also concern over the ability of large buyers to extract price concessions from their suppliers.

The resulting piece of legislation has been more heavily criticized by informed observers than any other aspect of U.S. antitrust. Among other things, the amendment has been held to embody a confusion of purpose; it cannot, as it were, make up its mind whether price discrimination is to be suppressed where it operates as an anticompetitive device, or whether the objective is rather to protect small business from price disadvantages. Furthermore, enforcement has concentrated on price differences rather than price discrimination, and there have been severe administrative problems.[6]

It is widely maintained that while the amendment may have resulted in the suppression of some anticompetitive pricing practices, it has also prevented acceptable and even desirable forms of differential pricing, e.g. those which can be justified by cost differences, and those which constitute one of the more important ways in which price competition periodically "breaks out", to the benefit of the consumer, in oligopolistic markets. One observer's general verdict is that "no statute better demonstrates the legislative folly of trying to define 'sin' in detail".[7]

Exclusive Dealing, Requirements Contracts and Tied Sales

It is appropriate at this point to refer briefly to the U.S. treatment of exclusive dealing, requirements contracts and tied sales -- trade practices which are found notably in the automobile service station industry in Canada, and which the Economic Council was specifically requested to consider as part of its study of competition policy. The main consideration of them will be found in Chapter 6 of this Report.

In the United States, these practices are principally dealt with under Section 3 of the Clayton Act, although in the case of tied sales, action may also be taken under the Sherman Act and the Federal Trade Commission Act. The Clayton Act condemns these practices when their effect "may be to substantially lessen competition or tend to create a monopoly...."

In determining whether or not competition has been substantially lessened, the courts generally look to the market share of the firm employing the practice, the absolute amount of trade involved, and the availability of alternatives for firms that have been excluded by the contracts or practices under examination. Assessing the competitive impact of a practice in any particular case is a complex matter, and the courts have come to rely on certain relatively easily obtained information as pointing unambiguously to competitive implications. Where certain criteria are satisfied, there is deemed to be a *prima facie* substantial lessening of competition.

The courts ruled in 1922, for example, that a system of exclusive-dealing contracts employed by a manufacturer with 40 per cent of the market did

substantially lessen competition and so violate Section 3; in 1923, a Section 3 charge was dismissed on the grounds that the supplier, with 1 per cent of the market, did not substantially lessen competition by his exclusive-dealing contract. The *form of the contract* was similar in the two cases; the *share of the market* as defined in each of the two cases produced the differing verdicts.

In 1949, the Supreme Court, in the important *Standard Stations* decision, found a firm's requirements contracts covering less than 7 per cent of the sales in the relevant area to be in violation of Section 3. The contracts, which required independent service station dealers to purchase from Standard Oil all their requirements of certain products, were renewed from year to year and were similar to contracts used by all six of Standard's competitors. The Court, while agreeing that the duration of the contracts was not excessive and that Standard did not by itself dominate the market, nevertheless held that an offence had been committed because competition had been foreclosed in a substantial share of the market. This decision changed the focus of Section 3 from one that rested on the alleged dominant position of the supplying firm to one that looked, as well, at the volume of business affected by the contract in question.

As to tying arrangements in the United States, it seems fair to state that they are less likely than exclusive-dealing contracts to be considered an acceptable form of business behaviour. They have frequently earned severe condemnation from the courts, with such terms as "pernicious effect on competition" and "lack of any redeeming virtue" being applied. The Supreme Court in 1962 indicated that one of the reasons for antitrust concern with tying agreements was that "they may destroy the free access of competing suppliers of the tied product to the consuming market".

Administration of Competition Policy

The experience of other countries throws useful light on the administrative problem discussed in the concluding section of the previous Chapter: that of determining whether to lean towards *per se* prohibitions of anticompetitive behaviour, or towards a more discretionary procedure involving considerable case-by-case examination of probable economic effects.

The United States uses both techniques. In Europe, some broad prohibitions are to be found, but they are usually subject to more or less important exemptions, and in general the European approach leans much more towards the discretionary end of the spectrum. Such an approach is typically less demanding of policy-makers but more demanding of those who are charged with administering competition policy. To no small extent, indeed, the latter are really called upon to create the policy. Where, for example, there are exemptions to broad prohibitions, the administrators must assess the economic circumstances surrounding the agreement or practice and decide whether, in the light of these circumstances, the agreement or practice should be allowed to continue. As a succession of such decisions occurs, the shape of the policy is gradually clarified, provided of course that the decision-makers have taken care to avoid major inconsistencies.

European countries have tended to avoid the direct use of criminal law in their competition policies, in marked contrast to the situation in Canada and the United States. Instead, the examination of the practices of individual business firms is undertaken and assessed by administrative tribunals such as the British Monopolies Commission and Restrictive Trade Practices Court, the French Technical Commission on Combines and Dominant Positions, the Swedish Freedom of Commerce Board and the Monopolies Control Authority of Denmark. These tribunals are normally composed of business and other interest groups as well as members of the legal profession. Only Germany departs from this procedure, adopting instead the principle of administering competition policy through the Federal Cartel Office, composed entirely of public servants. Although the character of the procedures before the tribunals varies from the somewhat legalistic British examination to the less formal activities of the Swedish Board, the enforcement machinery in European countries appears to be better suited to the examination of the underlying economic evidence and probable economic effects than in the United States. The American courts have, it is true, gone a considerable distance in this direction, but even there a special body in the form of the Federal Trade Commission has been instituted to supplement the work of the courts.

In most of the European countries, the legislation now contains more or less detailed specification of the criteria against which business practices restrictive of competition and exemptions from the prohibition on restrictive agreements are to be assessed. This is particularly true in Britain where the interpretation of exemption gateways has had a considerable deterrent effect, leading as it has to a dismantling of many restrictive agreements of long standing without any attempt at a formal defence. While the value of criteria both to administrators and to the business community must be recognized, such experience as that with the Robinson-Patman Act in the United States warns of the dangers sometimes involved in specifying criteria in too detailed a form. A golden mean must be sought: the administrators have to be given some guidance, but not so much that they are deprived of the flexibility necessary for the successful operation of the discretionary approach.

Remedies to Combat Anticompetitive Practices

The effectiveness of competition policy depends as much on the remedies at the disposal of administrators to bring about appropriate changes in business conduct and industrial structure as it does on the administrative machinery itself. The United States draws upon a wider assortment of alternative remedies than does Canada. Once its investigations uncover evidence that warrants a charge, the U.S. Department of Justice must decide whether to proceed by criminal prosecution or civil action. A criminal case can lead to the punishment of offenders for past offences, and is considered appropriate in those cases where the law is clear and the facts indicate a flagrant offence and plain intent to restrain trade unreasonably. The deterrent efficacy of the Act requires such criminal prosecutions. In order, however, to remedy the situation rather than merely punish the guilty, an additional civil action is often instituted. In the civil case, a decree containing injunctions regulating the industry in the future can be obtained, and it is for this reason that the Department of Justice frequently brings concurrent criminal and civil proceedings.

In the case of a criminal charge under the Sherman Act, the accused firm may plead *nolo contendere* -- a plea that may or may not be accepted by the

U.S. Department of Justice. Such a plea, while not an admission of guilt, enables the court to impose fines or other punishment as if the case had been fought and lost by the defence. In a civil suit under the Clayton Act, the equivalent of *nolo contendere* is to enter into negotiations with the Department to arrive at a consent decree, under which the firm involved agrees to modify or discontinue a particular practice without going through the process of a trial. Where a consent decree is agreed upon, the approval of a court must be obtained; any infringement of the decree then becomes punishable as contempt of court.

When the Federal Trade Commission, the tribunal which administers the civil Federal Trade Commission Act and (concurrently in some areas with the Department of Justice) the Clayton Act, believes that a business practice is in violation of the law and that its termination would be in the public interest, it issues a formal complaint. Thereupon, a Hearing Examiner, who is a legal member of the Commission's staff, acts as a court of first instance. The Hearing Examiner reaches a decision and, if appropriate, issues on behalf of the Commission a cease-and-desist order. The Commission may review the Examiner's decision either on its own account or on appeal by an aggrieved party. The Commission's cease-and-desist order, unless appealed, has the force of law. Any violation is subject to fine. Appeals from the Commission's decisions are restricted to matters of law; its findings of fact are final. The effect of this restriction does, of course, depend on what meaning is given by the Appeal Court to the phrase "matter of law". A company against which a complaint has been issued can negotiate a consent order with the Commission's prosecuting lawyers, without the matter going before a Hearing Examiner. The Commission may accept the settlement arrived at and promulgate the indicated cease-and-desist order, or it can reject the order submitted and refer the case to the Hearing Examiner.

Consent orders have been a particular feature of U.S. merger policy. They may call for total or partial divestiture of the acquired company or, more commonly, for a prohibition on future acquisitions by the acquiring company in fields related to those in which the acquired company operated. A formidable enforcement burden is placed upon the Commission and

the Department of Justice by their responsibility for policing cease-and-desist orders, whether obtained by consent or resulting from litigation.

An individual or firm, damaged as a result of a restrictive agreement or anticompetitive practice carried on by another, may, under both the Sherman and Clayton Acts, be able to claim treble damages for the injury. Both *nolo contendere* pleas before the Department of Justice and the acceptance of consent orders by the Federal Trade Commission without a formal case lessen the possibility of a treble-damage suit by private individuals, since there is no court finding of fact on which to base damages. The deterrent effects of a possible treble-damage suit depend on the nature of the offence, the measurability of the damages, and the amount of the damages suffered by individual persons or businesses relative to the cost of suing for damages. Although an antitrust conviction makes available *prima facie* proof of certain facts in a private suit, the courts still face the difficult task of establishing that the private individual or business was injured by the illegal conduct, and of determining the extent of the damage suffered.

It should be emphasized again that where negotiatory procedures are used, or where exceptions are made to broad prohibitions, the enforcement agency will more often than not find itself required to exercise some continuing surveillance over the agreements and practices that have been either modified by negotiation or granted exemption. This task may come to absorb a significant proportion of the time and resources of the agency.

Purely negotiatory enforcement procedures appear to have had some effect, notably in Sweden, where the Freedom of Commerce Board attempts to work out appropriate changes in business conduct with the firm in question. However, Sweden is both an open economy and a unitary state. There has evolved a long tradition of co-operation between business, labour and government with a view to providing aggressive competition in the world economy. In such an environment the mere publicity given to, for example, the registration of cartel arrangements has led in many cases to their abandonment. But where such a tradition has not evolved, and where too, as in Canada, business relates to provincial as

well as to federal and local governments, purely negotiatory enforcement is not likely to be as effective. A backstop of stronger remedies must normally be available.

Conclusion

The modest objective of this Chapter has been to indicate briefly certain aspects of foreign experience with competition policy that have exerted a particularly significant influence on the policy recommendations contained in later chapters. There is undoubtedly a great deal more in foreign experience that is relevant for Canada, and as that experience continues to accumulate, it will be important for Canadians to study it.

In drawing lessons from abroad, appropriate allowance must of course be made for differences between the Canadian and foreign economic environments. This has often been pointed out with reference to the United States. Although competition policies in Canada and the United States, as instituted in the late nineteenth century, were in many ways a response to common concerns, their subsequent divergence has been partly a reflection of certain rather deep-seated differences between the two countries. Among these may be mentioned the greater constitutional freedom of the federal government in the United States to enact laws affecting commerce; the stronger feeling of ideological commitment in the United States to private enterprise, competition and the diffusion of economic power; and the smaller size and greater openness and world-trade orientation of the Canadian economy. Perhaps the most important implication of the latter difference is that the Canadian economy is less able than its U.S. counterpart to afford a competition policy that, on occasion, may be prepared to sacrifice economic efficiency for other ends, such as the preservation of small business.

As for European experience, what has to be chiefly remembered is that much of it has been related to a tradition of rather more detailed governmental intervention in the operations of private industry than has existed in Canada. One might make some exception to this statement in the case of Sweden, with its unique degree of industrial self-regulation in certain areas. But here again, the tradition is rather a different one from Canada's, and this affects the range of practicable techniques for competition policy.

All this having been said, however, it remains a fact that with significant competition policies now being practised in many more countries than before the war, there is a richer and more varied experience on which to draw. More than ever, therefore, the continuous observation and analysis of foreign developments should be an important part of the conduct of competition policy in Canada.

Notes and References

[1] James P. Cairns, *The Regulation of Restrictive Practices -- Recent European Experience*, Economic Council of Canada, Special Study (forthcoming).

[2] A. D. Neale, *The Antitrust Laws of the United States of America*, Cambridge, Mass., Harvard University Press, 1960, p. 425.

[3] Carl Kaysen and Donald F. Turner, *Antitrust Policy, An Economic and Legal Analysis*, Cambridge, Mass., Harvard University Press, 1965, p. 107.

[4] In fact, the Dupont decision handed down in 1957 was based on the unamended Clayton Act (i.e. prior to the Celler-Kefauver amendment). In this decision, the Court ruled against Dupont's acquisitions of General Motors stock, thereby interpreting the unamended Act as covering vertical mergers as well as mergers between firms in a horizontal relationship.

[5] Some more recent developments in respect of the Merger Guidelines should be noted. In testimony before the House of Representatives Ways and Means Committee on March 12, 1969, Richard W. McLaren, Assistant Attorney General, Antitrust Division, U.S. Department of Justice, stated as follows:

> At the Senate Judiciary hearing on my confirmation in January, I stated that I was not persuaded that Section 7 will not reach purer types of conglomerate mergers than have been dealt with by the courts thus far. In public statements since that time I have tried to warn businessmen and their lawyers that they cannot rely on the Merger Guidelines issued by my predecessors in this area --

> that we may sue even though particular mergers appear to satisfy those Guidelines -- and that, to be safe, firms desiring to merge should learn our enforcement intentions by applying for a Business Review letter.

[6] Kaysen and Turner, *op. cit.*, pp. 181-182.

[7] Neale, *op. cit.*, p. 464.

CHAPTER 4

BRIEF HISTORY AND ASSESSMENT OF CANADIAN COMPETITION POLICY

In contrast both to the discretionary civil law approach which characterizes competition policies in Europe, and to the combination of civil and criminal law used in the United States, Canadian anticombines policy has always been framed in terms of criminal law. The power of the federal government to enact criminal legislation is firmly entrenched in the Constitution and has been upheld by various rulings of the Supreme Court. Among the consequences of the criminal law basis of anticombines policy are the requirements that offences be proceeded against whenever they are believed to have been discovered and that the Crown, to win its case, must prove guilt beyond a reasonable doubt. These requirements have hitherto considerably narrowed the scope in Canada for effective competition policy directed towards economic ends.

In tracing the historical evolution of the policy, the discussion here will touch only lightly on developments prior to 1950, the history of that period having been well summarized in the Report of the MacQuarrie Committee. Much of the Chapter will be given over to an account of changes in the legislation since the MacQuarrie Report, while in the concluding section, a brief assessment of the effectiveness of the legislation will be presented. A more detailed history and assessment of Canadian competition policy will appear in a special study commissioned by the Economic Council, to be published at a later date.[1]

Basic Legislative Provisions to 1950

The cornerstone of Canada's present combines legislation was laid by Parliament in 1889 when it passed an Act prohibiting conspiracies and combinations in restraint of trade. The legislation defined as unlawful any agreement to limit unduly facilities for transporting, producing, storing or selling any article, or to restrain commerce in it, or to unreasonably enhance its price. Also forbidden was any agreement to unduly prevent or lessen competition in relation to an article or to the price of insurance "upon persons or property". With some modification, these provisions were imported into the Criminal Code in 1892 as indictable offences,

where they remained until the consolidation of the Combines Investigation Act in 1960.

The first Combines Investigation Act was passed in 1910 in an attempt to remedy a weakness in the original legislation: the lack of any special machinery for investigation of alleged combines offences. In this Act, the definition of the kind of "combine" activity that could be investigated was set out in language similar to the wording of the combination offence in the Criminal Code, with the significant addition of the words "merger, trust or monopoly". A qualification introduced into the Act was that to be unlawful the combination, merger, trust or monopoly must have "operated or be likely to operate to the detriment or against the interest of the public, whether consumers, producers or others". This comprehensive definition was retained in the new 1923 Combines Investigation Act, which, as subsequently amended, is the law today. An interesting feature of the 1923 Act was that it did not restrict itself to trade in "articles" and the price of insurance: in principle, at least, trade in services was also included, although no cases relating to services were brought to court. However, the restriction to articles and the price of insurance reappeared in the legislation of 1937 and has remained to the present day.

In 1935, Section 498 of the Criminal Code was amended to bring price discrimination within the reach of public policy for the first time. Under the shadow of the Great Depression, there had emerged considerable concern about the large spreads between prices received by producers and those paid by consumers. There was disquiet also about price advantages obtained by large buyers that were deemed to discriminate against small competitors. These considerations were reflected in a new prohibition which banned the granting of discriminatory discounts and predatory price-cutting. This provision was transferred from the Criminal Code to the Combines Investigation Act in 1960 and remains in the Statute today.

Machinery for Investigation and Enforcement to 1950

As already noted, the establishment of the machinery required for the detection and investigation of alleged combines, missing from the legislation of 1889, made its first appearance in the Combines Investigation Act of 1910. This Act contained a provision

whereby any six citizens could apply to a superior court judge for an order directing an investigation into the activities of parties thought to constitute a combine. On issuance of an order, the Minister of Labour was required to appoint a board composed of one representative of the applicants, one representative of the parties alleged to be a combine and a third member to be designated by the other two. The board was given the necessary powers to permit it to carry out a full inquiry and was required to transmit to the Minister a report of its findings and recommendations. Following publication of the report, continuation of activities by the parties named as a combine in the report constituted an indictable offence. But the legislation still failed to provide any continuity of administration. Since the boards were constituted on an ad hoc basis, they ceased to function once an inquiry had been completed, leaving behind no means to ensure that their recommendations were carried out.

Dissatisfaction with this situation led Parliament to include, in the 1919 Board of Commerce Act, a provision establishing a permanent board of three commissioners charged with the responsibility of administering a second new Act, the Combines and Fair Prices Act. (Together, these two Acts replaced the 1910 Combines Investigation Act, which was repealed.) The board could begin an inquiry on application from one citizen or on its own initiative, and retained the wide powers of investigation held by the previous ad hoc boards. In addition, if a combine were found to exist, the board could issue "cease and desist" orders directed at the cessation of offending practices. Noncompliance with such orders was deemed an indictable offence. This legislation, however, was found *ultra vires* of the federal legislature, for reasons discussed below, and in 1923 a permanent Registrar was appointed to administer the new Combines Investigation Act of that year. This official was empowered to hold a preliminary inquiry on his own initiative, on formal application of six persons, or on ministerial direction. If this preliminary investigation revealed that a formal inquiry was warranted, such an inquiry was conducted either by the Registrar or by an ad hoc commissioner. In 1935, the Dominion Trade and Industry Commission Act transferred the administration of the Combines Investigation Act and the powers of investigation and inquiry to a new three-man commission. However, parts of this Act were declared by the Supreme Court to be

unconstitutional, and although the Dominion Trade and Industry Commission continued to have a legal existence until 1949, it did not exercise any functions in the area of combines legislation.

It is worth digressing briefly to note the reasons given for the two findings of unconstitutionality mentioned above. In its 1921 judgment on the Combines and Fair Prices Act and the Board of Commerce Act, the Judicial Committee of the Privy Council attached particular significance to the power of the Board to make orders prohibiting (a) the accumulation of articles that were necessaries, and (b) the withholding of such articles from sale because of sellers' dissatisfaction with prices fixed by the Board. Also, the Board could regulate profits, and deal with cases individually, rather than merely follow principles of general application. It was the view of the Privy Council that this power of a federally appointed board to regulate particular trades and businesses could not be upheld under the constitutional heads of either criminal law or trade and commerce.

In its finding that the 1935 Dominion Trade and Industry Act was *ultra vires* of the federal legislature, the Supreme Court focused notably on a part of the Act that reflected the economic environment and attitudes of the Depression years. The Act empowered the Dominion Trade and Industry Commission, if it found that wasteful and demoralizing competition existed in an industry and that agreements among persons in the industry to modify competition would not unduly restrain trade or operate against the public interest, to recommend approval of such agreements. (Like the National Recovery Act in the United States, the Dominion Trade and Industry Act embodied an attempt to attack some of the major symptoms of the Great Depression, whereas today the principal remedy to any such situation would be judged to lie, not in throwing competition policy into reverse, but in the more fundamental and efficacious step of expanding aggregate demand in the economy through the use of fiscal and monetary policy.) Section 14 of the Act, however, was found unconstitutional by the Supreme Court, and this effectively nullified the main purpose of the legislation even though other parts of the Act were later upheld by the Privy Council. As in 1919, Parliament had attempted to give an administrative tribunal power to regulate the operation of combines

and similar business arrangements by administrative direction, and once again the attempt was disallowed.

Following the Supreme Court ruling, Parliament in 1937 again vested the administration of competition policy in a single permanent official (the Commissioner), whose role it was to conduct investigations under the Combines Investigation Act, although a special or ad hoc commissioner could also be appointed. The Commissioner was empowered to compel the attendance of witnesses, secure testimony under oath and require the production of documents. In 1949 the Act was amended to facilitate prosecutions. One amendment resulted from the acquittal of the defendants in the Ash-Temple (Dental Supplies) case on the grounds that there was no proof that actions of company officers had been authorized by their firms. The amendment provided that documents found in the possession of individuals acting as officers, employees, agents or representatives of businesses were admissible as *prima facie* evidence against the company.

Remedies in the Legislation to 1950

The Combines Investigation Act of 1923 stipulated that anyone offending the prohibition against combines was liable to a penalty not exceeding $10,000 or two years' imprisonment for individuals and not over $25,000 for corporations. A further penalty provided for the reduction or removal by executive action of the tariff on an article where the court found that a combination had unduly enhanced prices or denied the public the benefits of reasonable competition. This tariff provision, which continues in effect today, has been a long-standing feature of Canadian competition policy, dating back to an 1897 amendment to the Customs Tariff Act. Finally, a provision first introduced in 1910 and carried forward to the present via the Act of 1923 enables the Exchequer Court to revoke patent protection where exclusive rights are used to limit unduly competition in the market for a particular product.

Publicity has always been considered to be a deterrent against violations of the principles of competition policy. In sponsoring the legislation of 1910, the Honourable W. L. M. King, then Minister of Labour, implied that criminal prosecution was secondary

to investigation and publicity in effective public control of combines. In the Act of 1923, the Minister of Labour was required to publish the report issued at the conclusion of a Commissioner's inquiry within 15 days, unless the Commissioner recommended against such action. This provision was retained in subsequent amendments.

The Situation as of 1950

By 1950, then, there existed fairly substantial machinery for the investigation and enforcement of prohibitions against anticompetitive practices and situations, including combinations, mergers, trusts and monopolies, and also certain unfair trading practices. The law provided for prosecution in the courts and gave the Commissioner extensive powers to enter premises, seize documents, and order the attendance of witnesses to testify under oath. Penalties consisted of fines, imprisonment, and the removal of tariff protection or patent rights. Finally, publicizing the results of the Commissioner's inquiries was intended to have a punitive effect, and the fear of publicity was regarded as a deterrent to anticompetitive practices.

The MacQuarrie Report and the Amendments of 1951-52

A controversy involving publicity and the suspension of anticombines activity during the Second World War, when production, the allocation of resources, and the setting of prices were subject to direct control, led to the establishment of the MacQuarrie Committee to review the legislation. In December 1948, the Combines Commissioner, Mr. F. A. McGregor, forwarded to the Minister of Justice the results of his inquiry into the flour-milling industry. In it, Mr. McGregor concluded that the leading milling companies had maintained price-fixing agreements since at least 1936, that these agreements were maintained in force during the war, and that the firms colluded in bidding for government contracts. Despite the requirements of the Act, the Report was still unpublished in October 1949. Mr. McGregor resigned on October 29, calling, in his letter of resignation, for "an even stronger statute than the Act in its present form, and a clear statement of government policy with respect to its enforcement". Tabled in the House of Commons on November 7, the flour-milling report raised, among other things, the issue

of an industry being condemned for carrying out policies sanctioned by the Wartime Prices and Trade Board during the war and tacitly allowed by the government in the subsequent period of decontrol.

Faced with a barrage of criticism for its handling of the matter, the Government in 1950 appointed the MacQuarrie Committee to study the purposes and methods of the Combines Investigation Act and related Canadian statutes as well as those of other countries. The Committee was instructed to recommend any amendments desirable to make the Combines Investigation Act "a more effective instrument for the encouraging and safeguarding of our free economy".

After hearing representations from interested parties and conducting studies of its own, the Committee issued its Report in two parts.[2] In response to the Government's specific request for opinions on resale price maintenance, an Interim Report, dated October 1951, dealt exclusively with this matter. The Committee assessed this practice against two standards: the desirability of a free economy and the need for economic efficiency. It concluded that resale price maintenance on the growing scale then practised was not justified. The Committee recommended that it should be made an offence for a manufacturer or other supplier:

"1. To recommend or prescribe minimum resale prices for his product;

2. To refuse to sell, to withdraw a franchise or to take any other form of action as a means of enforcing minimum resale prices."

In connection with its examination of resale price maintenance, the Committee looked also at "loss-leader" selling. The latter practice, though condemned as monopolistic and not conducive to the general welfare of the public, was not viewed as presenting any immediate danger in the then current period of inflation and relative scarcity.

The Interim Report was considered by Parliament in December 1951, and an amendment to the Combines Investigation Act was passed which made it an offence to fix minimum resale prices, although suggested resale prices were still allowed.

Competition Policy

The final Report of the Committee was issued in March 1952. Despite strong statements about the need for public policies in support of competition to be "adaptable to complex and rapidly changing problems", the Committee refrained from recommending any substantial change in the concept or direction of the combines law. One impediment to change was the constitutional problem. The Committee stated that publicity and criminal prosecution had been the principal means used against monopolies, "mainly because the legislation has been based on the federal power over criminal law and has been upheld by the courts on this ground". Recognition was given to "another view" to the effect that the federal power over trade and commerce would give Parliament complete jurisdiction in monopoly situations, at least those involving international and interprovincial trade. But, because neither of these views had been sanctioned by judicial decision, the Committee preferred to leave the question of extending the scope of the legislation to some future time. As the Report stated: "Our recommendations are directed to the strengthening and improving of the procedures, organization and remedies laid down in the Act rather than to revolutionizing them."

The chief recommendation of the MacQuarrie Committee was in regard to administration. The Committee proposed that there be a separation of function between investigation and research on the one hand and appraisal and report on the other. The Committee had received representations from the business community that the existing Commissioner was placed in the position of both prosecutor and judge. To effect a separation, the Committee recommended that the duties of the Commissioner be divided and assigned to two separate agencies: an agency for investigation and research, and a board for appraisal and report. The amendments to the Combines Investigation Act introduced in 1952 provided for a Director of Investigation and Research and for a Restrictive Trade Practices Commission consisting of not more than three members appointed by Governor in Council. The Director could initiate inquiries, but the powers needed to pursue an inquiry effectively -- seizure of documents, oral examination of witnesses, and orders for written returns -- could only be exercised after authorization by a member of the Commission. The Commission was to hear and appraise all evidence presented to it by the investigation and research agency as well

as such other evidence as was necessary to ensure that persons under investigation had full opportunity to be heard.

The Committee recommended that the board report to the Minister, that the public report be retained for its deterrent effect, and that the scope of the Report be widened. The Committee was also concerned about the various areas of government policy which impinged on competition policy:

> Numerous other aspects of the Federal Government policy may greatly contribute to strengthen or weaken monopoly power. Money lending, currency management, negotiation of international trade agreements, import and export controls, public works, taxation, technological research may all directly or indirectly affect the interests of particular business groups. The way our legislation on banking, insurance companies and corporations is framed and administered may also greatly affect the monopolistic picture of our industry.

To effect the desired co-ordination of government policy, the Committee recommended, first, that administrative procedures be designed to ensure close liaison between the proposed board and other government departments whose activities might affect the competitive structure of the economy, and secondly, that the board should be empowered to recommend any legislative or administrative change within the competence of Parliament if "such change could be used as an effective remedy to correct an undesirable monopolistic situation or practice". Although no administrative procedures to ensure a greater degree of liaison were in fact established, the legislation of 1952 did direct that the report of the Restrictive Trade Practices Commission "review the evidence and material, appraise the effect on the public interest of arrangements and practices disclosed in the evidence and contain recommendations as to the application of remedies provided in this Act or other remedies".

With regard to offences, the Committee proposed no new prohibitions to strengthen the merger or monopoly provisions in the Act or to curb discriminatory or injurious monopolistic practices. In the body of the Report, discriminatory practices were defined to include quantitative price discrimination (via unjustified

quantity discounts) and spatial forms of price discrimination such as freight equalization and freight allowance, and zoning or basing-point price systems. Other more injurious practices were said to be "derogatory and harassing practices, price wars, 'loss leaders', threats and spreading of false information". The Government followed the advice of the Committee and, in the legislation of 1952, left the sections dealing with offences virtually unchanged, except that the provision relating to price discrimination was amended so as to prohibit only the systematic practice of price discrimination rather than any single act. The Committee did suggest that the Minister refer the loss-leader practice for review by the proposed new investigation and research agency and by the new board, but the subsequent study by these bodies led to no recommendations for changes in the Act.

The legislation of 1952 also incorporated the Committee's principal recommendation regarding remedies: that existing statutory limits on fines should be abolished and that the fine in each case should be at the discretion of the court. The Committee also suggested further use of supplementary judicial remedies such as the judicial restraining order. Accordingly, a provision was inserted in the Act authorizing the court to issue an order prohibiting the repetition or continuation of an offence. In a conviction under the merger, trust or monopoly clause, the court was empowered to order dissolution of the merger or monopoly "in such manner as the court directs".

The Committee's recommendation that research into monopolistic situations and practices should become "one of the most important assignments of the investigation and research agency" led to the introduction of a new section in the Act. Section 42 provided that the Director of Investigation and Research, on his own initiative, or on direction from the Minister, or at the instance of the Commission, should carry out an investigation of monopolistic situations or restraint of trade in relation to any commodity that might be the subject of trade or commerce. Such a "general inquiry" would be dealt with in the same manner as an inquiry involving a possible infraction of the law. In line with the suggestion of the Committee, the publication of the results of such a general inquiry should await subsequent review of the evidence by the Commission

which should then forward the report to the Minister for publication. Since 1952, five such reports have been published, relating to: loss-leader selling; discriminatory pricing practices in the grocery trade; automobile insurance; drugs; and tires, batteries and accessories sold through service stations.

The 1960 Amendments

Only in 1960, when further amendments were introduced into the combines law, did the Government follow the MacQuarrie Committee's recommendation that the Criminal Code provision relating to combinations be brought into the Combines Investigation Act. In this process, the definition of "combine" was dropped, the word "trust" was eliminated, and separate provisions were enacted defining mergers and monopolies and making them offences only where they were likely to be, or to operate, "to the detriment or against the interest of the public".

In addition, Parliament attached certain provisions to the combination or conspiracy section of the Combines Investigation Act. In a rather unusual turn of phrase, one of the new provisions directed that "the court shall not convict the accused if the conspiracy, combination, agreement or arrangement relates only to one or more" of certain matters, including exchange of statistics, defining of trade terms, co-operation in research and development, or restriction of advertising, or some other unobjectionable activity. Nevertheless, by a second new provision, Parliament made it plain that such an agreement must not be used as a device for breaching the fundamental prohibition of combinations or conspiracies.

A further new provision related to export agreements. Parliament provided that "the court shall not convict the accused if the conspiracy, combination, agreement or arrangement relates only to the export of articles from Canada". A qualification was added, however, to the effect that the provision does not apply if the agreement reduces the volume of exports of an article, works to the specific detriment of Canadian exporters or would-be exporters, or lessens competition unduly in the domestic market.

The section banning resale price maintenance was also amended. The law passed in 1952 included a provision making it an offence for a supplier to refuse to sell to a dealer who would not maintain the supplier's prices. In 1960, Parliament provided a group of defences for suppliers charged with refusing to sell. Henceforth no inference unfavourable to the accused could be drawn if he satisfied the court that "he and any one upon whose report he depended had reasonable cause to believe and did believe" that the buyer was using the goods as loss leaders, was making a practice of misleading advertising in regard to such articles, or was not providing the level of servicing that his customers might reasonably expect. While Parliament in this amendment obviously viewed these practices with disfavour, it did not go so far as to prohibit them directly.

Parliament did, however, insert in the Act a provision to outlaw misrepresentation of the ordinary price of an article ("misleading price advertising"). Another new prohibition banned discriminatory promotional allowances. This latter provision had the twofold purpose of preventing discrimination in distribution and of limiting promotional expenditures.

Also in 1960, the prohibition of price discrimination on a territorial basis was strengthened by making it illegal for a seller to engage in a policy of selling articles in any area at lower prices than he exacted elsewhere in Canada if the effect or tendency or design was to substantially lessen competition or eliminate a competitor.

A change was also introduced in the procedure for prosecutions under the Act. Although proceedings in any case under the Act could continue to be launched in any superior court of criminal jurisdiction, they could henceforth also be instituted by the Attorney General of Canada in the Exchequer Court of Canada provided that all the accused consented to this. (An exception to this procedure was made for misleading price advertising, which offence was made punishable on summary conviction.) The new procedure had the advantage of by-passing intermediate appeal and of moving cautiously in the direction of a single, specialized court to hear competition policy cases.

In addition, in 1960 the scope of the injunction provision was extended to grant the courts power to dissolve an offending merger or monopoly without the necessity of first obtaining a conviction.

Assessment of the Present Combines Investigation Act

There exists no neat, scientific method for assessing the economic impact of a piece of legislation such as the Combines Investigation Act. A simple count of the number of cases brought to court over a period and the percentage won or lost tells rather little; indeed, it may be misleading inasmuch as publicity and deterrence have traditionally been supposed to play an important role in Canadian competition policy. The perfect anticombines law, if such a thing could be imagined, would be known to all, and 100 per cent effective in its deterrence, with the result that no cases whatever would occur! But the present law is far from perfect and its actual deterrent effect can only be assessed very impressionistically. Many people are understandably reluctant to discuss how their behaviour may have been influenced by criminal legislation, and the use of some such technique as a "deterrence survey" of Canadian businessmen would be unlikely to yield reliable results.

We have put forward in this Report the view that the encouragement of economic efficiency should be the objective of Canadian competition policy, and it is accordingly in relation to this objective that the present legislation should be assessed. This is a difficult task, however, inasmuch as the state of efficiency of the Canadian economy at any point in time and changes that may have occurred in its efficiency over time reflect the influence of a vast number of factors in addition to the Combines Investigation Act. Much the same thing may be said about the intensities and types of competition prevailing in the Canadian economy: they too are the product of many influences of which the Combines Investigation Act is but one.

Like most assessments of economic policy, therefore, that of Canada's present competition policy must be undertaken on a basis of imperfect knowledge. An initial point worth making is that over the postwar period, the scope of the legislation and the breadth and vigour of its enforcement have on balance increased.

More research has been done; a greater number and a wider range of industrial situations have been investigated; and the legislation has become a more important factor in the minds of businessmen and hence in the operation of the economy. Partly because of this greater volume of activity, and partly also because of greater efforts to publicize the nature and objectives of the legislation, the Act has become better known to important elements of the public, and by virtue of this fact alone may well have increased somewhat in deterrent power.

It must immediately be added, however, that there appear to be few grounds for supposing that the total impact of the legislation on economic efficiency has been more than modest. Certainly, the impact has been uneven. The Act has mainly been effective in restraining only three kinds of business conduct deemed to be detrimental to the public: collusive price-fixing, resale price maintenance, and misleading price advertising. A fair number of instances of each type of practice have been struck down by the courts, and partly because of the examples thus provided, there has probably been an appreciable deterrent effect as well.

It is unlikely that the Act has done much to affect efficiency via changes in the structure of the Canadian economy. The main claim that might be advanced is that the banning of resale price maintenance has probably encouraged the entry into some sectors of price-cutting retailers. It is possible too that other prohibitions of conduct in the Act may have had some indirect effects on economic structure. But in respect of corporate mergers, which are one of the most important means by which changes in industrial concentration and other dimensions of economic structure take place, the Act has been all but inoperative. The only two cases brought to court under the merger provisions (the *Canadian Breweries* and *Western Sugar Refining* cases) were both lost by the Crown, and were not appealed. There may have been certain deterrent effects in this area (the Director's *Annual Reports* indicate that some prospective mergers have been abandoned following consultations under the "program of compliance" discussed below), but the Crown's lack of success in the courts has presumably limited the amount of deterrence achieved.

There have been no court cases in respect of the section of the Act dealing with price discrimination. As to whether this section has exerted any important deterrent effect, opinions differ. One qualified observer has made the following comment:

> Those who are called upon professionally to advise on problems relating to combines legislation are impressed by the importance attached to it by the business community. It is probably equally true to say that the prohibition against predatory pricing has at least eliminated grosser attempts by large organizations to pre-empt a market or to drive competitors out of business.[3]

It should be carefully noted that the economic impact of the Combines Investigation Act is not solely a function of the terms of the law itself and the way in which it has been interpreted by the courts. The resources available for its enforcement, including notably resources consisting of persons skilled in economic analysis, have also been a very important factor. Had these resources been greater, so too would have been the economic effects of the legislation. Still another factor has been the size of fines imposed upon offenders. In general, these have not been such as to contribute greatly to the total deterrent effect of the Act.

Pursuing further the assessment of Canada's present competition policy, it is enlightening to look first at some of the points often raised by those who feel that the policy is not vigorous enough, then to turn to the views of those who feel on the whole that the policy is too vigorous. Some of these differing views are distilled from written submissions that we have received on the subject of combines, mergers, etc., while others are taken from other available literature. Many of the opposing positions in this field are of many years' standing, reflecting in some cases basic underlying dilemmas in the formulation and application of competition policy.

Those who would make Canadian competition policy more vigorous put much of their emphasis on the uneven effectiveness and incomplete coverage of the Combines Investigation Act. It does not, for example, extend to most service industries. Then there is the

question of whether, if it be granted that presently illegal price and other agreements tend to have adverse effects on consumers, these same effects may not come about in other ways that the Act does little or nothing to bar. May they not come about, for example, if instead of entering into an agreement, the firms involved simply merge? Even this may not be necessary: in cases where the number of firms in an industry is relatively small, there may exist a sufficient measure of tacit understanding among them that their economic behaviour is not greatly different from what it might be if they had either merged or formed a collusive agreement. The condition of oligopoly, with firms following a price leader or otherwise acting upon "recognition of mutual dependence", appears to be fairly common in the Canadian economy.[4]

In addition to urging that more be done about mergers and oligopoly, some of those who favour a more vigorous competition policy have advocated the extension of the Act to cover a wider range of trade practices. The Act now covers refusal to sell only when used to enforce resale price maintenance. Other practices not now covered by the Act include the exclusive-dealing and tying arrangements described in the "T.B.A." Report of the Restrictive Trade Practices Commission.[5]

But, while some observers have felt that Canadian competition policy is not vigorous enough, others (particularly businessmen) have criticized it in other ways. The business briefs that have been received by the Economic Council in connection with the Government's Reference include most of the criticisms that Canadian businessmen have made of the Act over the last several years. Of criticisms that deal not with detailed procedures under the Act or with the repugnance to businessmen of its criminal law basis, but rather with its general character, philosophy, and approach, the following four would appear to be the most important:

(1) Proceedings under the Act are often extremely drawn-out, leaving accused firms in a state of uncertainty for long periods of time.

(2) Additional uncertainty is produced by failure to spell out offences clearly, with the result that businessmen often do not know whether their contemplated course of action will bring them into contravention of the Act.

(3) Since the main underlying objectives of the Act are economic in nature, it is inappropriate that the courts, in deciding whether an offence has been committed, should not give more attention than they do to the probable economic effects of the business actions complained of. In other words, there should be less relative emphasis on industrial *conduct* and *structure*, and more on economic *performance*.

(4) By the restraints that it exerts on agreements, mergers and monopolies, the Act hampers the achievement of greater "rationalization" and specialization of Canadian industry, the promotion of exports, and the building-up of large-scale, research-based enterprises.

It is worth pausing to consider a little further these four criticisms, for they help to illuminate some basic problems that all countries with competition policies have had to face in the formation and development of such policies.

To begin with, there is a certain incompatibility, already commented upon in previous chapters, between criticisms (1) and (2), which call for greater speed and certainty in the application of competition policy, and criticism (3), which calls for more flexibility, discretion, and consideration of economic effects. Greater speed and certainty could be obtained by redrafting the entire Act as a series of relatively clear and unqualified *per se* offences; this would undoubtedly accelerate procedure and give businessmen a more precise idea of whether their proposed actions were likely to attract a prosecution. But the resulting Act, if it were reasonably free of loopholes and comprehensive in its coverage, would likely be found intolerably rigid.

Conversely, however, a move to have the courts give greater consideration to economic performance and probable economic effects would tend to lengthen procedures and increase uncertainty. As it is, many recent price-fixing cases have taken five years or more to complete from the opening of the initial investigation. How much longer would they have taken if the courts had had to consider, in addition to evidence bearing on whether or not a combine existed, a full range of

evidence concerning the alleged economic effects (past, present and future) of the combine? The difficulties that are involved in basing competition policy very largely on economic performance criteria and the analysis of probable economic effects were pointed out in Chapter 2.

Another dilemma is suggested by criticism (4) in the list above, concerning mergers, monopolies, rationalization, and specialization. The typical problem is that whereas a proposed merger or agreement regarding specialization, exports, or both, may give some promise of bringing about longer production runs and lower unit costs, with possible favourable implications for international competitiveness, it may also create a monopoly or near-monopoly in the domestic market, with possible unfavourable implications for the domestic consumer. Much will, of course, depend on other circumstances, such as the extent to which the domestic market is protected from foreign competition by tariffs or transportation costs.

Returning to the matter of uncertainty, it is normally thought desirable for criminal law to be characterized by an especially high degree of certainty and fair warning. The Combines Investigation Act is notable for the use of a large number of qualifying words and phrases such as "unduly" (Section 32 on combinations), and "having the effect or tendency of substantially lessening competition or eliminating a competitor, or designed to have such effect" (Section 33A on price discrimination). On the face of things, these qualifications might seem likely to produce considerable uncertainty. Regard must be had, however, to the jurisprudence as well as to the letter of the Act. Where there has been little jurisprudence, as in the section on price discrimination, much uncertainty does exist; but where the courts have been more active, as in the section on combinations, the state of affairs under the Act has become clearer. Thus the word "unduly" ("to prevent, or lessen, unduly, competition in the production, manufacture, etc....") has acquired a specific quantitative significance. It has been interpreted in such a way that a price agreement covering the whole of the relevant market can now virtually be said to be illegal *per se*, while an agreement covering less than the whole but well over half of the market runs a substantial risk of being held illegal.

An important point about the jurisprudence in this area is that while the courts have been prepared to consider economic evidence relating directly or indirectly to the share of the market covered by agreements, they have steadfastly declined to consider evidence relating to the economic *effects* of agreements. This is well brought out in the decision of Mr. Justice Spence in the *Fine Paper* case:

> Surely the determination of whether or not an agreement to lessen competition was "undue" by a survey of one industry's profits against profits of industry generally, and a survey of the movement of the prices in that one industry against the movement of prices generally, would put the Court to the essentially non-judicial task of judging between conflicting theories of economy and conflicting political theories. It would entail the Court being required to conjecture -- and by a Court it would be nothing more than mere conjecture since a Court is not trained to act as an arbitrator of economics -- whether better or worse results would have occurred to the public if free and untrammelled competition had been permitted to run its course.[6]

The quantitative, share-of-market interpretation that the courts have placed on "undueness" has been such as to allow the striking-down of a considerable number of price agreements. But in respect of mergers, where a similar piece of qualifying language prevails, the effects have been very different. In *Rex v. Canadian Breweries Limited*, the trial judge, Chief Justice McRuer, stated that it was not the motive but the effect of the merger that was important -- "whether it has operated to the detriment or against the interest of the public, or is likely to do so". Chief Justice McRuer asserted that these words, applied to mergers, had substantially the same meaning as "unduly", applied to combinations. It followed that if the effect of a merger was to virtually eliminate competition, an offence had been committed; otherwise not.

To demand that a price agreement, in order to be declared illegal, must embrace most of the relevant market leaves considerable room for successful prosecution by the Crown, since if an agreement had not this characteristic, its prospects of effectiveness would

in most cases be too low to induce anyone to enter into it. But to apply a similar market standard to mergers all but rules out successful prosecution by the Crown since few mergers virtually eliminate competition even though some of them have considerable and long-lived effects on competition.

Establishing the share of the market covered by a price-fixing agreement is a relatively simple operation, since the area covered by the agreement itself is of considerable assistance in defining the market. However, the delineation of the relevant market in cases involving mergers and other restrictive practices confronts the Director of Investigation and Research, the Restrictive Trade Practices Commission and the courts with a more difficult task. Sometimes the task is virtually synonymous with that of defining industry boundaries, an industry being thought of as a group of sellers who market a certain product or range of products. But in a world of product differentiation and product substitution, where should market lines be drawn? Should one think in terms of the market for a particular kind of steel product, of the market for all steel products, or of the market for steel, aluminum, plastics and perhaps some other materials? The decision will turn on how readily market buyers can substitute one material or item for another. The geographic extent of markets, transport costs, and the relative costs of producing the substitute products will have to be taken into account. The result is very much a matter of judgment. For purposes of competition policy, market boundaries, if not always industry boundaries, should be drawn as narrowly as is required to ensure that no substantial group of buyers *within* the boundaries should be unable readily to substitute one product for another.

The present situation of Canadian competition policy with respect to mergers provides a good illustration of an area where it has proved impossible, within the confines of criminal court procedure, to provide the sort of examination of complex economic phenomena that would adequately satisfy the protection of the public interest. The MacQuarrie Committee was well aware of this kind of problem and attempted to devise a means of dealing with it while at the same time adhering to the assumption that the criminal law basis of Canadian combines legislation would have to be continued for the time being. In proposing the

creation of a board very similar to what shortly thereafter emerged as the Restrictive Trade Practices Commission, the Committee was not only concerned to separate the functions of prosecutor and judge previously lodged with the Commissioner under the Combines Investigation Act; it also hoped to provide a means whereby significant economic issues in matters brought before the Commission could be thoroughly aired and reported on, and remedies other than (or in addition to) criminal prosecution could be proposed.

The task conceived for the Commission was an extremely difficult and challenging one, and if the expectations of the MacQuarrie Committee have not been wholly fulfilled in practice, this should not be taken as any reproach to the diligence and vigour with which members of the Commission have discharged their duties. The Commission has made some highly useful original contributions to the evolution of competition policy in Canada. Examples of such contributions would include the Commission's report on ocean shipping conferences and its active participation in certain general inquiries under Section 42 of the Combines Investigation Act. But it must be said also that, on the whole, the Commission itself has not been able to escape from the criminal law strait jacket to the degree hoped for by the MacQuarrie Committee. For reasons some of which are readily understandable, the Commission has paid close attention to the interpretation of the Combines Act by the courts and, to a considerable extent, has assimilated its role to that of the courts. It has not ventured into broader economic analysis to the extent that was anticipated and has not, by and large, provided an adequate solution to the problem of dealing with practices and situations that do not lend themselves well to treatment via the normal procedures of criminal courts.

Another means that has been utilized in an attempt to overcome some of the rigidities and other disadvantages of the present legislation has been the development of a "program of compliance" by the Director of Investigation and Research under the Combines Investigation Act. Under this program, businessmen have been encouraged to discuss with the Director *in advance* courses of conduct which they are contemplating, in order to determine whether the adoption of such courses would lead him to launch an inquiry under the Act.

Altogether, it is apparent that there are numerous causes for dissatisfaction with the present situation of Canadian competition policy. It cannot be expected that such a policy will ever please everyone. Remedies for undesirable situations must be provided, and those on the receiving end of these remedies will rarely if ever enjoy the experience. But it does appear to us that a point has been reached where competition policy can be restructured to meet, at least partly, some of the more serious and important criticisms that have been made of it, and where it can also be better related to national economic objectives. Thus altered, it should be able to command a wider measure of that public understanding and support that are essential to its successful operation.

Notes and References

[1] Joel Bell, *The Development of Canadian Antitrust Legislation*, Economic Council of Canada, Special Study (forthcoming). For other general references, see J. A. Ball, *Canadian Anti-Trust Legislation*, Baltimore, The Williams and Wilkens Company, 1934; Richard Gosse, *The Law on Competition in Canada*, Toronto, The Carswell Company Limited, 1962; G. Rosenbluth and H. G. Thorburn, *Canadian Anti-Combines Administration, 1952-60*, Toronto, University of Toronto Press, 1963.

[2] *Report of the Committee to Study Combines Legislation and Interim Report on Resale Price Maintenance*, Ottawa, Queen's Printer, 1952.

[3] Gordon Blair, "Combines: The Continuing Dilemma", *Contemporary Problems of Public Law in Canada*, O. E. Lang, ed., Toronto, University of Toronto Press, 1968, pp. 18-19.

[4] Economic Council of Canada, *Third Annual Review*, Ottawa, Queen's Printer, 1966, pp. 132-136.

[5] Restrictive Trade Practices Commission, *Report on an Inquiry into the Distribution and Sale of Automotive Oils, Greases, Anti-Freeze, Additives, Tires, Batteries, Accessories, and Related Products*, Ottawa, Queen's Printer, 1962.

[6] *Regina v. Howard Smith Paper Mills, Limited, et al.* (1954), O.R. 543 at 571.

CHAPTER 5

SOME STRUCTURAL ASPECTS OF CANADIAN INDUSTRY

The preceding chapters have discussed the appropriate objectives of competition policies and the legislation and administration of these policies both in Canada and abroad. It is of course impossible to draw inferences about appropriate Canadian policy from a comparative study of national policies without having regard to the economic environment within which each set of policies operates. While the Canadian environment clearly has many aspects that are similar to those found elsewhere, it also has a number of distinctive features that need to be taken into account in any assessment of present Canadian policies and proposals for their revision.

How does one obtain information about the features of the Canadian economy that are relevant for competition policies? Unfortunately, much of the information about the structure and practices of Canadian businesses, and about the process of their interaction with other private and public practices and policies has been neither collected nor examined. Neither consumers nor businessmen, nor the designers and administrators of public policies operate in a situation where their information is perfect or anywhere near perfect. Certain salient features of the Canadian economy have, however, been subject to some examination, and it is on the basis of available knowledge of these features that public and private decisions must be made. This information is available from a number of different sources. The major collectors of information are usually, though not always, public bodies such as the Dominion Bureau of Statistics and other federal and provincial government departments and agencies. The documentation of cases under the Combines Investigation Act, reports of the Restrictive Trade Practices Commission and the Canadian Tariff Board are notable sources, as are certain Royal Commission reports, and industry studies carried out under nongovernmental auspices.

For the most part we have been able to rely in this Reference upon the very substantial body of documented analysis of the Canadian economic environment that had accumulated prior to the time our work commenced. To some degree, however, we felt it necessary to expand

this knowledge to embrace here and there some sections of hitherto unexplored or inadequately explored territory. Thus, while we have been able to rely on existing work in the area of scale and specialization and the size of Canadian markets, we felt the need to improve and bring up to date knowledge about industrial concentration in Canada and about postwar merger activity. We have also devoted some resources to throwing additional light on aspects of business behaviour directed to the specific activities of research and development. While our contribution within this Reference to existing knowledge about the Canadian economic environment has been modest, and while the sum total of existing knowledge in relation to the size and complexity of the environment is much less than it should be, it is nonetheless adequate to distinguish the desirability and direction of certain changes that should be made in our competition policies. The changes are of two kinds. The first kind involves changes in competition policy based upon long-standing features of the Canadian economy with which our existing policies, for a number of reasons, have never been able to deal adequately. The second kind of change reflects the need to update policies to meet changing technological and other features of the environment that have evolved since the MacQuarrie Report on combines legislation in 1952.

We propose in this Chapter to discuss some of the salient features of the Canadian economic environment, then to proceed in the following Chapter to the policy changes that we recommend.

Market Size, Scale and Specialization

One of the most obvious limits on efficient use of available resources is the size of the market into which the goods and services produced by those resources are channeled. In an open economy such as Canada's, market size is affected to a considerable extent by the tariff policies adopted by both foreign and Canadian governments. Tariffs erected by other countries hamper the efforts of Canadian producers to move beyond national borders and compete for sales in world markets. Tariff barriers set by Canada shelter the domestic market from the inroads of foreign suppliers, and increase the tendency for Canadian manufacturers to try to provide a full range of the requirements of Canadian consumers. Attempts by Canadian manufacturers

to supply the wide range of products desired by consumers all too often result in inadequate specialization and short production runs. There are, of course, other impediments limiting market size; in some industries, transportation costs and nontariff barriers such as patents and the valuation placed on imports for customs purposes may have a more powerful impact.

The size of the market for the output of a particular industry in turn determines the number of firms or plants of minimum efficient size required to produce, distribute and market the product. One of the consequences of Canada's economic structure is that the conditions which tend to call for a relatively small number of relatively large firms also generate in many instances small, or at any rate inadequately specialized, plants operating at levels too low for maximum economic efficiency. How does this come about and why does it persist? Part of the answer may lie in the greater urgency of the pressures generated by the Canadian environment to achieve scale economies *other than at the plant level*. These would include economies to a firm in respect of such things as distribution, advertising and possibly in some cases overall management. The drive to capture such economies may help to explain why firms are relatively few and large in many Canadian markets. But this fewness of firms in turn may, over time, tend to lessen competitive pressures to the point where inefficient *plants* are able to persist. Inadequate specialization is especially marked in industries where the distribution system offers marketing advantages to firms producing a "full line" of products. In such cases, while the industry may contain the number and size of *firms* consistent with efficient production of its *total* output, maximum efficiency in terms of individual *products* is unlikely to be achieved because each of the firms is producing a full line instead of specializing in a few items only. It is important to stress at this point that the situation that has been described should not necessarily be attributed to inefficient management. Once a pattern of multiproduct output is established, it is not necessarily in a firm's own interest to specialize. An attempt to do so may not only place a firm at a marketing disadvantage vis-à-vis other firms that still offer a full line of products; it may also expose the firm to a price war if it tries to convert its lower unit costs on specialized items into lower prices.

The evidence on scale and specialization in many industries leaves little room to doubt that existing market forces are often incapable of bringing about minimum cost levels. Eastman and Stykolt's study[1] of 16 widely representative Canadian industries showed that plants of minimum efficient size (taking into consideration both scale and specialization) produced on the average only 43 per cent of the output of these industries. This was in sharp contrast to a similar study by Bain which showed that in the United States the average was 80 per cent.[2] In only four of the Canadian industries was 75 per cent or more of the output produced in plants where full advantage was taken of available production economies. There are still important unanswered questions in this area -- questions that relate to the extent of the gap between minimum efficient size and the average size of plants in each of the industries and to cost differences between plants of different sizes. But it is known that cost differences can be quite large and indications are that the cumulative detrimental effect on the Canadian economy of inadequate plant size across a broad spectrum of industries is considerable.[3]

The proposed changes in competition policy presented in Chapter 6 of this Report have been influenced in two important respects by the evidence on scale and specialization in Canadian industry. This evidence has had a direct bearing on our recommendation that specialization agreements, under appropriate safeguards, should be permitted, and secondly that, in evaluating a merger, weight should be given to the effect on cost levels in addition to other factors. One of the key questions that had to be answered was whether the shortfall between actual and potential performance in the area of scale and specialization was sufficiently important to justify provisions in our recommended policy which could in some cases result in less, rather than more, competition. In reaching an affirmative answer to this question, we hasten to add that the approval of specialization agreements must be on a selective basis -- they are by no means appropriate for all industries. A case-by-case appraisal also appears to be required in dealing with mergers where it is necessary to sort out and evaluate the variety of reasons that may underlie a decision to merge. It is interesting to note that the admittedly imperfect evidence from a survey conducted by the Combines Branch, discussed

below, suggests that the exploitation of greater scale and specialization opportunities did not rank among the main factors motivating the extensive merger activity that took place in Canada during the postwar period. This is not to say that the other motives were necessarily inappropriate or that greater efficiency resulting from economies of scale and specialization did not in fact come about as a result of the merger. But it does point up the necessity of a case-by-case appraisal, in the light of surrounding circumstances and taking into account all relevant factors, in order to predict with any degree of confidence both the possible economies and the potential adverse effects on competition that may result from mergers, and indeed from other types of business practices.

The existence of tariff protection on many final products produced in Canada raises important potential obstacles to efficiency. The tariff may act as an effective upper limit on prices; in other words, the laid-down (or tariff-paid) cost of imports into Canada is used in some cases as the limit above which manufacturers may not price their products, regardless of how many other competitors they face or how large a share of the market they control. This limit price is not necessarily a level that affords producers high or excessive profits, but the fact that it does exist and that it is easily recognizable may reduce the need to strive continuously to achieve efficiencies. In a number of manufacturing industries, Canadian producers may in fact be able to hold prices below the upper limit set by the tariff, but they are under little or no pressure to do so. The tariff in these industries provides a margin within which inefficiencies may persist; this is true regardless of whether or not advantage is taken of the full margin of tariff protection. In addition, the fact that the limit price is clearly defined by the laid-down cost of imports may have implications for conduct that are relevant to the analysis of competition policy. It may be less difficult, for example, to achieve a tacit consensus among firms in a Canadian manufacturing industry in respect of their pricing policies than it is in the United States where situations in which similar upper limits exist and appear to play a significant role in business pricing decisions are apparently less widespread. The laid-down cost of imports into Canada can be taken as the price that would be charged if market power was fully

exercised in the sheltered Canadian market. This indication of market power may weigh critically in assessing the implications of such things as mergers or specialization agreements which, on the one hand, promise efficiency gains in production but, on the other hand, produce increased industrial concentration or something very similar in its economic effects.

It has been argued that the reduction of tariffs following the Kennedy Round and the change in the Canadian economic environment which these reductions will bring about will be such as to make possible a major dismantling of competition policy. This seems highly unlikely. Nominal tariff rates will still be fairly high -- on the average about 15 per cent. In many industries the effective protection provided by the new tariff rates will be about the same as before the Kennedy Round, because the reduction of the tariffs on inputs used by these industries offsets the decrease in protection on their own output.[4] Nevertheless, the reduction of tariffs on a broad front should result in some inducement for industries to move towards larger scale and increased specialization. Domestic tariff levels *have* come down. Moreover, foreign markets have been made more accessible to domestic producers. The market discipline and the opportunities created by the multilateral tariff reductions should result in a more efficient structure of Canadian industry. But the continuation of substantial tariff and nontariff barriers for some time into the future is another reason behind the need for public policies geared to promote efficiency.

There are of course some industries in which market size, industrial structure and business conduct are not conditioned by the level of tariff barriers. Where the product is perishable, such as milk, or where the bulk or weight of the product is high relative to its value (e.g. cement), the potential area served by a plant is determined by economies of scale, transportation costs, and the geographic distribution of buyers. The markets served by many retail and wholesale distributors and by many service-producing establishments are also, by their nature, local, and are, moreover, a large and growing part of the economy.

A further force influencing the Canadian environment is the presence of factors outside Canada that tend to restrain competition significantly in some

industries even in the complete absence of a Canadian tariff. For instance, the main potential foreign competitor might be the corresponding U.S. industry, and this industry might itself be highly oligopolistic and in many ways relatively noncompetitive. The comparative lack of competition in a Canadian industry closely linked to its American counterpart via parent/subsidiary or other affiliate relationships would have to be regarded as due in large measure to the competitive situation in the United States. In such cases all that national competition policy can realistically accomplish is to restrain any attempt to abuse a position of market dominance.

It is obvious from this brief look at some of the elements of Canadian economic structure and associated business conduct that competition policy cannot deal with these aspects on the basis of any universal law. But it is equally clear that in some cases they may be of sufficient importance that policy must be devised to take account of them on an individual basis. For example, while the power to introduce tariff reductions must reside with the government, cases may come up where a lowering of the tariff barrier may be a highly appropriate means to ensure that efficiency gains, such as result from a merger, for example, are passed on to the consuming public.

Concentration

The level of concentration -- the extent to which a small number of firms account for the bulk of an industry's output -- has an important bearing on the state of competition in an industry. Where concentration is high, so too are the risks of strong market power, low competitive pressure, inefficiency and poor resource allocation. One must be very careful however not to be overly simplistic and to translate measures of concentration into indexes of market power, for concentration is only one of the variables helping to produce these undesirable conditions. But the higher the level of concentration, the more likely it is that certain undesirable practices will occur. For instance, more stress is likely to be placed on nonprice forms of competition, and both the ease of reaching joint decisions on pricing and the temptation to do so are likely to be greater. Where, on the other hand, there are 20 or more firms in an industry with no three or

four of them highly dominant, the probability of firms being able to reach joint binding decisions on price, either through explicit agreement or through some form of implicit bargaining, is slight. The tendency to engage in secret price-cutting would likely override even a formal agreement. Many studies have proven that there exists on the average a positive relationship between high levels of concentration and high profit levels.[5] The ability to maintain earnings, year after year, over and above the amount required to cover costs plus a reasonable return on invested capital, is an indication that something is amiss in the efficiency of resource use in the economy. (One cannot, however, turn this coin around and infer that where earnings just cover costs plus a reasonable return on capital, efficiency necessarily reigns. As was observed in Chapter 2, lack of competitive pressure in an industry may lead to sloppiness, poor cost control, and merely comfortable profits.)

Changes in the level of concentration in a particular industry can be brought about by a number of factors. Among the most important are the speed at which the industry grows; shifts in the size of plants and firms required to maximize efficiency; the importance of technology embodied in patents held by existing firms; the size and availability of capital investment required for a new firm to break into the industry; other barriers to entry; and the extent of merger activity which has taken place within the industry.

It is obvious from even this very brief list that industrial concentration is *one* of the elements to be taken into account in the design of a competition policy which strives to promote economic efficiency. What is not so obvious is the degree of importance to attach to concentration in the Canadian context. At the outset of our work, the only available empirical evidence was a study by Rosenbluth based on 1948 data for 96 Canadian industries. In order to update this work, the Council commissioned Professor M. Stewart to undertake a study based on various industry bulletins published by the Dominion Bureau of Statistics. The results of this study, which is shortly to be released, are summarized briefly in Appendix III. But for present purposes it is sufficient to note that in more than one-third of Canadian manufacturing industries in 1964 as few as eight firms within each industry accounted

for 80 per cent or more of the shipments of that industry. At the other end of the scale, however, in another group of industries again accounting for more than one-third of total manufacturing, 20 or more firms were required to account for 80 per cent of total shipments of their respective industries. A comparison of shifts in aggregate industrial concentration over time suggested that, although more than one-half of the manufacturing industries for which reasonably comparable data were available over the period were more concentrated in 1964 than they had been in 1948, more than one-third had a lower level of concentration.

Thus one can only conclude that in some parts of the Canadian economy certain industries may have a high and increasing degree of concentration. One cannot, however, determine from the figures whether the degree of concentration in these industries is such that full advantage is being taken of economies of scale. Clearly such an assessment must rest on a much more penetrating analysis of individual firms and a finer classification of the industries within which they operate. What one can say is that if concentration levels in each of these industries were lower and falling, there would be less need for concern over mergers and trade practices with a potential for detrimental effects on efficiency. Except in circumstances where there is public control over the entry of new competitors into an industry, high concentration is a necessary, although by no means sufficient, condition for market power. Where there is no significant market power in an industry, then practices of individual firms, such as tied sales and refusals to deal, for example, are not likely to result in detrimental effects on the public interest, because the buyers of the industry's product can turn to other producers for their supplies. Indeed, in the absence of market power it is much less likely that potentially detrimental practices will exist at all.

Mergers

The discussion so far has highlighted the fact that the behaviour of firms is influenced by the structure of the industries within which they operate. But this is not a one-way process. What firms do affects, in turn, the structure of industries. All forms of market behaviour have the capacity to change industrial structure. Policies of existing firms with

respect to pricing, advertising, and research and development can exert a powerful influence on what size and other characteristics a new firm must have to enter an industry successfully, and on the capacity to survive of some of the firms already in the industry. These policies ripple out to produce gradual changes in the structure of industries, giving competitors the opportunity to adjust their own policies if they feel this to be necessary. Abrupt changes in structure, brought about by sharp alterations in conduct, are therefore rare.

There is, however, one exception to this general statement: mergers between competitors and between customers and suppliers have an immediate and sometimes substantial impact on the structure of industry.

Mergers are brought about in two principal ways. An acquiring firm may purchase all of the assets of another company, or it may secure enough of the voting stock of the acquired company to ensure effective control. Mergers have two effects, both of which are of concern to efficient resource use and to competition policy. The first relates to the increase in market power brought about by the merger. If the acquired and acquiring companies are in the same industry, a merger will obviously reduce the number of firms, whereas a merger between companies in a customer-supplier relationship leads to an increase in the degree of vertical integration within the industry. Alternatively, in the case of a merger of firms engaged in unrelated activities, the merger will have no necessary impact on those aspects of market structure which have hitherto been most studied and analysed. But the fact that the analysis of such "conglomerate mergers" is still in its relative infancy calls for caution in reaching conclusions on how they affect business structure and conduct.[6] The second effect produced by a merger is that by increasing the volume of assets and sales under the control of individual firms, they increase the rate at which cost-saving opportunities may be exploited. Other effects of mergers, such as changes in the degree of foreign control of Canadian industries, fall outside the ambit of competition policy.[7]

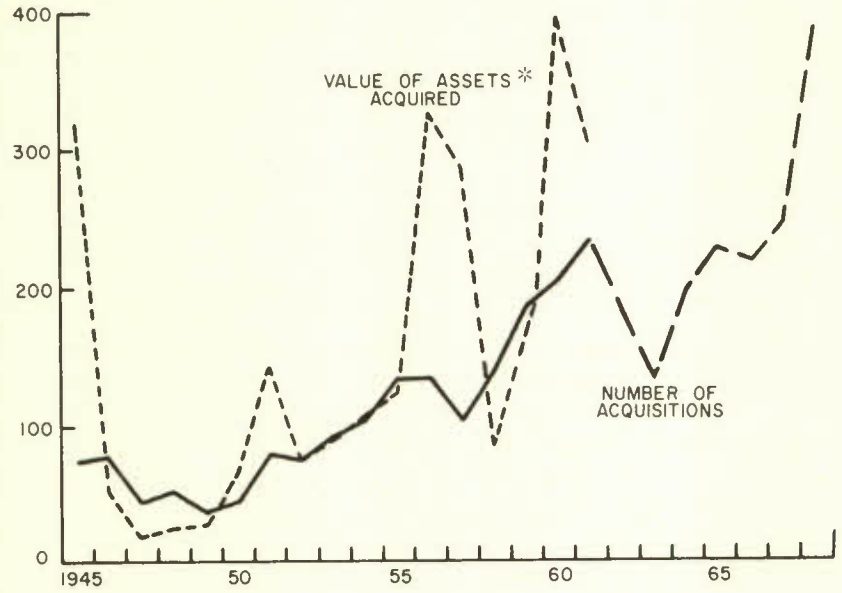
The Combines Branch of the Department of Consumer and Corporate Affairs recently completed a survey of mergers taking place among firms whose activities fell within the jurisdiction of the Combines Investigation Act and which made any publicly recorded acquisitions from the beginning of 1945 to the end of 1961. Coverage of sectors such as manufacturing, mining and trade appears to have been virtually complete. However, there was only fragmentary coverage of acquisitions by firms in the service sectors, such as financial institutions, most utilities, advertising agencies and real estate companies. The survey recorded 1,826 acquisitions over the 16-year period, acquisitions being defined as the purchase of the whole or part of an operating business capable of sustaining an independent operation and costing in excess of $10,000.

The annual breakdown of the number of acquisitions and the volume of assets acquired is shown in Chart 5-1. Two characteristics stand out. The first is that there were some wide fluctuations in both the number and value of acquisitions and, second, that there was a fairly strong upward trend over the period, particularly in the number of acquisitions. As was discovered in the United States,[8] the number of acquisitions bears a fairly close statistical relationship to a number of major economic variables, but particularly to the average level of stock market prices. Since mergers seem to respond positively to generally buoyant economic circumstances, as reflected in stock market prices, and given the apparent determination on the part of Canadian and foreign governments not to permit any prolonged slowdown in economic activity, an environment favouring a high level of merger activity is likely to persist into the foreseeable future.

Other results of this survey are to be found in Appendix III to this Report.

Chart 5-1

MERGER ACTIVITY IN CANADA, 1945-61(1)



* MILLIONS OF DOLLARS, DEFLATED TO 1949 BASE

(1) Mergers covered in the survey include only acquisitions made in the period 1945-61 by companies whose activities fall within the Combines Investigation Act. Data pertaining to the number of acquisitions undertaken in 1962 to 1967 were tabulated from published sources.

Source: Questionnaire Survey, Combines Branch; Economic Council of Canada.

In the previous Chapter, attention was drawn to the fact that the Canadian courts' interpretation of the existing merger section of the Combines Investigation Act has been such that acquisitions by firms with substantial market power are not precluded by law. In the light of what has been said about the potential dangers inherent in an overly concentrated industrial structure, and in view of the somewhat rough indications that in some industries in Canada concentration could be approaching a danger point, Canada's stance with regard to mergers gives grounds for concern. On the other hand, there is evidence of a need for greater specialization in some lines of Canadian production so that potential economies of scale can be fully realized. How can Canadian policy resolve this dilemma? Certainly, the state of existing knowledge about industrial concentration, scale and specialization, is not such as to lend itself to any crude, mechanistic formula which weds these factors together. What appears to be needed is some sort of selective approach where certain merger proposals are examined for possible detrimental effects on the public interest in efficient resource use, with careful attention being paid to the circumstances of the particular industry involved. But given the possibility of initiating such a procedure, one may understandably want to ask how many of the mergers that have taken place in this country in the past might have been regarded as appropriate candidates for a public interest examination. Careful note should be taken of the exact question being asked: not "How many mergers should have been disallowed?", but "How many mergers might well have been examined for evidence of possible detrimental effects on the public interest?"

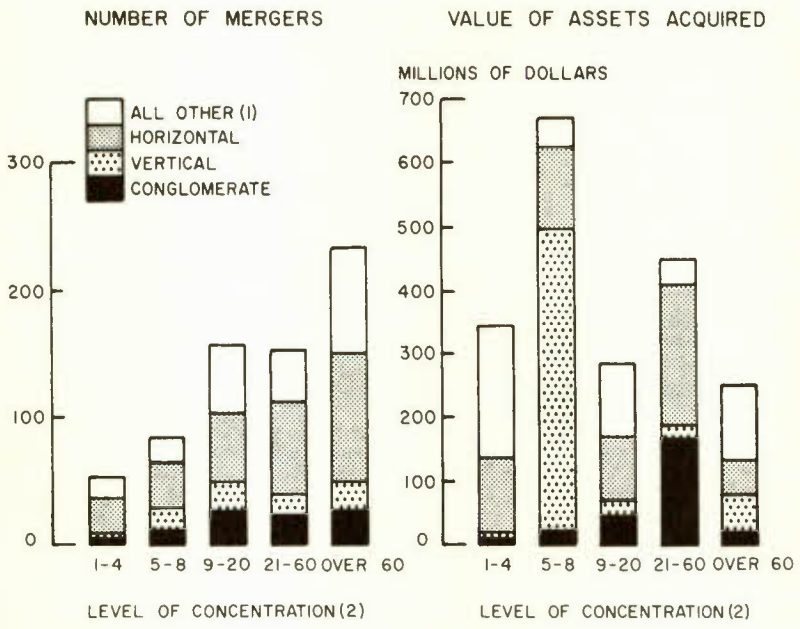
Presumably, the mergers selected for examination would, by and large, be those that appeared to confer substantial increases in market power on the acquiring companies, and particularly those that enhanced an already substantial degree of market power. The identification of market power is often a difficult task. Even in the initial phases of the selection process, an agency charged with screening out mergers for examination would be bound to take account of numerous factors. Here, the procedure employed is necessarily much cruder. Two rough estimates are attempted.

The first of these estimates is based on a cross-classification of 76 per cent of the acquisitions of manufacturing companies during the period 1945-61 (the remaining 24 per cent were not included since the industries in which the acquired firms could be placed were broader than the classification for which concentration data were available). These mergers are classified according to (a) the types of acquisition and (b) the levels of industrial concentration prevailing in each of the manufacturing subclassifications where mergers occurred. It is assumed for purposes of the estimate that only in rather highly concentrated industries would increases in market power resulting from mergers be worrisome enough to call for a public interest examination. If "rather highly concentrated" industries are taken to be those where eight or fewer of the largest firms accounted for 80 per cent of total shipments, this immediately drops the number of possible candidates for examination to 136. If one assumes that the 18 mergers falling into our "catch-all" conglomerate category have no detrimental effect on the public interest, this figure drops to 118. This would represent 17 per cent of the total number of mergers and 49 per cent of total value of assets acquired. The data on which this estimate is based is summarized in Chart 5-2, while the detail may be found in Table A-4 in Appendix III.

A second estimate is somewhat more sophisticated, involving a case-by-case appraisal of 997 acquisitions by manufacturing firms. Various factors bearing on market power are taken into account, including the level of concentration in the industry of both the acquiring and acquired firms, the market relationship and size of the acquired and acquiring firms and where available the size ranking of the firms in their respective industries. Another factor taken into account was the history of merger activity of the acquiring firm. On this basis, it appears that about 8 per cent of acquisitions, accounting for 34 per cent of total acquired assets, might have qualified for a public interest examination.

Chart 5-2

TYPES OF MERGERS AND THE LEVEL OF CONCENTRATION OF THE MANUFACTURING INDUSTRIES WITHIN WHICH THE ACQUIRED FIRMS WERE OPERATING, 1945-61



(1) Includes mergers described as "Geographic Market Extension", "Product Extension" and "Other Horizontal", data for which are shown separately in Table A-4 in Appendix III.

(2) Number of firms required to account for 80 per cent of shipments in 1964. Because levels of concentration were estimated from grouped data, they may be expressed as fractions of firms. In the Chart, wherever such fractions fall between the upper and lower values of two adjacent bars, the industry was placed in the bar with the higher value; for example, an industry with the concentration level of 4.1 appears as part of the concentration interval 5-8.

Once again, it should be emphasized that both of the above estimates are derived by crude methods. Their main value is the very rough indication which they provide that the institution of a procedure for examining mergers which appeared to involve a possibility of detriment to the public interest would probably affect a fairly small proportion of total mergers.

Returning to the merger survey conducted by Combines Branch, the questionnaire attempted to elicit from the acquiring firms the cost savings that resulted from the acquisitions. (This question was raised in the hope of determining what proportion of the mergers effected between 1945 and 1961 were undertaken in order to realize cost reductions through increased scale.) The replies, which are more fully discussed in the Appendix, were somewhat surprising and must be interpreted with caution. One surprising result, for example, was the large percentage of acquisitions that, in the opinion of the acquiring company, yielded negligible or no economies. Another was the fact that administration and management were considered to be far and away the most important source of economies. This is in contrast to expectations that, particularly where the companies involved were selling the same product in the same market, and where, consequently, much attention might be focused on improving scale and specialization, economies achieved through the integration of plants and the use of raw materials might have appeared more frequently. It must be repeated, however, that one should not read too much into these results. It is very evident to us that this area merits a good deal of further exploration and analysis before firm conclusions can be drawn. Determining the approximate size and nature of the economies which may result from a proposed merger will be one of the most difficult tasks to be faced by those charged with administering Canadian competition policy in a way which furthers the objective of efficient resource use.

Industrial Research, Development and Innovation

Discussion in Chapter 2 of this Report indicated that in formulating competition policy with a view to promoting economic efficiency, it is important to conceive of competition in its dynamic dimension -- that dimension which consists of the irruption onto the industrial scene of new and improved products and new methods of production and distribution. As the writings

of Schumpeter and others remind us, there are situations in which this can be the most powerful of all forms of competition.

It is important, however, not to proceed from the above to some such oversimplified conclusion as the following: "Industrial research, development and innovation are very good for the economy; we need more of them; large firms typically devote more of their resources to such things than do small firms; therefore competition policy should never stand in the way of the achievement of greater corporate bigness and industrial concentration." Such an unqualified line of reasoning is unacceptable, not only because competition policy must take into account important factors in addition to R&D and the innovative process but also because the relationship between such activity on the one hand and industrial structure on the other is in reality more complex than the statement suggests.

To be sure, it is a generally accepted proposition that a highly fragmented industry like agriculture, producing for the most part very homogeneous products, is unlikely to generate on its own an adequate volume of R&D and innovative activity. The typical production unit is too small to support a volume of activity likely to lead to useful improvement, and even if the unit were large enough, the improvement (whether it were a new strain of wheat or a better method of cultivation) could be too easily and quickly copied by others to make a sustained research program by an individual farmer worth his while: lacking patent protection (no plant patents are granted in Canada), he could not capture an adequate return for his effort. An analogous situation may be found in at least some sectors of the construction industry. There is a strong presumption that industries of this type, left to themselves, would generate much less R&D and innovative activity than would be socially desirable, and this provides the underlying rationale for the considerable volume of activity mounted by Canadian governments in such fields as agricultural and building research.

As one moves away, however, from highly fragmented industries into more concentrated sectors of the economy, the picture begins to change. The inducements for firms to carry on R&D and innovative activities become more powerful, and judgments of the extent if any to which these activities fall short of,

or exceed, socially optimal levels grow more difficult. Where an industry is dominated by a few large firms, heavy outlays on research and development and particularly on innovation may play a major role in the competitive strategy or rivalry among the few. This is partly because in such an industry the large firms (often possessing substantial retained earnings) will usually find the financial and other resources required for R&D programs and the application of new technology easier to come by, and partly because an individual large firm that innovates successfully will usually be in an immeasurably better position than an individual farmer or a small firm to capture an adequate return for its outlays. Aided, often, by patents and the possession of detailed technical know-how, it may be able to get a significant "jump" on its rivals, or if not that, then at least to keep technologically more or less abreast of them.

All this may at first glance seem entirely commendable; a certain type of competition among the few has helped to generate a high level of R&D and innovative activity within an industry. And, indeed, great benefit for consumers may result. But a caution is in order. Unless the improvements result in lower unit production costs, at least part of which are passed on to the consumer, then what is occurring is a form of nonprice competition. As was indicated earlier, nonprice competition can sometimes bring tangible benefits to the consumer -- it may for example make more extensive the range of available real alternatives. This is not invariably the case, however. Moreover, in respect of some product and process innovations, account must be taken of adverse "external" effects such as traffic congestion, noise, and air pollution. It cannot safely be presumed that *every* new or partly new product puts the consumer far enough ahead to justify, from the point of view of society as a whole, the heavy use of R&D and other resources that may have been required for the product's creation. Large expenditures may have gone into "inventing around" another firm's patented product. The end result may not be all that new and improved; instead it may be just sufficiently different from what was already on the market to furnish the basis for a heavy

advertising campaign and a successful sales promotion. This is not meant to deny the existence of some situations in which "inventing around" may be a very necessary part of the competition strategy of some industries. Where, for example, a patent owner sets unreasonably high licence fees, other firms in the industry may be forced into large research outlays to remain competitive. But in other situations, expenditures on innovation and on advertising may play more similar roles than at first seems apparent; both may serve as important and often closely linked forms of nonprice competition. And where outlays are heavy, both may constitute significant barriers to the entry of new competitors into the industry.

The market situation faced by large firms and the types of competition in which they prefer to engage are not the only factors explaining the proportionately lower R&D expenditures of small firms. Particular inventions and innovations, and occasionally even certain kinds of research programs, may require expensive equipment and a large staff to be carried to a successful conclusion. Also, a firm producing a full line of products is likely to have a better chance of finding a use for the unexpected fruits of its research activity than a more specialized firm. This characteristic is important in industries where diversification of output tends to be greater, the larger the size of the company. Finally, as implied in the foregoing discussion, the discovery-invention-innovation process is risky. Failure as well as unexpected benefits may result from research activities, while the crucial innovation stage may involve heavy costs. One of the advantages accruing to firms able to devote a large amount of resources to these activities is that they can pool their risks by undertaking a number of diverse projects.

What evidence is there with respect to expenditures and other measures of research, development and innovative effort, and what does this evidence tell us about the relationship between the size of a firm and such activity? Unfortunately these questions cannot be answered with any degree of accuracy. For one thing, the available statistical evidence is confined mainly to R&D expenditures, but these figures fail to capture

"the costs of the other activities that make up the remaining parts of the innovation process".[9] As was noted in the *Fifth Annual Review* of the Economic Council, innovation involves the coupling of the results of R&D with the engineering, design, financing, tooling-up, production and marketing processes required to bring products, processes and services into use. What the data on R&D do tell us is that the main effect of size is on the decision of companies to initiate research and development. A survey by the U.S. National Science Foundation revealed that the percentage of companies performing research and development in three broad size categories increased very sharply in moving from the smaller to the larger categories.[10] However, once the decision to undertake R&D activities has been made, there does not appear to be a consistent relationship between R&D expenditures and corporate size.[11] When smaller companies undertake R&D at all, they do not necessarily devote a smaller proportion of their resources to it than do larger companies. This conclusion is illustrated below with reference to Canadian statistics.

Because virtually all the available statistics of industrial R&D and innovative activity are expressed in terms of R&D expenditure, there is a danger of jumping to the easy assumption that the larger are expenditures, the correspondingly larger and more useful are the innovative consequences which flow from them. In fact, investigation has shown that useful new products and processes can by no means always be traced to the inventive activity of the big battalions. Important inventions have been created by firms of all sizes, with smaller firms contributing at least a proportionate share of the inventions surveyed.[12] A recent scientific panel study for the U.S. Government listed a number of twentieth century contributions as having originated with independent inventors and small organizations: xerography, DDT, insulin, penicillin, titanium, terylene/dacron, the zipper, the automatic transmission, the jet engine, the FM radio, the helicopter, air conditioning, the Polaroid Land camera, and the oxygen steelmaking process.[13]

Another U.S. investigation compared the contribution of innovations by the four biggest firms and the remaining smaller firms in three industries: iron and steel, petroleum refining, and bituminous coal.

In iron and steel, the share of the four biggest firms in innovations was smaller than their share of the product market. The reverse was true in the petroleum and coal industries.[14] These results suggest two questions which it is important to ask about research, development and innovation in a given industry. The first is: How much, on average, must be invested in R&D and in innovation in this industry in order to bring new products and new processes to the market? The second is: How many firms in this industry are big enough to be able to undertake investments of that size?

Here again the available aggregate industry statistics focus only on R&D, and therefore fail to provide a complete answer. What is known is that overall levels of expenditure on R&D alone are heavily influenced by a relatively small number of firms in a few particular industries. Of 684 companies that had their own "intramural" research programs in 1965, five accounted for one-third of expenditures and 50 for three-quarters. Breaking intramural expenditures down on an industry basis, about 60 per cent of expenditures were made by firms in the electrical, aircraft and chemical industries. Computations performed on behalf of the Economic Council by the Dominion Bureau of Statistics on the relationship between size of companies and R&D in the chemical and electrical products industries indicated that there was some tendency for R&D expenditures as a percentage of sales to increase with company size. However, as is shown in Table A-6 in Appendix III, there are considerable variations from industry to industry.

While "intramural" activities are concerned mainly with the search for new knowledge and new inventions, innovative activity draws heavily on technological information from the existing knowledge base. The fact that approximately 95 per cent of our patents are granted for inventions created outside of Canada is evidence of Canada's dependence on foreign sources for much of our technology. However, statistics on net payments abroad for patents, licences and technical know-how do not necessarily reflect the total cost of importing technology. Parent companies may elect to take higher profits from their subsidiaries in lieu of specifically earmarked payments. With this cautionary warning, it is nevertheless of some interest to note that 825 companies reporting R&D expenditures in 1965 also reported spending $25 million for patents and

licences from abroad, most of which went to parent and affiliated companies.[15] Moreover, there has been a movement in recent years towards increased R&D expenditures in Canada relative to payments for R&D outside Canada.[16]

Once again the serious limitations inherent in the data serve to emphasize with what caution the available statistics must be interpreted, and with what care the consideration of R&D and innovative activity must be introduced into the formulation and application of competition policy. One useful conclusion appears to be that firms of many different sizes have important roles to play in the development of inventions and innovations. Small firms do well in the early development of inventions, but large firms may have important advantages in carrying inventions through to the stage of widely used processes and products.

Because of the difficulty of arriving at generalizations about the relationships between R&D and innovative activity, industry structure and firm size, here as in other areas a selective approach on the part of competition policy is required. Scale economies in R&D and innovation will have to be taken into account in merger evaluations. However, given the distribution of such activity by industries, the importance of this factor will probably vary greatly from merger to merger, depending on the industries in which the merging firms operate.

The questions raised in this Chapter about market size, scale and specialization, the role of the tariff, industrial concentration, mergers and research, development and innovation have influenced the formulation of the recommendations outlined in the following Chapter. The fact that no hard and fast answers to these questions have sprung from either the empirical work that had already been done or from such efforts as we were able to make ourselves has led us to one major conclusion: although each of these aspects can have a significant influence on competition and on the degree of efficiency with which resources are used, the sectors of competition policy where decisions turn importantly on these aspects must be based on a case-by-case approach where economic analysis can be brought to bear on the examination of specific factors influencing the behaviour and performance of individual firms. That the present Combines

Investigation Act fails to provide for such an approach is evident from the discussion in the previous Chapter. We turn now to our suggestions for a new approach.

Notes and References

[1] H. C. Eastman and S. Stykolt, *The Tariff and Competition in Canada*, Toronto, Macmillan, 1967, Table 1, Chapter 3. Many of the industries referred to in this study are more narrowly defined than the DBS classifications used later in the present Chapter. Also, see D. J. Daly, B. A. Keys, and E. J. Spence, *Scale and Specialization in Canadian Manufacturing*, Staff Study No. 21, Economic Council of Canada, Ottawa, Queen's Printer, 1968, for additional evidence and references to other studies.

[2] Joe S. Bain, *Barriers to New Competition*, Cambridge, Mass., Harvard University Press, 1956, p. 185.

[3] It is very important, when considering the effect of size of production units on resource allocation, to distinguish between differences in total costs per unit and differences in value added per unit. A percentage difference of 5 per cent in total costs per unit, say, will reflect a 15 per cent difference in the resources used if the value added is a third of total cost. See Ronald J. and Paul Wonnacott, *Free Trade Between the United States and Canada*, Cambridge, Mass., Harvard University Press, 1967, Chapter 15, for an estimate of the cost to Canada of the U.S. and Canadian tariffs due to the impact on the size of markets available to Canadian producers, and consequently on the size of production units.

[4] James R. Melvin and Bruce W. Wilkinson, *Effective Protection in the Canadian Economy*, Special Study No. 9, Economic Council of Canada, Ottawa, Queen's Printer, 1969.

[5] The most recent studies confirming a widespread positive relationship between concentration levels and rates of profit are N. R. Collins and L. E. Preston, *Concentration and Price-Cost Margins in Manufacturing Industries*, Berkeley and Los Angeles, University of California Press, 1968, and R. W. Kilpatrick, "Stigler on the Relationship between Industry Profit Rates and Market Concentration", *Journal of Political Economy*, vol. 76, no. 3, 1968, pp. 479-488.

[6] A good discussion of how the presence of large diversified firms changes the analytical and, by implication, policy relevance of the usual definitions of market relationships is contained in Corwin D. Edwards, "The Changing Dimensions of Business Power", published in *Das Unternehmen in der Rechtsordnung*, C. F. Mueller, Karlsruhe, Federal German Republic, 1967.

[7] For an extensive discussion of the acquisition of Canadian firms by foreign firms, see Grant L. Reuber and Frank Roseman, *The Take-Over of Canadian Firms, 1945-61*, Special Study No. 10, Economic Council of Canada, Ottawa, Queen's Printer, 1969.

[8] See S. R. Reid, *Mergers, Managers, and the Economy*, New York, McGraw-Hill, 1968, pp. 1-120, for a review of merger activity in the United States and of studies of that activity.

[9] Andrew H. Wilson, *Science, Technology and Innovation* Special Study No. 8, Economic Council of Canada, Ottawa, Queen's Printer, 1968.

[10] *Industrial R and D Trends in Relation to Other Economic Variables*, National Science Foundation, Washington, 1964, Table 54.

[11] D. Hamberg, "Size of Firm, Oligopoly and Research: The Evidence", and F. M. Schrier, "Size of Firm, Oligopoly and Research: A Comment", *Canadian Journal of Economics and Political Science*, February and May 1965. Also see C. R. McConnell and W. C. Peterson, "R & D: Some Evidence for Small Firms", *Southern Economic Journal*, April 1965.

[12] J. Jewkes, D. Sawers and R. Stillsman, *The Sources of Invention*, New York, St. Martin's Press, 1958.

[13] U.S. Department of Commerce, Panel on Invention and Innovation, *Technological Innovation: Its Environment and Management*, Washington, U.S. Government Printing Office, 1966, p. 18. Only a selection from the list of inventions by small firms is given here.

[14] E. Mansfield, *Industrial Research and Technical Innovation*, New York, Norton and Company, 1958, Chapter 5.

[15] Dominion Bureau of Statistics, *Industrial Research and Development Expenditures in Canada, 1965*, Ottawa, Queen's Printer, December 1967, Table 10, p. 27. If payments by companies not performing R&D and relying solely on the purchase of patents and licences were included in the survey, the total net payments for technology would be higher.

[16] Dominion Bureau of Statistics, *Industrial Research and Development Expenditures in Canada, 1965*, Ottawa, Queen's Printer, December 1967, Table on p. 14.

CHAPTER 6

A NEW APPROACH TO COMPETITION POLICY IN CANADA

We come now to a first set of specific proposals for a new approach to competition policy in Canada. These proposals relate only to those aspects of business activity where market forces are an important means of social control. They are further restricted, for the moment, to those lines of economic activity (largely related to the production and distribution of goods) that now come within the ambit of the Combines Investigation Act. Later chapters will deal with competition policy in relation to service industries not now covered by the Combines Act, and with sectors of the economy that are largely or wholly state-owned, or are subject to a major degree of direct state regulation.

The basic philosophy that has guided us in formulating these proposals may be recapitulated. Essentially, we take the position that while historically the shaping of competition policy has been influenced to some extent by noneconomic considerations, it is likely to be clearer, more consistent and more effective in the future if it is treated more exclusively as a branch of economic policy. It should, moreover, be better integrated than in the past into the total structure of economic policies.

Competition policy has some bearing on all the major goals for the Canadian economy elaborated by the Economic Council in its successive Annual Reviews. The strongest and most direct bearing, however, is on the goal of rapid economic growth. A well-conceived competition policy endeavours to further the achievement of this goal by removing impediments to the attainment of maximum dynamic efficiency in the use of resources by the Canadian economy. Fundamentally, of course, efficiency and growth are desired not for their own sake but for the many and varied benefits that they bring to Canadians as consumers of goods and services. The maximization of the flow of benefits to ultimate consumers should accordingly be a key concept in the application of competition policy to particular situations.

Competition Policy

It is important to keep in realistic proportion the potential role of competition policy as an engine for improving the workings of markets and thus promoting efficiency and growth. In the first place, many other factors help to condition the operation of markets. The tariff position, the strength of import competition, whether the industry is also an export industry facing important competition abroad, and government policies at all levels in respect of such matters as taxation, and governmental purchasing may be mentioned. The degrees and types of market competition that prevail are a product of the total economic environment and not of competition policy alone.

In the second place, competition policy cannot itself supply the creative dynamism (one might also speak of "dynamic tension") in both production and distribution that is in the long run the consumer's most powerful ally in a market system. There must exist a set of attitudes and an institutional structure that are conducive to beneficial change -- to the introduction of useful new goods and services, along with better and cheaper methods of producing already established goods and services. Given these preconditions, with which it may creatively interact, competition policy can play a modest but useful facilitating role. It can help to wear down barriers to change, to expose previously sheltered areas of waste and inefficiency to fresh breezes of innovation, and more generally to liberate the creative forces already latent in the system. The principal result, as we have noted, will be a more efficient use of available resources. Economic growth will be speeded up and the pattern of output more closely related to consumer desires.

How can Canadian competition policy be restructured to play this role more effectively? Our proposals amount to an enlargement of the range of available instruments and procedures so that the policy can be better attuned to the various specific problems with which it has to deal. Some of these problems are of such a character that they can best be dealt with by means of broad and relatively unqualified prohibitions; others are not, and it is here, in this second category, that new policy approaches are most needed.

In the sections that follow, we recommend that Canadian competition policy continue to retain

certain broad prohibitions of price-fixing and closely related practices, misleading advertising, and resale price maintenance. The definition of these offences and of legal "defences" available to alleged offenders would be altered somewhat, but the offences would remain in large measure *per se* and also criminal. All other matters of relevance for competition policy, including mergers and a wide range of trade practices, would become the responsibility of a new, civil law tribunal. New procedures permitting specialization and export agreements to be operated in certain circumstances would be set up.

If false hopes have been aroused that in the course of our work we would seek to resolve the problems of specific industries whose situations have been brought to our attention, it should be clearly stated that from the outset we decided to confine our attention to devising an improved general framework for competition policy. Given the number of industries in Canada, the number of man-hours required for a thorough study of even one industry, and the Council's lack of the very special expertise required to analyse and adjudicate particular competition policy cases, we believed this general approach to be sound.

Retention of Certain Broad Prohibitions

For competition policy to prohibit a practice *per se*, or to prohibit it subject only to a few clearly defined exceptions, is a course worthy of consideration if the practice in question appears upon analysis to be inimical to the public interest and rarely if ever productive of any substantial public benefit. Where such conditions exist, the cost of striking down those few instances of the practice capable of producing some net benefit to the public may be judged to be outweighed by the greater clarity and certainty of a *per se* ban.

Whether or not to utilize a *per se* ban, or something close to it -- that is, a prohibition with relatively few exemptions or conditions attached -- is thus a question that must usually be decided by a balancing of advantages and disadvantages. Our own consideration of the range of practices and situations that is now, or might be in the future, of interest in relation to competition policy has led us to the view that five practices now dealt with in the Combines

Investigation Act should be subject to essentially *per se* prohibition under criminal law. These practices are as follows:

(1) collusive arrangements between competitors to fix prices (including bid-rigging on tenders);

(2) collusive arrangements between competitors to allocate markets;[1]

(3) collusive arrangements between competitors to prevent the entry into markets of new competitors or the expansion of existing competitors;

(4) resale price maintenance; and

(5) misleading advertising.

All five practices are already subject to something close to *per se* prohibition under Sections 32, 34, 33C and 33D of the Combines Investigation Act. With respect to resale price maintenance (Section 34) and misleading advertising (Sections 33C and 33D), the nature of what is prohibited emerges with reasonable clarity from the language of the statute. This is not true, however, of Section 32. Here, it is necessary to consult the jurisprudence in order to clarify what is prohibited and to discover what the main practical effect of the Section has hitherto been to strike down collusive price agreements embracing all or a substantial proportion of the relevant market.

In recommending that these five practices continue to be treated as, to a considerable extent, they are already treated under the existing law, we are in effect making a judgment that none of them is likely, except possibly on rare and sporadic occasions, to result in appreciable public benefit.

To deal first with collusive arrangements to fix prices, allocate markets or exclude competitors, we would propose that Section 32 of the Combines Investigation Act be rewritten so as to become as much as possible a *per se* ban of these practices. Such a rewriting, it might be hoped, would make clearer the nature of what is being prohibited and invest the Section with a greater degree of those characteristics of

certainty and fair warning that are thought to be particularly desirable in a piece of criminal law. The rewriting would reduce the scope of the Section. However, as will shortly be seen, we are proposing other arrangements in respect of undesirable practices that might now be found illegal under Section 32 but might escape prosecution under the Section as revised.

A definitive redrafting of Section 32 will not be attempted here; that is best left to experts. We gave some consideration to whether, in a Section 32 revised along the lines we have proposed, there would still be a need to retain the qualifying word "unduly", but were able only to arrive at an appreciation of the significant arguments that could be made both for and against retention. On the one hand, the retention of "unduly" would preserve a link with an extensive jurisprudence developed over many years. If the word were dropped, one of the problems that might arise would be the possible exposure to prosecution under Section 32 of certain co-operatives and relatively loosely organized chains of grocery supermarkets and auto accessory stores whose emergence on the retail scene has by and large brought about an increase in effective competition. Some other qualifying language, possibly requiring considerable clarification through jurisprudence, might have to be inserted into the Section to exempt the organizations mentioned. Finally, it is argued that "unduly" furnishes some protection against the swamping of the courts and other parts of the enforcement machinery with a host of minor cases.

On the other side, it is argued simply that the retention of "unduly" would compel the courts to continue to engage in the task of measuring markets, and in this and other ways prevent the three criminal offences here being discussed from being as "invested with certainty" as they otherwise might be. There would be some loss of clarity and public understanding, and consequently of deterrence.

If the decision were made to retain "unduly", it would nevertheless perhaps be possible to exempt from its scope the rigging of bids on tenders. This practice could surely be prohibited without any qualification whatever.

Two specific exemptions or "gateways" in a revised Section 32 appear desirable. The first, which would replace the present subsections (4) and (5), would be for "registered export agreements". The second would be for "registered specialization agreements". Such agreements would not give rise to offences under the Combines Investigation Act. Definitions of export and specialization agreements and descriptions of the procedures whereby they would be subjected to public interest tests in order to qualify for registration are given in a later section of this Chapter.

No major change appears to be required in subsections 34(1), (2), (3) and (4) dealing with resale price maintenance, the fourth of the practices recommended for *per se* treatment, although some attention might be given to the possibility of specifically requiring a manufacturer who printed a retail price on a package to indicate clearly that it was a suggested price only. Subsection 34(5), however, might well be given major reconsideration. This subsection, inserted in 1960, provides certain defences against a charge of enforcing resale price maintenance by refusing to sell. It reads as follows:

> Where, in a prosecution under this section, it is proved that the person charged refused or counselled the refusal to sell or supply an article to any other person, no inference unfavourable to the person charged shall be drawn from such evidence if he satisfies the court that he and any one upon whose report he depended had reasonable cause to believe and did believe
>
> (a) that the other person was making a practice of using articles supplied by the person charged as loss-leaders, that is to say, not for the purpose of making a profit thereon but for purposes of advertising;
>
> (b) that the other person was making a practice of using articles supplied by the person charged not for the purpose of selling such articles at a profit but for the purpose of attracting customers to his store in the hope of selling them other articles;

(c) that the other person was making a practice of engaging in misleading advertising in respect of articles supplied by the person charged; or

(d) that the other person made a practice of not providing the level of servicing that purchasers of such articles might reasonably expect from such other person.

The provision of these defences implies that the practices to which they refer (loss-leadering including "bait-and-switch" tactics, misleading advertising and inadequate servicing) are undesirable. If that is in fact the case, consistency and fairness would seem to demand that they be more directly and generally prohibited. To discourage an undesirable practice by weakening the prohibition of another is not a sound principle.

We therefore recommend that misleading advertising be dropped as a defence from Section 34. (Misleading price advertising is already subject to direct prohibition under Section 33C of the Combines Investigation Act, and, as noted below, other misleading advertising would be dealt with under a proposed new Section 33D now before Parliament.) It does not seem possible to deal directly with inadequate servicing, which would be a difficult charge to prove, and which has not figured in any of the jurisprudence on Section 34 since 1960. We recommend that it be dropped as a defence under Section 34 and that no direct governmental attempt be made to enforce adequate servicing on distributors.

Turning now to loss-leadering, this has already been the subject of an inquiry by the Restrictive Trade Practices Commission,[2] but judging from submissions that we have received, many businessmen believe that the practice has lately been having injurious effects in a number of markets. We recommend that this matter be subjected to an early general inquiry by the civil tribunal that we propose in a later section of this Chapter. The purpose of the inquiry would be to determine (a) in what ways and to what degree this practice appears to be detrimental to the public; and (b) to the extent that it does appear detrimental, to recommend to the government appropriate remedies of a more direct and

general character than those contained in the present subsection 34(5). At that stage, loss-leadering could appropriately be dropped as a defence against a charge of resale price maintenance.

The question of misleading advertising brings us to the last of the five practices recommended for *per se* prohibition. Misleading price advertising is the subject of Section 33C of the Combines Investigation Act, a Section that does not appear to require any change of wording. The practice in question amounts to a species of fraud, of just the kind that most tends to bring a market system into disrepute. Advertising can of course be misleading with respect to matters other than price, and the amendments to the Criminal Code, recently passed by Parliament, include a provision that brings into the Combines Investigation Act, as a new Section 33D, Section 306 of the Criminal Code which deals with a broad range of misleading advertising. The new Section 33D in conjunction with 33C treats all forms of misleading advertising as *per se* criminal offences, thereby removing any justification that may have existed for making misleading advertising by a distributor a defence against a charge of resale price maintenance.

A word is in order about the general procedure that might be followed in enforcing the five prohibitions here being discussed. The existing Combines Investigation Act gives the Director of Investigation and Research the option, when he has reason to suppose that an offence is being or is about to be committed, of sending the matter to the Restrictive Trade Practices Commission. Alternatively, he may refer the matter directly to the Attorney General of Canada who will consider whether legal proceedings should be instituted. We recommend that in respect of the five *per se* prohibitions, the second course should be the one normally followed in the future. Only on those occasions when a case presents novel economic features that appear to require careful analysis should the more roundabout route be followed. Especially if Section 32 is rewritten as we have suggested, occasions of this sort are likely to be rare, and for the most part there would not appear to be good reasons for retaining in the procedure a stage of hearing, review and appraisal such as may now be carried out by the Restrictive Trade Practices Commission. The main effect of such a retention would be to lengthen procedure unnecessarily. This does not mean that there

should not continue to be an important place in other sectors of competition policy for the type of work that has heretofore been performed by the Commission, by way of hearing, review and appraisal, and by way also of the publication of reports. But, as will shortly be seen, we are proposing that these functions of the Commission become part of the duties of the new tribunal.

Proposed Change to a Civil Law Basis

Most of our remaining recommendations for Canadian competition policy rest upon the assumption that it will be possible in this field to enact civil legislation that will be found by the courts to lie within the constitutional powers of the federal government. There can be no certainty concerning this matter until the courts have had an opportunity to pronounce upon it, but on the basis of highly competent advice, we are sufficiently persuaded both of the need for civil legislation and of the improved prospects for obtaining it that we are prepared to make this assumption.

There appear to be two ways in which the road could be opened for the federal government to enact civil legislation. We have no special preference between them, and we leave the choice to those expert in constitutional matters. The first way would be for the federal government to reach agreement with the provinces to make an appropriate change in the constitution. The change might well involve an enlargement of the trade and commerce power. The second way would be, within the existing constitution, to refer proposed legislation to the Supreme Court of Canada for the Court's opinion on its constitutional validity. Again, the issue would perhaps be most likely to turn on whether the legislation lay within the powers of the federal government under the trade and commerce head of Section 91 of the British North America Act.

It could be that the prospects of success via either route would be enhanced if the federal government sought only to enact civil legislation in respect of goods and services affecting international and interprovincial trade. Here again, this is a matter best left to experts.

We would like to make it emphatically clear that in recommending such a test we intend no implication whatever that the federal government should seek exclusive occupancy of the field of competition policy under civil law, or that only the federal government is competent to manage competition policy in Canada. On the contrary, while it is clear that a considerable proportion of Canadian economic activity crosses provincial and international boundaries, and would be impossible to subject effectively to any provincial competition policy, we believe that the provinces could play a most useful role in respect of other lines of activity under their existing constitutional powers. Their assumption of such a role would be a most welcome development. If the recommendations of this Report are largely framed in terms of federal legislation, this is because a federal presence is clearly indispensable and the federal government has hitherto been, to all intents and purposes, the sole active occupant of the field. But the door to provincial participation should be left widely ajar. Such activity by the provinces would be in many ways a natural extension of their already considerable activity in the field of consumer protection. We recommend that before preparing new legislation embodying major changes in competition policy, the federal government should take the initiative in proposing that discussions of competition policy and related policies be arranged between the Minister of Consumer and Corporate Affairs and appropriate provincial ministers.

The best outcome, in our view, would be for the federal government to obtain the advantages of a civil law basis for some of its competition policy and for the provinces also to interest and involve themselves in the field. Having regard to the need for federal civil legislation to pass a constitutional test, we have tried to frame our proposals for such legislation in terms of a concept, which we believe to be valid, of the Canadian economy as a coherent entity, with numerous links of interdependence between its various parts. Evidence to support this concept will be found in Appendix IV. It should also be noted that the rules and criteria incorporated in our proposals are all couched in general terms and are intended to be of general application. At no point do they focus *a priori* upon particular industries, or upon particular regions or provinces of Canada.

The basic reasons for seeking to place some of the federal government's competition policy on a civil law basis would be to improve its relevance to economic goals, its effectiveness, and its acceptability to the general public. The greater flexibility afforded by civil law is especially to be desired in those areas of the policy that do not lend themselves well to relatively unqualified prohibitions and that may in addition call for some case-by-case consideration of the likely economic effects of particular business structures or practices. The unsuitability of criminal law in such areas has been well described as follows:

> The present constitutional foundation for the Combines Investigation Act rests on the power of the Parliament of Canada to enact criminal law. This has contributed to the rigidity and inflexibility of the law and its administration. Criminal offences must be proved beyond a reasonable doubt. Charges must be expressed and proven in the categorical manner specified in the statute. The present provisions for injunctive proceedings against existing or proposed arrangements can only add limited flexibility because they must rest on the capacity of the Crown to meet the rigorous standards of criminal proof. Courts have no latitude to consider all the economic and commercial qualifications which might apply to particular cases and are compelled to adopt an "all or nothing" approach in deciding whether offences have been committed. In addition, the classification of commercial arrangements as criminal has created a bad psychological background for administration, which, as early as 1910, was recognized by Mackenzie King and has undoubtedly militated against whole-hearted acceptance of the legislation by the business community.[3]

Proposed New Tribunal

While the shifting of part of Canada's competition policy onto a basis of civil legislation would be an important and necessary step forward, it would, in our view, be necessary to accompany this step with the formation of a specialized tribunal. Merely to enact civil law in this area, then to leave the ordinary civil courts to cope with it as best they could, would surely impose an unfair burden on those

courts. Judges would in principle be required to make, virtually on a continuing basis, difficult balancing judgments founded upon complex economic arguments and analyses.

This problem might be dealt with in one of two ways. The first would be to attach to an existing court such as the Exchequer Court of Canada a panel of lay experts to assist in the adjudication of competition policy cases. The second would be to set up an entirely new tribunal whose members would be so selected as to bring to their work a mixture of relevant expertise in economics, business, and law. Our preference has leaned to the latter alternative on the grounds that this would be more likely to give the elbow-room and flexibility of operation that would appear to be necessary in the hearing and adjudication of complex economic issues. As will be seen, the body that we propose would, like any ordinary civil court, carry out functions of hearing, adjudication and the imposition of remedies. In addition, however, it would engage in economic analysis and in the issuance of reports similar to many of those now issued by the Restrictive Trade Practices Commission so that the important process of public education, the documentation of particular cases or inquiries, and the formulation of recommendations thereon would be continued. The new tribunal would absorb the functions and perhaps also some of the qualified personnel of the Restrictive Trade Practices Commission.

Notwithstanding its special nature, the tribunal would retain some of the characteristics of a court. In particular, it would ensure the right of interested parties to be heard in accordance with the principles of natural justice. It would, for example, make known to the parties all evidence bearing or likely to bear upon its decisions.

On the other hand, the tribunal's proceedings would be less formal than those of a court and, it might be hoped, devoid of any strong sense of crime and punishment. Hearings would ordinarily be public. The prevailing atmosphere would ideally be one of a collective search for understanding of business practice and its economic effects, and for the progressively clearer discernment of the nature of the public interest in particular cases. In line with this objective, the tribunal might wish to give witnesses considerable freedom in their presentation of evidence.

The tribunal might be named the "Competitive Practices Tribunal". Its membership should be large enough to enable it on occasion to sit as two separate panels. There might be as many as seven full-time members, who should possess a blend of experience and qualifications appropriate to the very difficult tasks with which they would be faced, and also be able to take a balanced and unbiased view of economic questions. The individual members would have to take particular care to avoid any conflicts of interest arising out of matters coming before them.

While, as will be indicated in Chapter 9, the tribunal would be able to draw upon the economic expertise of the staff of the Department of Consumer and Corporate Affairs, it should also have, in part as an assurance of independence, a small expert staff of its own. In addition to its ordinary research duties, the staff might on occasion be called upon by the tribunal to provide factual information and analysis which the tribunal considered to be essential for the adjudication of a case or the conduct of a general inquiry, and which was not forthcoming from any other source. Information thus provided by the staff would be made available to other parties to the case or inquiry.

Functions of the Tribunal

All the functions of the tribunal would be exercised in accordance with a general statement of principles, contained in a preamble to the legislation bringing the tribunal into being. The wording that follows is not an attempt at final legal draftsmanship, but only an attempt to suggest the general character of the statement:

> It is hereby declared that whereas competitive market forces provide an important means whereby the total productive resources available to the Canadian economy may be employed as efficiently as possible to maximize real income and the economic welfare of Canadian consumers, whether directly or through the development of mutually beneficial trade with other countries,
>
> (i) there should be established a tribunal to be known as the Competitive Practices Tribunal;

(ii) and this tribunal, acting within the powers hereinafter granted to it, should endeavour to impose and/or recommend means of removing or forestalling impediments to the effective working of competitive market forces (including notably competition with respect to price) for the benefit of the people of Canada.

On the basis of some such statement, and having regard to certain more specific considerations set out at appropriate points in the body of the legislation, the tribunal would perform the following principal functions:

(1) examine certain corporate mergers to determine whether any such mergers were on balance not in the public interest, and in cases where they were judged to be not in the public interest, impose or recommend appropriate remedies;

(2) examine certain types of proposed intercompany agreements respecting exports and the specialization of production to determine whether the agreements were on balance in the public interest, and in cases where they were judged to be in the public interest, place the agreements in a public register and designate them as "registered" export or specialization agreements;

(3) examine the employment of certain trade practices to determine whether such employment was on balance not in the public interest, and in cases where it was judged to be not in the public interest, impose or recommend appropriate remedies; and

(4) sponsor general inquiries similar in character to those now provided for in Section 42 of the Combines Investigation Act, and report on such inquiries.

The remedies that the tribunal itself would be empowered to apply would consist of the issuance of interim and final injunctions. Interim injunctions could be utilized in cases where it appeared desirable to prevent a merger from being consummated or a trade

practice from continuing until the tribunal had had an opportunity to determine whether the merger or practice was on balance not in the public interest. Final injunctions could be utilized when a decision had been reached that the merger or practice was not in the public interest. The tribunal would be empowered to recommend other remedies to the Minister of Consumer and Corporate Affairs. Such recommendations might or might not be accompanied by the issuance of an injunction. The tribunal might undertake to remove an injunction if certain other remedies were applied.

All decisions of the tribunal and all reports on general inquiries would of course be made public. It would be expected that, in reporting on matters involving issues not previously confronted, the tribunal would discuss these issues at some length and describe in some detail the economic analysis that it had employed. The furtherance of public education in matters relating to competition policy would be considered one of the important duties of the tribunal. Maximum availability of all information genuinely relevant to a case or inquiry should be one of the tribunal's touchstones.

Appropriate rights of appeal from the tribunal to the courts on questions of law would be authorized.

Procedure Regarding Mergers

The previous Chapter emphasized that the basic reason for public policy to be concerned with mergers is that in the majority of cases they result in permanent changes in the structure of industry -- changes that may have important implications for the future performance of the economy. These implications may be for good or ill or a mixture of both, and can usually be foreseen only very imperfectly. On the good side, mergers may be an important means by which owners who wish to divest themselves of a business or part of a business can do so with a minimum of disruptive economic effects. They may also be the most appropriate means of achieving certain cost savings, or of bringing about industrial reorganizations made necessary by changes in patterns of demand or in the technical conditions of production. On the bad side, mergers may bring about significant increases in market power capable of redounding to the disadvantage of consumers, and that can be extremely difficult to reverse or offset once the merger has been completed.

This is plainly an area where public policy must tread warily, avoiding *per se* rules and simple *a priori* assumptions that mergers are generally good or generally bad. It would not be at all inconsistent, in Canadian circumstances, for public policy to act against certain mergers while positively encouraging certain others -- those which, for example, were regarded as part of a necessary reorganization of an industrial sector to meet changing world trading conditions. We would suggest that in instances where the federal government, through the Department of Industry, Trade and Commerce, might on occasion act as a marriage broker and actively seek to bring about certain mergers deemed to be in the public interest, prior consultations between this Department, the tribunal and the Department of Consumer and Corporate Affairs should take place. Such public sponsorship, provided it were based on adequate study of the particular industrial structures involved, would be entirely in accord with our general philosophy of approach to mergers. The precise machinery by which prior consultation might be arranged, we leave to others; for the present, our immediate concern is to recommend a procedure for safeguarding the public, to the greatest extent possible, against the adverse effects of mergers undertaken on the initiative of a firm or group of firms. The role of the Competitive Practices Tribunal in this regard would be to examine those mergers that appeared to contain a significant potential for harm, and where such a potential was found, to balance this off carefully against any potential for good that was also found (both good and bad potentials to be viewed, of course, from the standpoint of the economy as a whole and the general public interest). Having made its balancing assessment, the tribunal would, according to its findings, make one of three types of decision:

(1) block the merger unconditionally;

(2) allow it to proceed unconditionally; or

(3) allow it to proceed in altered form, or subject to other conditions designed to ensure that potential disadvantages were reduced to the point where they were outweighed by potential good effects.

One of the fundamental tasks of the tribunal would therefore be to keep itself fully informed about merger activity. This would be needed, *not* to investigate every one of the many mergers going forward in Canada each year, but to facilitate the examination of those that appeared to contain a significant potential for harm. As was stated in Chapter 5, it is our impression that the number of mergers that would require examination by the tribunal would constitute a relatively small proportion of the total.

A very important part of the procedure with regard to mergers would be a process of selection. It would be essential that this process ensure timely consideration of all mergers in which there was a significant potential for harm. Appropriate procedures should be initiated to accomplish this objective in a regular and comprehensive way. If necessary, a registration procedure could be implemented.

It might be well to provide the tribunal with the power to issue interim injunctions to stay the "scrambling" of the assets of merging firms while the hearings were in progress. In the light of its early experience, the tribunal would specify a time limit within which it would bind itself to render decisions on mergers.

During the hearings, it would be the responsibility and prerogative of the Director of Legal Proceedings -- an official to whom we will refer in Chapter 9 -- and his staff to place before the tribunal evidence concerning the likely effect of the merger on competition and the public interest. The parties to the merger would also be invited to give evidence. The tribunal might also call for factual evidence from its own professional staff, or any other appropriate source, subject to the proviso that such evidence be made available to the Director and to the parties to the merger.

In its examination of a merger, the tribunal might be expected to have regard to all aspects of the merger that were related in any important way to the tribunal's general terms of reference. It would be primarily concerned with whether the merger was likely to lessen competition to the detriment of final consumers, and whether there were likely to be any offsetting

public benefits. In addition, and without restricting the generality of the foregoing, the tribunal would be requested to pay attention to the following matters *in so far as they appeared to be of substantial economic importance in any particular case:*

(1) the degree of effective control over the acquired firm or firms that the merger conferred upon the acquiring individual or firm (in assessing effective control, the tribunal would be expected to look not only to the size of the purchase but also to such matters as the composition of the board of directors of the acquired company, if this seemed relevant);

(2) the history of previous acquisitions by the acquired and acquiring firms and by other firms within the affected industry or industries;

(3) the shares of relevant markets held by the acquired and acquiring firms;

(4) the amount and intensity of domestic and import competition in relevant markets;

(5) the situation, both before and after the merger, regarding financial and other barriers to the entry of new competitors into the relevant markets;

(6) the likelihood that an acquired firm, had it continued its separate existence, would have been a vigorous and effective competitor in relevant markets;

(7) the existence of possible alternative buyers of the acquired firm or firms; and

(8) the likelihood that the merger would be productive of substantial "social savings", i.e. savings in the use of resources (including resources used for such purposes as research and development), viewed from the standpoint of the Canadian economy as a whole.

The process of referring a merger to the tribunal would normally be in the hands of the Director of Legal Proceedings. He would be concerned with the likely effect of the merger on competition, and also, more specifically, with items (1) to (7) inclusive in the above list. He would leave the consideration of item (8), dealing with social savings, to the tribunal, which in many cases would find itself required to perform a balancing assessment between possible detrimental effects on competition and possible beneficial effects in the form of social savings. It should be pointed out in this connection that what appear to be cost savings to individual firms are not always "social savings", i.e. savings for the total economy. Thus, for example, a firm that has grown larger by acquiring another firm may be able to obtain certain supplies more cheaply purely by virtue of its greater bargaining power. There are various possible outcomes in terms of profits and prices, but there is no saving in terms of the real resources (the physical amounts of labour, capital, etc.) required to produce and transport the supplies in question. No real resources are freed for other uses in the economy. On the other hand, an example of a cost saving to a firm that was also a social saving would be the case of a company that had grown through acquisition to the point where it was able to order its raw materials by unit trainloads and so benefit from a lower freight rate. In this instance there would be a social saving arising from the fact, of which the lower freight rate was a reflection, that moving goods in unit trainloads requires lesser total inputs of capital and labour. Thus resources would be freed, and the economy as a whole would gain.

Attention should be drawn to the fact that the list of considerations to be taken into account, where important, in merger cases has been cast in sufficiently general terms that the tribunal would be able to address itself to any class of merger, whether horizontal, vertical or conglomerate. That is to say, there would be no built-in restriction as to the market relationship between acquired and acquiring firms that would have to prevail in order for the tribunal to examine a merger.

Conglomerate mergers between firms that are in neither a competitive nor a customer-supplier relationship to one another have only recently begun

to appear in any number in Canada. There is relatively little experience of them and even less analysis of their nature and modes of operation. It is therefore difficult at present to discern what significance they may have in relation to the public interest. But since some of them are, or may soon become, very large enterprises, ramifying into many sectors of the Canadian economy, the tribunal would be expected to examine them as and when any possibilities of adverse effects on the public interest become apparent.

There are means other than mergers (for example, arrangements involving major financial institutions with intercompany links via interlocking directorates) by which the activities of a number of firms can be brought under a significant measure of centralized managerial control. Suitable drafting of the legislation setting up the tribunal would permit it to examine such developments where they seemed of possible significance for competition policy. The power of general inquiry, to be specified later, might be a useful tool in this regard.

It would be open to the tribunal to indicate to the parties involved that whereas a merger appeared to be not in the public interest in its original form, it might be judged acceptable in some other form (for example, if the extent of the total acquisition was reduced). Also, following the same procedure as that employed by the U.S. Federal Trade Commission in the issuance of consent decrees, the tribunal might approve a merger subject to certain conditions being observed, e.g. that the merged firms engage in no further acquisitions within a certain market. Another possibility would be for the tribunal to pronounce against a merger but to indicate that if the situation were to be materially altered in certain ways (for example, by changes in tariffs and/or other trade barriers that had the effect of injecting a new element of foreign competition), the merger would be eligible for reconsideration.

Specialization and Export Agreements

In the discussion in the previous Chapter, reference was made to the opportunities available to Canadian industry for cost reductions based on longer production runs, and to the fact that market forces

cannot always be relied upon to bring about the exploitation of these opportunities. It seems to us that firms considering themselves to be in this position should be given a chance to satisfy the proposed tribunal that they could, by means of specialization agreements, achieve longer production runs and lower unit costs. The tribunal would also have to be satisfied that a substantial part of any cost savings realized was likely to be passed on to Canadian consumers of the affected products.

A specialization agreement would be defined as a temporary agreement between firms to accomplish a restructuring of production and distribution with a view to increasing the scale and specialization of Canadian output and, in this way, reducing costs. Those desiring to draw up such an agreement would be required to place an outline proposal before the tribunal. If the tribunal judged that there was a reasonable chance of achieving an agreement likely to be in the public interest, it would direct the prospective parties to confer in the presence of a hearing examiner -- a servant of the tribunal for whom we shall shortly be specifying additional functions -- and to draw up a full draft agreement. This agreement would subsequently be examined by the tribunal and, if approved, entered in a public register. To negotiate, or to attempt to negotiate, a specialization agreement in accordance with the above procedure would not be an offence under the Combines Investigation Act.

During the period that the agreement remained in force, the tribunal would be entitled to satisfy itself that the agreement was being operated in accordance with its original objects and was not being abused in any way. The tribunal might at its discretion specify a time period at the end of which experience under the agreement was to be thoroughly reviewed and a decision reached as to whether the agreement needed to be continued any longer.

A somewhat similar procedure would be provided in respect of export agreements, which would be defined as agreements between firms to form consortia or other selling groups for the purpose of improving the competitive position of Canadian goods in foreign markets. In examining any such agreement, the tribunal would be expected to give consideration to the likely

impact of the agreement on the volume and value of exports, on the export business of other Canadian firms not parties to the agreement, on the conditions of entry into the export industry concerned, and most particularly on the state of competition in the Canadian domestic market for the goods in question. An important reason for assigning this matter to the tribunal would be to facilitate the fullest consideration of ways in which any likely adverse effects of export agreements on domestic markets could be mitigated or offset, to the point where the agreements could be judged to be in the public interest.

The procedure for negotiating export agreements would be essentially similar to that already proposed for specialization agreements. Again, negotiation according to the laid-down procedure, with the hearing examiner present, would not be an offence under the Combines Investigation Act. There would be no limit to the term of export agreements, but the tribunal would have the right to satisfy itself that agreements were not being abused. Parties to existing export agreements who wished to avail themselves of the protection of the new procedure would have to apply for registration.

In examining proposed export agreements, the tribunal would have to take cognizance of any international obligations that Canada might assume in respect of competition policy. This question is discussed in Chapter 8.

Procedure Regarding Certain Trade Practices

Another area of activity for the tribunal would be that of certain trade practices not covered by broad prohibitions or by such of the tribunal's proposed functions as have already been described. The philosophy of approach would be essentially the same as what has been suggested for mergers. That is, none of the practices would be treated as undesirable *per se*. Rather, the presumption would be that while the practices could well be harmless or even beneficial to the public in some circumstances, they could be harmful in others. The tribunal's responsibility would be to examine cases where harmful effects were suspected and, upon finding that harm was indeed being done, to impose and/or recommend appropriate remedies. One feature of some importance would be the provision of an interim

injunctive procedure whereby, if a practice was before the tribunal for examination, and if it appeared that the continuation of the practice was likely to bring about a significant change in the relevant market circumstances, such as the bankruptcy of a buyer because of a refusal to sell, a temporary suspension of the practice could be promptly ordered by the tribunal pending final disposition of the case.

The tribunal would be given, in the legislation, a list of trade practices, defined in rather broad terms, as well as the criteria to be applied in the examination of these trade practices. In the light of this list and these criteria, it would be expected to establish, as it worked through cases referred to it, the principal types of circumstances under which the designated trade practices were detrimental to the public.

Two routes are proposed for bringing a trade practice to the attention of the tribunal. The first would be for the Director of Legal Proceedings, if he had reason to believe that the practice was within one of the classes of practice listed in the tribunal's terms of reference and was detrimental to the public interest, to request that the tribunal hold hearings regarding the practice. The second route would be for private parties deeming themselves to be affected by the practice to submit a request for a hearing to the hearing examiner. If the examiner determined that there appeared to be public interest grounds for subjecting the practice to a full hearing before the tribunal, he would recommend to the tribunal that hearings be held. If the continuation of the practice threatened to bring about a change in the relevant market circumstances before the tribunal had reached its decision, the Director or the hearing examiner, in referring the trade practice, could recommend to the tribunal the issuance of an interim prohibitory injunction.

As will be noted later, the tribunal would have a general power of inquiry, not linked to its injunctive powers, into any possibly harmful practice or situation relating to competition policy. However, the *particular* classes of trade practice, the employment of which in certain circumstances would be referrable to the tribunal via the procedures outlined above, would include the following:

(1) Refusals to deal, including refusals under franchise arrangements, but excluding refusals to deal connected with the enforcement of resale price maintenance and covered by Section 34 of the Combines Investigation Act;

(2) Basing-point pricing and other horizontal arrangements other than those prohibited by the revised Section 32 of the Combines Investigation Act;

(3) Exclusive-dealing and tying arrangements, including "full-line forcing" and directed buying;

(4) Market-access arrangements;

(5) Predatory practices;

(6) Price discrimination, including discriminatory promotional allowances; and

(7) Consignment selling.

It should be re-emphasized that none of the above classes of practices would be an offence or be banned as such. Only where there was reason to suppose that their use in a particular situation might be having a deleterious effect on the public interest would they become the subject of hearings by the tribunal. Argument and evidence would then be received by the tribunal from the parties involved in the practice and from the Director of Legal Proceedings. Factual evidence could also be requested from the tribunal's professional staff, subject again to the proviso that such evidence be made available to the parties involved in the practice and to the Director of Legal Proceedings.

In examining any trade practice, the tribunal, having regard to its general terms of reference, would, above all, be concerned with whether the practice was likely to lessen competition to the detriment of final consumers. Not the interest of particular competitors but the interest of ultimate purchasers would be paramount. Subject to this overriding consideration, the tribunal would be invited to give attention to the following more specific matters:

(1) whether the practice was being engaged in by person(s) or firm(s) accounting for a substantial share of the relevant market;

(2) the extent to which the practice was likely to foreclose sources of supply or channels of distribution to other participants in the market;

(3) what alternative sources of supply or channels of distribution, if any, were available or could readily be made available to other participants in the market;

(4) whether the practice was likely to encourage or discourage cost-lowering innovation in methods of distribution;

(5) whether the practice could be justified as an effective means of creating a market for a new product, or of introducing an established product into a new market; and

(6) whether the practice was likely to make it possible for one or more competitors to eliminate or exclude other competitors from the market by means other than superior performance, on a sustained basis, in supplying goods and services to the public.

Where a trade practice was found detrimental to the public, the tribunal could itself impose a remedy by issuing a permanent injunction prohibiting the practice. In addition, or alternatively, the tribunal could recommend to the federal government other remedies, including notably the issuance of special licences to import duty-free. Again, as with mergers, the tribunal could undertake to lift a prohibitory injunction if other remedies were applied. A "consent decree" or negotiatory procedure would also be open; i.e. the tribunal might undertake not to issue an injunction prohibiting a practice, provided certain conditions were observed by the parties engaging in the practice. For example, the parties might be required to alter the practice in some respects, so as to prevent certain deleterious effects.

Distribution of Petroleum and Related Products

This is an appropriate point at which to recall that in the press release of July 22, 1966, requesting the Economic Council to study combines, mergers and other matters, the then President of the Privy Council made special mention of the so-called "T.B.A." Report of the Restrictive Trade Practices Commission. The following is the relevant passage:

> Referring to the Report of the Restrictive Trade Practices Commission concerning the Distribution and Sale of Automotive Oils, Greases, Anti-Freeze, Additives, Tires, Batteries, Accessories, and Related Products (1962) (T.B.A. Report), the Minister said that in studying the recommendations of the Commission the Government has viewed most sympathetically the recommendations in that report which are intended, if possible, to improve the situation which has given rise to much concern on the part of the service station dealers in their relations with their oil company suppliers, particularly in relation to the practices of exclusive dealing and tying arrangements, as well as consignment sales. The Government has given a great deal of careful thought to the whole matter and is of the opinion that the recommendations of the Commission, if implemented, would be unlikely to give the relief sought by the service station dealers if the legislation must be drafted in terms of criminal law as is the case at present in view of the constitutional law decisions of the courts. It is therefore the intention of the Government that this particular recommendation for amendment of the legislation should be taken up and considered as part of any revision of the Act as a whole in the light of both the views of the Economic Council and the constitutional position as it may emerge.[4]

In its Report, the Restrictive Trade Practices Commission had recommended that exclusive-dealing and tying arrangements and market-access agreements and arrangements be prohibited under the Combines Investigation Act where such agreements or arrangements were likely to "lessen competition substantially, tend to create a monopoly or exclude competitors from a market to a significant degree".[5] For our part, we do not recommend that these practices be made criminal

offences under the Combines Investigation Act. Instead, we have included them in the list of trade practices that would be referrable, under civil law, to the proposed Competitive Practices Tribunal in any case where there was reason to suppose that they might lessen competition to the detriment of final consumers.

Since the appearance of the Report by the Restrictive Trade Practices Commission, three major inquiries into gasoline retailing and associated matters have been carried out in the provinces of British Columbia, Alberta and Nova Scotia.[6]

Our recommendations regarding the work of the Competitive Practices Tribunal in the field of trade practices would cover a good deal of the same territory embraced by these inquiries. The reports, for example, make recommendations in respect of tied sales, exclusive dealing, consignment sales, and basing-point pricing. Under our proposal, it would be open to the tribunal to examine all of these matters, including in its consideration the three provincial reports with all their accompanying published studies, submissions and minutes of evidence. It would be important also that the tribunal consider evidence relating to other provinces, so that in formulating any recommendations it may consider appropriate, account could be taken of the degree to which conditions in the industry varied from province to province.

Some of the matters dealt with in the reports, such as the terms of mortgages, leases and conditional sales contracts, would probably be found to fall under the constitutional powers of the provinces to deal with matters concerning property and civil rights in the provinces. Here again, however, there would be much to be gained in arriving at remedies which were national in their scope, and in avoiding situations in which significantly different ground rules were applied to different parts of Canada. With this in mind, provincial governments might wish to consult regarding these problems and try as much as possible to co-ordinate and make consistent both their diagnosis and their remedies. Such consultation could benefit considerably from the tribunal's analysis and judgment. Using its broad powers of inquiry, to be outlined below, the tribunal would be able to undertake a thorough and careful investigation of all problems in this industry, and

where its analysis pointed to the need for action by the provinces, make any recommendations it considered would be effective. If the provinces so requested, the tribunal could work closely with them in arriving at a satisfactory set of remedies.

We would hope that in their analysis and appraisal both the tribunal and the provinces would give particular care to the definition of relevant markets, and would consistently bear in mind the interests of the final consumer of service station products.

Advertising

The general subject of the economic benefits and costs of advertising is both difficult and complicated and only two aspects of it are touched upon in this Report. The practice of misleading advertising was discussed earlier in this Chapter. We come now to a second economic aspect. At issue in recent cases in both the United Kingdom and United States has been the economic power which advertising may confer. The argument centres on the degree to which a firm engaging in extensive advertising impedes or prevents the entry of new firms into the market for that product. New entrants, even those with superior products, may not have access to the resources that will permit them to inform consumers of the merits of their product, given the imperfection of channels of information. Thus inability to achieve an adequate sales level in turn prevents them from achieving those economies of scale in production which are essential to making their product competitive in price with established products. Consumer detriment thus arises from the existence of imperfect information channels and the inability of the challenging firm to acquire funds for advertising or to attain economies of scale at some higher level of output. Barriers to entry in the form of heavy advertising outlays have concerned a number of observers. In the United States, a recent study showed large advertising expenditures to be very closely associated with high levels of concentration and above-average profits.[7]

Advertising as a barrier to entry would be of concern to the Competitive Practices Tribunal under its proposed terms of reference. Where relevant, advertising could be taken into account in both merger and trade practice cases, as well as in general inquiries.

General Inquiries

A final function of the tribunal would be to sponsor and report upon certain types of general inquiry. Its role in this respect would be similar to that provided for the Restrictive Trade Practices Commission in Section 42 of the Combines Investigation Act. We propose that Section 42 be retained in the Act, except that the tribunal should take the place of the Commission. In addition, the legislation setting up the tribunal should provide for similar inquiries into all matters falling within the tribunal's broad field of competence. As under Section 42 of the Combines Investigation Act, such inquiries would be carried out by the Director of Investigation and Research upon his own initiative, upon direction from the Minister of Consumer and Corporate Affairs, or at the instance of the tribunal. The tribunal would have the same responsibility as the Restrictive Trade Practices Commission now has to report on such inquiries to the Minister.

As to the fundamental purpose of general inquiries, this would still be much as it was envisaged by the MacQuarrie Committee in 1952:

> At least our main industries should be the objects of continuing study and observations. Facts should be systematically assembled concerning the behaviour of an industry and its current policies bearing on prices, production, innovation, investment, costs, profits, market areas, business practices, the use of patents, corporate structures and inter-relations as well as any other matter affecting competitive conditions. We need to know much more in detail than we now do the various aspects of the movement of concentration of economic power in Canada. Large business units raise a special problem for public policy but factual knowledge is much too scanty to warrant any specific proposal. Judgment on the giant enterprise cannot be final before extensive empirical research has provided the facts concerning their organization, their processes of business policy formation and their performance. Our knowledge in the wide field of monopolistic practices is just as inadequate. Such practices as discrimination, "loss-leaders", price leadership, tying contracts, combination

> sales, advertising, basing-point systems and probably many others should be subjected to empirical studies in order to know their extent, their operation, their effects and the remedies to cope with them if necessary. Finally, some attention should be given to the field of remedies in order to add to the rather restricted list of weapons we are now using to combat undesirable monopolistic situations and practices.[8]

While a number of important general inquiries have been carried out under Section 42 of the Combines Investigation Act, much remains to be done in order to achieve the objectives set forth by the MacQuarrie Committee. In some instances, general inquiries, some of which might well be of a continuing nature, would no doubt bring to light practices and situations detrimental to the public interest, leading the tribunal to recommend appropriate remedies to the federal government. Among such remedies might be additions to the classes of trade practice referrable to the tribunal. There would also be the possibility that in the light of experience the tribunal might decide that a certain well-defined practice met the rigorous requirements of a *per se* offence under the Combines Investigation Act. In this event, the inclusion of the offence in that Act would be recommended.

It would be essential, however, to conceive the purpose of general inquiries as something much larger than that of simply adjusting the "thou-shalt-not" features of competition policy to changing economic circumstances. The fundamental purpose would be to broaden and deepen understanding of the structure and operation of the Canadian economy, and in so doing to furnish a better basis for the formulation of a wide range of economic policies.

Monopolies and Dominant Firms

It will have been observed that nowhere in our proposals is there any special provision for dealing with monopoly and dominant-firm situations *as such*. But this does not mean that the existence of such situations or of tendencies towards their emergence would be without significance for competition policy. They would, in fact, be of considerable significance for the tribunal's operations with respect to both

mergers and trade practices. It would be implicit in the criteria listed earlier that, in examining any merger, the tribunal would place appropriate weight on whether the merger was likely to bring about a situation of market dominance or monopoly. Similarly, in examining a trade practice, the tribunal would have regard to (a) whether the practice was being engaged in by a monopolist or dominant firm (in which case its implications would inevitably be viewed in a different light than if it were only being engaged in by one of a number of strong competitors), and (b) whether the practice was likely to bring about market dominance or monopoly "by means other than superior performance, on a sustained basis, in supplying goods and services to the public".

To put the matter in another way, competition policy would be concerned with monopoly and dominant-firm situations both in their incipiency and in their actuality. There would be no barrier to the achievement of market dominance or monopoly via the route of internal company expansion and superior efficiency. But the achievement of dominance or monopoly via merger or via the employment of "exclusionary" trade practices would be open to examination and questioning. Where market dominance or monopoly had already been achieved, trade practices would tend to be scrutinized more carefully than under other circumstances. If this proved insufficient, resort could be had to the power of general inquiry in order to determine what undesirable practices or situations existed and to recommend how they might best be remedied. In extreme cases of dominance or monopoly, the tribunal might recommend to the government that it reduce the dominance or monopoly by special legislation to divide the enterprise into smaller units. On the other hand, a tariff reduction might obviate the need for so drastic a step. Still a further alternative would be to conclude that the situation was one calling for resort to direct public regulation; as we observe later, this option should be considered very much a last resort.

Conclusion

The main general point to be made about the proposals in the present Chapter is that they embody a new approach to some important areas of competition policy in Canada. Only Sections 32 and 34 of the Combines Act, as revised, and Sections 33C and 33D would

be retained as criminal offences, while Sections 33 on mergers and monopolies, 33A on price discrimination, and 33B on promotional allowances would be replaced by the new proposals which involve a shift to a civil law basis. This shift requires that provision be made for a greater use of economic analysis in the consideration of individual cases. As a result, it should prove possible for competition policy to adapt itself more readily to the changing circumstances of the Canadian economy.

If acted upon, our proposal to set up a Competitive Practices Tribunal would be a very significant step. We are fully conscious of the magnitude and complexity of the task that we are proposing for the tribunal. It would be asked to evaluate, from the point of view of the public interest, mergers, specialization agreements, export agreements, and a variety of trade practices. Not only would there be problems of economic analysis; there would also be decisions to be reached requiring comparisons of public benefits and public detriments -- decisions partly reflective of value judgments. Inevitably, the significance of legislation in areas subject to the tribunal's assessment would depend to a considerable extent on the tribunal's judgment. Its task could not be regarded as merely applying clear criteria to the facts of particular cases. It would therefore be most important that the membership of the tribunal and its staff be of the highest calibre. It would also be important, however, that the goals to be achieved and the principal criteria to be applied should be spelled out sufficiently clearly that the tribunal could feel itself to be guided by the considerations regarded as important by Parliament in passing the legislation.

Since the formation of the tribunal would be a distinctly new departure, it would seem wise to make provision for a thoroughgoing review of the tribunal's operations and of Canadian competition policy generally. Following the example of the Bank Act, this review should be decennial, with the first review taking place no more than 10 years after the legislation setting up the tribunal first comes into effect. Given the rapid structural and other changes that are likely to occur in the Canadian and world economies over the next decade, it may be anticipated that even the most flexible and forward-looking set of competition policies will in some measure be overtaken by events and thus require reassessment.

Notes and References

[1] It would probably be necessary to qualify this prohibition sufficiently to allow the continuance of such practices as that whereby a group of drug stores in an area arrange that one or more of their number remain open on Sundays and to permit the operation of formal franchise operations. We later propose that franchise arrangements containing a possibility of damage to the public interest be included in the responsibilities of a civil law tribunal.

[2] Restrictive Trade Practices Commission, *Report on an Inquiry into Loss-Leader Selling*, Ottawa, Queen's Printer, 1955.

[3] Gordon Blair, "Combines: The Continuing Dilemma", *Contemporary Problems of Public Law in Canada*, O. E. Lang, ed., University of Toronto Press, 1968, p. 159.

[4] Press Release of July 22, 1966, issued by the President of the Privy Council, Ottawa. See Appendix I.

[5] Restrictive Trade Practices Commission, *Report on an Inquiry into the Distribution and Sale of Automotive Oils, Greases, Anti-Freeze, Additives, Tires, Batteries, Accessories and Related Products*, Ottawa, Queen's Printer, 1962, pp. 133-135.

[6] The provincial studies are: "Gasoline Marketing in the Context of the Oil Industry", *Report of the Gasoline Marketing Enquiry Committee*, Queen's Printer for Alberta, 1969; *Report of the Royal Commission on Gasoline Price Structure*, Queen's Printer for British Columbia, 1966; and *Report of the Royal Commission on the Price Structure of Gasoline and Diesel Oil in Nova Scotia*, Queen's Printer for Nova Scotia, 1968.

[7] W. S. Comanor and T. A. Wilson, "Advertising, Market Structure and Performance", *The Review of Economics and Statistics*, November 1967.

[8] *Report of the Committee to Study Combines Legislation*, Ottawa, Queen's Printer, 1952, pp. 43-44.

CHAPTER 7

COMPETITION POLICY AND THE SERVICE INDUSTRIES

Reference has already been made to the fact that Canadian competition policy as now embodied in the Combines Investigation Act embraces for the most part only goods-producing and some goods-distributing activities. Other activities remain largely outside the Act. This exclusion is indeed an anomaly, especially given the rapid postwar growth of employment in the service sector of the economy. As was noted in the *Fifth Annual Review* of the Economic Council, the greater part of the labour force is now employed in service-producing industries, reflecting a shift that has come about as a result of increased mechanization of most goods production, an absolute decline in employment in agriculture, and a rapid upsurge in demand for services. Consumers today demand a wide range of repair and maintenance services for their larger stocks of durable goods. A fast-growing and capital-intensive economy has given birth to new and expanded financial services to better deploy the pool of savings available for productive investment. The higher qualifications demanded of the labour force have stimulated the growth of educational and training services. Higher incomes have helped to expand requirements for a variety of professional services. Several more items could be added to the list.

Concern about the exclusion of service industries from the anticombines law has been voiced in a number of quarters. The 1967 Report of the Joint Senate-House Committee on Consumer Credit, under the chairmanship of Senator Croll, suggested that the Combines Investigation Act be extended to cover "captive" sales finance companies. The 1968 Report of the Batten Royal Commission on Consumer Problems and Inflation, otherwise known as the Prairie Provinces Cost Study Commission, contained a recommendation that the scope of the Act be extended to embrace at least all financial institutions. The first Minister of Consumer and Corporate Affairs, Mr. Turner, stated in the House of Commons:

> I do not want in any way to anticipate the current study undertaken by the Economic Council of Canada which, by virtue of a reference made by this

> government on July 22, 1966, is reviewing the Combines Investigation Act, but I should like to say that since services amount to about 35 per cent of our gross national product it seems strange to me that goods should fall within the ambit of the act and services should not.[1]

The usual economic definition of "service industries" embraces all industries other than primary resource industries, utilities, manufacturing and construction. Some service industries may be closely allied to particular commodities or classes of commodities (pharmacies, retail and wholesale grocery stores and inland water transport are examples), but their activities are deemed to lie outside the production of tangible goods. Actually, in terms of activities, the statistical separation of service production from goods production can rarely be complete. Production statistics are typically broken down by industries, by firms and by plants or establishments, and these in turn may be classified according to whether their *major* activities are goods production or service production. But many categories of goods production contain a minor element of service production and vice versa. For example, firms that specialize in retailing and financing are deemed to belong to "service industries", but manufacturing firms that provide some of these services for themselves are still classified in "goods industries". Again, lawyers, accountants or economists who set themselves up in specialized partnerships are in "service industries", but if they join the payroll of a large construction firm they are, for most purposes, statistically transferred to "goods industries". Only a detailed cross-classification of employment by industry and occupation will reveal the true state of affairs.

Even in terms of a "standard" statistical breakdown of production into goods and service industries, the bald statement that the Combines Investigation Act does not extend to service industries is not really true. The position is in fact even more anomalous, in that the Act covers some activities carried out by service industries but not others. Basically, it endeavours to protect competition in respect of "articles" and of the price of insurance. But the reference to articles embraces not merely the production and manufacture of articles, but their "purchase, barter, sale, storage, rental, transportation or supply". Thus

it is that much of the activity of retail and wholesale trade, of the transportation of physical goods, and of the storage and rental of goods, is covered by the Act. In addition, the major services supplied by hotels, restaurants and taverns are believed to be included, although this has not yet been tested by the courts. Some other parts of the boundary line have, however, been clarified by court decisions. For example, it seems fairly well established that anticompetitive practices carried on in service industries may be thwarted by the Combines Act when the effect of these practices is to limit unduly competition in the market for particular articles. On the other hand, it appears that a completed house or building does not fall within the legal interpretation of an article.

Some of the principles applying in this area are documented in the 1967-68 Report of the Director of Investigation and Research, where the outcome of some recent cases is discussed. In one of these cases, *Regina v. J. W. Mills and Son Limited, et al.*, the services of freight forwarders engaged in assembling small shipments into railway car lots were ruled as being within the purview of the Act even though the forwarders did not own or operate transportation facilities. (This decision is being appealed to the Supreme Court.) In *The Queen v. Canadian Warehousing Association*, the contention that the storage of household goods was not governed by the Act was dismissed on the grounds that the widest meaning of the clause "article ... that may be the subject of trade or commerce" would include even privately owned goods that are not for sale. In *The Queen v. Canadian Coat and Apron Supply Limited*, a charge of price-fixing was sustained against a group of companies in the linen-supply industry whose function was to provide customers with cleaned and ironed towels, uniforms and related articles.

The construction industry offers instances of the confused state of affairs in respect of the applicability of the Act to service activities. What happens, for example, with regard to contractors whose main purpose is to install plumbing or electrical wiring and fixtures or to lay flooring or to pave roads? A case involving the Electrical Contractors Association of Ontario was only one of several which established the rule that these pure service activities were within the Act in so far as they affected unduly competition

in the market for various construction materials. But in a more recent case against nine Ontario paving companies *(The Queen v. K. J. Beamish Construction Co. Limited, et al.)*, the Crown was not successful in securing a conviction on alleged price collusion and rigged tendering, even though the court agreed that these practices had been carried on over a period of several years in connection with municipal tenders on road work. Mr. Justice Schroeder stated in his decision on the case:

> Section 32 is concerned only with agreements or arrangements of the kind prohibited with respect to tangible things -- articles or commodities that may be the subject of trade or commerce, and does not touch or concern agreements or arrangements which relate solely to the provision of services.... There is not the slightest doubt that the actions of the respondents were completely devoid of business ethics.... Be that as it may, the Court is here concerned with the legality of the respondents' conduct rather than with its moral aspects.... Viewing the evidence in the present case in its entirety I cannot escape the conclusion that the contracts in question are predominantly contracts for work and labour, in which the materials were supplied only incidentally ... the evidence does not suffice to establish beyond a reasonable doubt that they had entered into a combine to prevent or lessen competition unduly or otherwise in the sale, supply or transportation of 'articles' as defined by the statute.... While the methods employed by the respondents in presenting rigged bids were reprehensible in the highest degree and cannot be condoned, the Court is called upon to determine whether their conduct ... fell within the penal provisions of section 32.... I cannot be persuaded that the Crown has proven anything beyond a conspiracy to prevent or lessen unduly competition in the performance of work and labour in the resurfacing of Provincial and Municipal roadways.... It follows that greatly as one must deplore the conduct of the respondents in hoodwinking the Department of Highways and the municipalities with which they dealt, the offence charged has not been proven and, not without some reluctance, I would dismiss the appeal.[2]

Thus a price-fixing conspiracy in an area of considerable importance escaped a finding of illegality because of the failure of the Act to cover services specifically.

It will be evident that there is no precise answer to the question of which activities carried on by service industries fall within the ambit of the Combines Act and which do not. Although the recent jurisprudence has tightened the link between services and goods, one cannot say that the end result has been to bring all article-related services within the reach of competition policy. The courts must still proceed on the basis of case-by-case examination of the impact of competition-restricting practices in service industries on the market for particular goods.

Exemption from the Combines Act via Regulation

In attempting to measure the economic significance of those areas where Canadian competition policy does not now extend, one must consider the question of whether other forms of social control in these areas are effectively protecting the public interest in efficient resource use. In Chapter 2 of this Report, we noted that competition policy constitutes the most indirect form of social control of industry, obviating or lessening the need for other forms of control. Where competition is weak or moribund, there are likely to be pressures to impose more direct public controls by way of regulation or even public ownership. Such pressures have indeed arisen in service industries, many of which operate under varying degrees of public regulation. Transportation, broadcasting and other forms of communication, public utilities and financial services spring readily to mind. It cannot simply be concluded, however, that the fact that these industries are regulated makes the application of competition policy unnecessary. Great care must be exercised to determine what particular *activities* of an industry are regulated and the extent to which the regulation really takes the place of the kind of social control normally supplied by vigorous competition. Many industries are regulated only in respect of certain parts of their activities and the regulation may or may not bear directly on such matters as price. One does better really to speak of "regulated activities" rather than "regulated industries" and to pay close attention to the nature and scope of the regulation that prevails.

Competition Policy

It is clear from the terms of the Combines Investigation Act, from statements by its administrators, and from certain court decisions, that the existence of regulation does not automatically result in a blanket exemption from the influence of competition policy. Mention has already been made that the transport of commodities, although subject to direct regulation by all three levels of government, is specifically covered by the Act. Some of the activities of regulated monopolies, such as Bell Canada Limited, are also within the scope of the Act. As the Director of Investigation and Research of the Combines Branch noted before the House of Commons Standing Committee on Transport and Communications:

> The telecommunications industry is an example of an industry which is in part subject to regulation by a government agency, in part subject to the Combines Investigation Act, and in part subject to neither of these forms of control.[3]

In the case of Bell, the rates for its telephone services are regulated by the Canadian Transport Commission, while the manufacture and sale of communications equipment is subject to the Combines Act, but the provision of many communications services other than telephones appears to be exempt both from the Combines Act and from specific regulation as to price.

In the jurisprudence to date, there has been only one case, *Regina v. Canadian Breweries Limited*, in which direct regulation was a central point at issue. Chief Justice McRuer of the Ontario Supreme Court addressed himself to the problem of determining how much room was left for competition policy in an industry in which the product was sold at controlled prices through government-supervised outlets. The Crown attempted to uphold its claim that the active program of mergers and acquisitions undertaken by the company constituted an offence under the merger provisions of the Combines Investigation Act. But the Chief Justice ruled that, to constitute an offence, the effect of a merger must be such as to virtually eliminate competition. He stated in part:

> ...when I apply the Combines Act as an act designed to protect the public interest in free competition,

> I am compelled to examine the legislation of the provinces to see how far they have exercised their respective jurisdictions to remove the sale of beer from the competitive field and to see what areas of competition in the market are still open. Having made this examination, I must then decide whether the formation or operation of the merger lessened or is likely to lessen competition to an unlawful degree in the areas where competition is permitted.[4]

His review of the regulations affecting the industry led to the conclusion that the acquisitions did not result in any undue restraint on competition:

> When a Provincial Legislature has conferred on a Commission or Board the power to regulate an industry and fix prices, and the power has been exercised, the Court must assume that the power is exercised in the public interest. In such cases, in order to succeed in a prosecution laid under the Combines Act with respect to the operation of a combine, I think it must be shown that the combine has operated, or is likely to operate, so as to hinder or prevent the Provincial body from effectively exercising the powers given to it to protect the public interest.[5]

The charge was dismissed.

The assumption that the regulation of prices is exercised in the public interest brings us close to a discussion of the economic objectives of regulation -- a subject taken up in the following Chapter. But in passing, it should be noted that the assumption made in the beer decision has not gone unchallenged. One economist, Professor J. C. H. Jones, has pointed to a crucial distinction which he argues should be made in determining the extent to which competition policy is free to operate in "regulated industries". He states:

> Provincial authorities can fix retail prices and not protect the public if all they are doing is putting a standard mark-up to the price the brewer quotes at wholesale, but exerting no influence over this quoted price.[6]

Chief Justice McRuer did examine the questions of which prices were regulated and whether the delegated authority was being exercised by the various provinces concerned, rather than by the industry. His conclusion was that the provincial regulators were setting prices, in addition to regulating advertising and distribution outlets, and that the only areas left open for competition were those affecting quality, taste, services and packaging. In these areas, competition in the brewing industry was judged to be without restraint.

Applicability of the Combines Act: An Industrial Classification

Given the prevailing uncertainty as to which activities of which service industries are now covered by the Combines Investigation Act, and given the further uncertainty regarding the degree to which the existence of direct regulation would in any case remove some service activities from the purview of the Act (the present status of some goods industries being uncertain for the same reason), any attempt to measure the economic significance of activities not now covered by the Act is bound to be arbitrary. Nevertheless, Table 7-1 attempts to show the contribution to 1967 Gross Domestic Product made:

(1) by industries whose activities are *largely* governed by the Combines Act;

(2) by industries where regulation and/or public ownership provide the chief means of social control; and

(3) by industries where there is no "public presence" of any of the three sorts mentioned.

The Table reveals that the Act at present applies to only slightly more than half of total domestic output. Of the balance, approximately 5 per cent reflects agricultural output where in many cases prices and other matters are regulated by marketing boards, while other service industries whose rates are affected by regulation account for another 12 per cent of output.

This leaves a residual group of industries, accounting for 31 per cent of output (see "Other service industries" in the Table), that is subject neither to

the Combines Act nor, except in some of the smaller subcategories, to a significant measure of direct public regulation. Some of these residual "industries" are, however, subject to social control in the form of public ownership: the 7 per cent of output accounted for by "public administration and defence" should be deducted for this reason. A further deduction of roughly 4 per cent should be made on account of the mainly noncommercial activities of educational institutions, health and welfare agencies, and religious organizations. This brings the residual down to a final, approximate figure of 20 per cent, representing the output share of a vast array of business, personal and recreational services, as well as real estate and financial services. It would be primarily these services that would be affected by any decision to extend the coverage of the Combines Act by dropping the present restriction to "articles" and the price of insurance. (With regard to the above figures, it is important to bear in mind that they are on a net-value-added basis, and that a compilation based on gross output or sales would show somewhat different results.)

The published history of the present Combines Act and its predecessors yields little explanation as to why the Act is not more comprehensive in its coverage. The inclusion of the price of insurance in the original legislation of 1889 was undoubtedly influenced by the previous discovery of a combine in that industry. During the course of the debate on that Act, criticisms by a member of the House of Commons over the exclusion from the legislation of lawyers and doctors went unanswered by the government. The Combines Investigation Act of 1923 did in fact appear to include most, if not all, services in the definition of a combine, but because most prosecutions during this period were based on the section of the Criminal Code prohibiting combinations rather than on the Combines Investigation Act, the position with regard to services was never clarified by the courts. In the process of amending the Act in 1935, the Bennett government originally introduced a bill which contained the same definition of a combine as did the 1923 Act. Following an unrecorded discussion by the Senate Banking and Commerce Committee, however, the Senate returned to the House, and the House eventually accepted, an amended bill which restricted the scope of the Act to activities pertaining to articles and the price of insurance. In 1949, the question of including services surfaced again, but the then Minister of Justice, Mr. Garson, opposed the move.

Table 7-1

THE CANADIAN ECONOMY BY SECTORS, CLASSIFIED ACCORDING TO THE APPLICABILITY OF THE COMBINES INVESTIGATION ACT

(Gross Domestic Product at factor cost, 1967)

	($ million)	(Per cent)
A. Sectors Largely Subject to the Combines Investigation Act		
Forestry	563	1.04
Fishing and trapping	146	0.27
Mining, quarrying and oil wells	2,212	4.08
Manufacturing	13,606	25.12
Construction	3,304	6.10
Storage other than grain	27 (1)	0.05
Wholesale trade	2,585	4.77
Retail trade	4,776	8.82
Insurance	734 (1)	1.35
Hotels, restaurants and taverns	789 (1)	1.46
Subtotal	28,742	53.06
B. Sectors Largely Exempt from the Combines Investigation Act		
Agriculture	2,479	4.58
Grain storage	102 (2)	0.19
Service industries		
a) Regulated (2)		
Transportation	3,190	5.89
Air transport		
Water transport		
Railway transport		
Truck transport		
Taxicab operations		
Pipeline transport		
Other transport		
Services incidental to transportation		
Communication	1,364	2.52
Radio and television broadcasting		
Telephone systems		
Telegraph and cable systems		
Post office		
Electric power, gas and water utilities	1,757	3.24

Table 7-1 (cont'd.)

	($ million)	(Per cent)
b) Other service industries[2]		
Financial institutions, real estate agencies, and real estate operators	4,782[1]	8.83
Public administration and defence[3]	3,961	7.31
Community, business and personal services	7,789[1]	14.38
Education and related services[3]		
Health and welfare agencies		
Religious organizations		
Motion picture and recreational services		
Services to business management		
Personal services		
Miscellaneous services		
Subtotal	25,424	46.94
Total	54,166	100.00

(1) Estimated on basis of the 1949 weight which this sector had in a larger sector of which it forms a part.

(2) The distinction between regulated and nonregulated industries is of necessity an arbitrary one. Regulated services include only those in which prices are affected by regulation. The nonregulated group includes banks and other financial institutions where regulation is not directed primarily at competitive pricing for financial services.

(3) Mainly government monopolies.

Source: Dominion Bureau of Statistics and Combines Investigation Branch.

Competition Policy

The present position of services vis-à-vis competition policy in Canada is inconsistent not only with the philosophy of competition policy outlined earlier in this Report, but also with the position taken by other industrial countries. Competition policy in the United States embraces all commercial activities; any exceptions arise either from specific amendments to the legislation or from judicial interpretations as to the authority of federal antitrust laws. In Britain, the Monopolies and Mergers Act of 1965 had the effect of extending the Monopolies and Restrictive Practices (Inquiry and Control) Act of 1948 to services. Acting under the authority of this new legislation, the Board of Trade has given to the Monopolies Commission references to inquire into practices pertaining to insurance, estate agents' fees and the professions. Of the other OECD countries, only Ireland follows the Canadian practice of limiting the scope of antitrust legislation to activities related to goods or commodities.

Competitive and Other Characteristics of Service Industries

Those who argue that competition policy should be extended to service industries at present exempt from the Combines Act might reasonably be asked to answer two questions. First, do the activities in question have characteristics such that the economic efficiency objective of competition policy is not relevant for them? Second, is competition not already functioning in these areas, even without benefit of the Combines Act, in a way that promotes efficiency and protects consumers from exploitation?

The economic characteristics of the group of services with which we are concerned are many and varied. They do, however, have in common certain elements which distinguish them to some extent from tangible goods. To begin with, services are of course intangible, a characteristic that limits the consumer's ability to conduct an informed search for the best value. Because he cannot examine and assess the "product" prior to purchase, he is normally restricted (household repairs are a good example) to a selection based on producers' general reputations and on price estimates. All too

often, the latter turn out to be greatly understated. The consumer is often in a much more dependent relationship with suppliers of services than with suppliers of goods. In respect of such things as electricity and gas, he requires the service on a continuing basis, which increases his vulnerability to exploitation. If he is dissatisfied with the price or quality of the service, he cannot easily hold off and haggle or quickly switch to a substitute "product". In addition, once he has purchased a service, the consumer can neither return nor resell it.

In most service markets, too, there is a notable absence of import competition. More than that, the markets are often not national or even regional in scope, but local. This arises primarily from the "nontransportability" of many services. In such fields as repair and maintenance, professional services and the like, the intangible nature of the "product" requires the supplier to deal directly with the final consumer, which in turn limits the geographical extent of the market. Competition may be virtually non-existent in some rural areas where consumers have a much smaller range of choice than city dwellers requiring similar services. The fact is that competition policy may be *more* needed to foster efficiency in service markets, particularly in sparsely populated areas, than it is in goods markets where imports often provide a good deal of competition.

It should be noted, however, that while the market for some service activities not now subject to the Combines Act is confined to local areas, other service industries operate in national markets. This is true, for example, of some of the activities of financial institutions, whose relatively small measurable contribution to Gross Domestic Product understates their central importance to the economy. The need to protect the savings of the public and to pool risks helps to bring about, in some parts of the financial "industry", a large scale of operations and relatively high concentration. Another noteworthy feature of the industry is that in some areas competition which might otherwise be forthcoming from foreign institutions and/or their Canadian branches and subsidiaries has been curtailed by special legislation.

The kinds and intensities of competition found in service markets vary greatly. Some services, such as those emanating from certain parts of the construction industry, may involve highly competitive suppliers selling to equally competitive and knowledgeable builders. In sharp contrast are situations where suppliers operating under circumstances of limited competition sell services to only one or two buyers. A good example of this is the situation between doctors in Saskatchewan and the provincial government. Under such circumstances of "countervailing power", the price for the provision of the service arrived at in the bargaining process may not be much different from that which would have prevailed under more competitive conditions, but this result can by no means be guaranteed.

The limited geographical size of many service markets, the difficulty which the buyer often has in assessing the product before purchase, and the impossibility of returning the product if it proves unsatisfactory, all combine to produce a situation where price discrimination of a type harmful to the public interest in an efficiently functioning economy can be relatively easily practised. There is of course a place, in service industries as in goods industries, for price differences which are justified by the lower unit cost of servicing large orders. But less benign discrimination, reflecting a misuse of bargaining power that may squeeze small buyers in ways that hinder rather than promote efficiency, may also occur. There is obviously a useful role to be played by competition policy in repressing undesirable price discrimination in service industries.

Thus the conclusion can be drawn that while there are important differences in the nature of the products supplied by goods and service industries respectively, these differences are not such as to render an efficiency-oriented competition policy less relevant for service industries. On the contrary, it may in some ways be more relevant.

This brings us to the second of the two questions raised earlier: Is competition already functioning satisfactorily in service industries to such a degree that the extension of competition policy to such industries is not really required? Our search for answers to this question has taken us not only to

those few cases under the Combines Act where service industries were shown to be engaged in price-fixing and market-sharing activities, but also to press reports of anticompetitive practices in the service field. An examination was also undertaken of relevant letters directed to Box 99, the mailing address for consumer complaints to the federal Department of Consumer and Corporate Affairs. It is of course the case that press reports and letters of complaint fall far below courtroom standards of evidence that certain activities in the service sector are reducing competition to the detriment of the public. Such proof positive could in most cases only be obtained by setting up the formal machinery for investigation and analysis that already exists for goods industries. But there is, we believe, sufficient information available to support the contention that markets for some services are not functioning satisfactorily, and to justify the setting up of formal machinery. The information referred to relates to a variety of fields; ambulance services, real estate, television repairs, and medical services are among the examples. Misleading advertising, both as to price and otherwise, appears to be as much of a problem in the service sector as it is in the goods sector. One particular form of misrepresentation -- the provision of highly inaccurate estimates to the potential buyer of such things as removal services and a variety of repair work -- seems indeed to be more rife in the service sector. It may be recalled also that in recent years the service component of the Consumer Price Index has risen a good deal faster than the goods component. Even if the application of competition policy to the full range of service activities contributed only modestly to reducing the rate of increase, the contribution would still be worth having.

Basic Recommendations Regarding Services

There is, in our view, enough evidence pointing to the existence in the service sector of anticompetitive practices detrimental to the public interest to lead to the conclusion that the continued exemption of parts of this sector from competition policy cannot be justified. We therefore recommend, first, that the *per se* provisions of the revised Combines Investigation Act be made applicable to *all commercial activities*, including services provided in connection with the sale or rental of land and buildings and the unregulated activities

of "regulated industries". The only major exemptions would be those which already exist in respect of bona fide trade union activities, and arrangements between fishermen in British Columbia and their customers. Some *de facto* exemptions would of course also continue in respect of activities clearly subject to alternate social control in the form of direct regulation or public ownership.

One of the effects of the recommended change would be to bring services related to "articles" immediately and clearly within the scope of the Act, without the protracted and socially wasteful litigation which the wording of the present legislation makes necessary in such cases. Personal services, such as those of hairdressers and travel agencies, would also be included, as would such business services as those provided by advertising agencies, building cleaners and telephone answering firms. The professions, financial institutions, a broad range of communications services, and all recreational services, including professional sports, would also be covered in so far as other types of social control did not apply.

We recommend, secondly, that the purview of the proposed Competitive Practices Tribunal embrace all economic activities, whether goods-producing or service-producing, coming under the head of the constitution which provides the basis for the tribunal's exercise of civil powers.

Professional Services

The extension of competition policy to service industries not now covered by it may meet with some objections and raise some special problems, but none appear insurmountable. The lack of published evidence forces a resort to conjecture, but it is likely that past reluctance to extend the Combines Act to service industries may have stemmed partly from an unwillingness to interfere with the time-honoured custom of allowing professional bodies to fix their own fees and control entry into their professions. More recently, however, such developments as the emergence of new arrangements for financing medical care have drawn public attention to fee-setting and other economically significant practices of professional bodies. It has become highly appropriate to consider anew why these practices should

not be subjected to some suitably structured system of checks and balances.

Competition policy provides one such system, but two others (collective bargaining and direct regulation) must also be taken into account. For any given self-employed group, the appropriate arrangement may consist of one of these systems separately, or two or more in combination.

In its recent Report, the [Woods] Task Force on Labour Relations recommended that certain designated groups of self-employed persons be given access to collective bargaining. These groups did not, however, include self-employed professionals. The Task Force took note of the existence of collective economic action by self-employed professionals, but made no recommendation either for or against the recognition of this as collective bargaining, with the protections that such a recognition would imply. It did express concern over the possible use of professional licensing as a restrictive device and suggested further study in this area. The following are the relevant passages of the Report:

> Where self-employed professionals choose to act collectively to establish fee schedules or otherwise to protect their economic interests, a case can be made that they too be required to act through an organization other than their licensing body in order to avoid a temptation to employ licensing as a restrictive device to reduce entry and control market supply. We suggest that this subject receive further investigation; it would be an appropriate assignment for the Incomes and Costs Research Board whose creation we recommend in a later section.
>
> We are concerned about accessibility to collective action by groups of self-employed persons who are economically dependent for the sale of their product or services on a very limited market or who for other reasons may have economic characteristics of employees. We have in mind such groups as fishermen, owner-drivers of taxis, and independent owner-drivers of trucks and delivery vans. We recommend that the Canada Labour Relations Board be given discretion to recognize these groups as bargaining agents within a specified market and

> that upon such recognition they receive the protection of section 410 of the *Criminal Code* and section 4 of the *Combines Investigation Act* from the criminal law of restraint of trade and from the operation of combines legislation, except where there is evidence of a collusive arrangement between such groups and those who employ their services.[7]

In the interests of clarity, we discuss first fee-setting for self-employed groups, leaving for later consideration the question of professional licensing. When may collective bargaining be considered a valid and practicable check-and-balance system for determining the remuneration of a self-employed group, whether professional or not? The answer, it seems to us, is when there is a genuine bargaining situation in which the group in question is confronted with an appropriate amount and kind of countervailing power on the other side of the table. Perhaps the best example of such a situation would be that involving doctors and a government of a province where Medicare is in effect: there is a certain balance of forces, and one of the parties has a strong interest (in this case, a political interest) in restraining increases in the price of services to the public.

It is more difficult to conceive of collective bargaining operating as an effective check-and-balance in the case of, say, lawyers. With whom would such a group as a county or provincial law society bargain? Lawyers' clients are many and varied, and not readily organizable into an "employer" interest for collective bargaining.

A second system would allow professional bodies to set their own rates of remuneration, provided that there was brought to bear upon these decisions, either at the time they were being made, or by way of subsequent governmental review and ratification, an effective "public presence" in order to ensure that the consumer interest was adequately safeguarded. Such arrangements would have to be embodied in provincial statutes or regulations of a kind that would in practice insulate the system from federal competition policy legislation.

The third system would of course be the application of competition policy to self-employed

professional groups. Some modification of the policy as it related to such groups might be required; in some areas, for instance, agreement on fees appears to be necessary in order that the operators of private and public insurance plans may forecast likely calls on their funds. The solution to this difficulty might be to provide that designated professional bodies could *suggest* the rates at which their services would be provided to the public, but that attempts to *enforce* these rates on individual members would be banned as illegal price-fixing. Many professions do not now enforce their tariffs; in those that do, there is some reason to believe that many individual members would welcome the freedom to charge below the suggested scale.

As a general rule, arrangements for determining the remuneration of self-employed professional and other groups should be subject to competition policy. Where, however, a group prefers a collective-bargaining or public-regulatory arrangement, and where conditions are such that this arrangement constitutes an adequate check-and-balance system, it would be in order to grant an exemption from competition policy in respect of those matters specifically covered by the alternative arrangement.

Turning now to licensing and other ways in which control may be exercised over the entry of persons into professions and institutions for professional training, it is clearly in the public interest that a close watch be kept on quality standards in professions such as medicine and the law. It is equally clear that this watch must be kept to a large extent by persons who are themselves members of these professions and have the requisite knowledge and experience to perform the task properly. But there is also a public interest in ensuring that the power to regulate the quality of professional services is not used in an unduly restrictive way, and that the size of likely future needs for professional services is kept in mind. This aspect of the public interest is all the more relevant in an age when a large proportion of the cost of professional training is a charge on the general taxpayer.

The question of the licensing of entry into professions was treated in the *Report of the Ontario Royal Commission Inquiry into Civil Rights*, which stated in part:

> We have made it clear that the power to admit a licensee is not conferred to protect the economic welfare of the profession or occupation. Those professions or occupations which have been granted self-governing status are charged with a responsibility not only to see that persons licensed are qualified, but that all qualified applicants are licensed. The public has a genuine and very real interest in knowing that the members of the self-governing bodies are properly trained and have good ethical standards. The technical nature of the services performed by the members of such bodies makes it very difficult for the layman to assess the competence of the practitioner and gauge the value of the services he has received. The public must be able to rely on the judgment of those who are empowered to decide that persons licensed to practise a profession or engage in a self-governing occupation are qualified. That being so, the responsible and experienced members of a profession or occupation on whom the power of self-government is conferred should be in the best position to set the standards to be met and the qualifications of anyone who aspires to enter the profession or occupation. But it must be recognized that each of the self-governing bodies has been given a statutory monopoly through its licensing powers. What has to be guarded against is the use of the power to license for purposes other than establishing and preserving standards of character, competence and skill.[8]

The Commission made a recommendation, which we endorse, that lay members should be appointed to the governing bodies of self-governing professions to represent consumers' interests and to check any tendency towards the exercise of power in the interests of the profession rather than that of the public. This device could be useful in respect not only of licensing but also of other economically significant activities of professional bodies, including that of fee-setting under the public-regulatory option already referred to. There would be some question of lines of responsibility: who would appoint the consumer representatives to the professional body, and to whom would they report? Appointments might perhaps be made by appropriate provincial ministers after consultation with organizations broadly representative of consumer interests. The

consumer representatives might then report back both to the government that appointed them and to the consumer organizations. If these arrangements stimulated more widespread and more informed discussion of the public interest in the adequate provision of high-quality professional services, this would be all to the good.

In so far as the affairs of professional bodies are now subject to regulation by statute, these statutes are almost entirely provincial. It follows that this is an area where considerable intergovernmental co-operation is likely to be required in order to arrive at that mixture of competition policy and other policies that best protects the public interest. We urge that this co-operation be forthcoming.

Financial Services

Financial institutions offer an instructive illustration of the fact that whether direct regulation obviates the need for competition policy depends critically on what kind of regulation prevails. Regulation may at times be irrelevant for the achievement of the objectives of competition policy. The chartered banks, for example, operate under the Bank Act which sets out, among other things, the capital requirements necessary to obtain a bank charter and the types of assets in which a bank may invest. These regulations are designed to ensure the protection of savings and the stability of the monetary system; they have little or nothing to do with efficiency in the supply of banking services. Other provisions of the Act, however, have a more direct bearing on competition. The Act spells out, for example, the steps that must be taken by banks contemplating a merger, ending with the requirement that the proposed merger must be approved by the Minister of Finance and by the full Cabinet. But there is no mention of the criteria that the Minister and his advisers should use in deciding whether or not to recommend approval of the merger.

Many of the recent changes in the Bank Act reflect the special emphasis placed by the Royal Commission on Banking and Finance on the need for more competition among financial institutions. Although the Commission did not specifically raise the possibility of applying the Combines Act to all financial institutions, the similarity between its approach and

the objectives of competition policy is plainly evident in the following passage taken from its Report:

> To the extent that legislation itself can do so, it should prevent the spread of practices and arrangements which inhibit competition, and to this end we believe that certain prohibitions should be written into the law. First, we recommend that all agreements among banking institutions affecting the terms and conditions of borrowing or lending be prohibited unless specifically approved by the Minister of Finance. While it would be quite impossible to prevent members of a close financial community from discussing matters of common interest, the habit of formal or informal agreement can and should be broken. So far as we can determine, rate agreements serve no useful purpose in the public interest.[9]

A ban on rate agreements on loans and deposits was incorporated into the revised Bank Act of 1967. Other recommendations of the Commission designed to foster competition in the financial area which have since been incorporated into the legislation include the attempt to prevent abuses of market power by limiting to 10 per cent a bank's investment in the voting stock of any one large corporation, including specifically trust and loan companies. Also, no person may now be appointed a director of a chartered bank who is a director of another chartered bank, of a Quebec Savings Bank or of a deposit-accepting trust and loan company, or who is a director of a company owning more than 10 per cent of the voting stock of a bank or trust or loan company.

The present Bank Act therefore reflects two different aspects of policy, both of which are designed to protect the public interest in the activities of the banking system. The primary focus of the legislation is on the need to ensure the stability and solvency of the chartered banks. But as the ban on rate agreements indicates, once this basic requirement is met, then the public is deemed to have a right also to the benefits of effective competition and efficient resource use in the financial system. Nor does there appear to be any reason why the extension of competition policy to all financial institutions cannot be a major factor making for efficiency in this area. Indeed, it is our view

that the application of competition policy is as relevant to the provision of financial services as it is to other fields. The Director of Legal Proceedings and the tribunal should be given the authority to investigate and, where appropriate, strike down practices in the financial area that are inimical to the public interest in competition and efficiency.

The principal problem posed by the extension of competition policy to the financial industry concerns administration. The Superintendent of Insurance, now located in the Finance Department, has the responsibility of administering the federal Acts regulating insurance companies, trust companies and mortgage loan companies. He is also the official responsible for the administration of the Small Loans Act, which regulates rates charged by finance and small loan companies on certain of their loans. In reporting under the first head of this Reference, on the subject of consumer affairs, we suggested that at some later date consideration might be given to transferring the Superintendent's functions in respect of small loans to the Department of Consumer and Corporate Affairs.[10] In the light of our present proposal to extend competition policy to financial institutions, it now seems to us that a good case could be made for relocating *all* the functions of the Superintendent in the new Department. These functions have a basic similarity to other functions relating to corporations that are already the responsibility of the Department, and their transfer would ensure greater co-ordination in carrying out the task of protecting consumers' dual interest in the solvency of financial institutions and in competition.

A similar logical case, founded on considerations of administrative co-ordination and efficiency, could be made in favour of transferring to the Department of Consumer and Corporate Affairs the Inspector General of Banks, who is charged with duties of supervision and inspection relating to the chartered banks and the Quebec Savings Banks. The government might feel, however, that certain traditional links between the banks and broad financial policy as administered by the Finance Department were of such a nature that the Inspector General should remain where he is. In that event, arrangements could no doubt be devised whereby the Department of Consumer and Corporate Affairs would assume responsibility for the application

of competition policy to those activities of the banks that were not regulated by the Bank Act and subject to surveillance by the Inspector General.

The extension of competition policy to the banks would not appear to create any serious conflicts with the objectives of monetary policy as administered by the Bank of Canada. On those rare occasions when it was found necessary to limit competition for deposits by an interbank agreement on interest rates, a request or approval to this effect by the Minister of Finance, in accordance with the relevant provision of the Bank Act, would appear to be sufficient to protect the agreement from a charge under the Combines Act. For greater certainty, however, and in the interests of public information, the passage of an Order-in-Council setting out details of the ceiling would serve notice that considerations of monetary policy for the time being superseded those of competition policy, and that the banks in complying with the ceiling were temporarily placing themselves under direct regulation in respect of rates.

As stated earlier, our recommendation that competition policy include a *per se* ban on price-fixing agreements is based on the belief that rarely, if ever, do such agreements bring benefit to the economy and to consumers. In the provision of some financial services, price agreements now exist that are tolerated, if not condoned, by federal and provincial regulatory authorities. Among such agreements are those relating to minimum commission rates on stock exchange transactions and to the rates charged by fire and casualty insurance companies belonging to the Canadian Underwriters' Association. If the public is in fact best served by permitting these practices to continue, they should be protected by appropriate regulatory legislation. The regulations should, however, spell out explicitly what sorts of agreements are to be allowed and under what circumstances. It would be a good thing, too, if the promulgation of regulations in this area could be preceded by informed discussion and public debate, in which the views of those responsible for the administration of competition policy and interested members of the public could be elicited. There is a place for the use of regulation as a means of social control -- a considerable part of the next Chapter of this Report is indeed devoted to this matter; but the

rationale for the regulation should be well understood, and the boundaries between regulated activities and those subject to competition policy clearly defined.

Summary

There is much to be gained by extending competition policy to all commercial activities including services. The *per se* approach here recommended for price-fixing and market-sharing arrangements is as relevant for service activities as it is for goods. Only in the financial area is there much likelihood that some rate agreements may be found to serve the public interest, and here the existence of legislation and regulation affords the opportunity for such agreements to be subject to government surveillance. The discretionary authority given to the tribunal in examining mergers and trade practices which may in some circumstances be against the public interest in the sale of goods is also well suited to deal with some of the inefficiencies and anticompetitive business practices that are to be found in the sale of services. The power of general inquiry vested in the tribunal would provide opportunities for exploring the existence of practices detrimental to competition and efficiency, for furthering public education about the economic role of service industries, and for pointing out useful directions for policy to take in the future. In this connection, we urge the tribunal and the Department of Consumer and Corporate Affairs to investigate possibilities for improving the quality and quantity of information so that consumers may be better equipped to select alternative suppliers of particular services. The question of estimates could usefully be examined from the viewpoint of encouraging greater accuracy in the estimation of costs to householders and other buyers who are attempting to allocate their resources intelligently.

The recent growth of service industries has been rapid, and it is likely that rising affluence will promote continued relative expansion in this area of the economy. Public policy initiatives to promote more efficient resource use in the service sector will therefore be extremely timely.

Notes and References

[1] Hansard, March 19, 1968, p. 7808.

[2] *Regina v. K. J. Beamish Construction Co. Limited, et al.* [1968], 2 C.C.C., 5.

[3] Evidence of D. H. W. Henry, Q.C., Director of Investigation and Research, Combines Investigation Act, before the House of Commons Standing Committee on Transport and Communications, *Minutes of Proceedings and Evidence*, December 7, 1967, p. 386.

[4] *Regina v. Canadian Breweries Limited*, 126 C.C.C., 133 at 146.

[5] *Regina v. Canadian Breweries Limited*, 126 C.C.C., 133 at 167.

[6] J. C. H. Jones, "Mergers and Competition: The Brewing Case", *Canadian Journal of Economics and Political Science*, November 1967, p. 556.

[7] *Canadian Industrial Relations* [The Report of the Task Force on Labour Relations], Ottawa, Queen's Printer, 1969, pp. 139-140.

[8] [Ontario] *Royal Commission Inquiry into Civil Rights*, Report No. 1, vol. 3, Toronto, 1968, p. 1172.

[9] *Report of the Royal Commission on Banking and Finance*, Ottawa, Queen's Printer, 1964, p. 370.

[10] Economic Council of Canada, *Interim Report -- Consumer Affairs and the Department of the Registrar General*, Ottawa, Queen's Printer, 1967, pp. 24-25.

CHAPTER 8

SOME SPECIAL PROBLEMS OF COMPETITION POLICY

The purpose of this Chapter is to focus on two problems relating to competition policy that have only been hinted at in earlier parts of this Report. The first of these concerns methods of social control over industry other than the market-oriented method, hitherto the principal subject of discussion. In this Chapter, we examine those areas of industrial activity subject in varying degrees to government regulation or ownership, with particular emphasis on the question of how their operation might be better related to the broad efficiency objective that we have already indicated as appropriate for the so-called "market sector" of the economy. We advocate the application of a suitably modified version of competition policy to regulatory agencies and government-owned enterprises.

Further in this same problem area, we also examine more briefly, from the same standpoint, the impact on industrial efficiency of government subsidy and procurement policies and certain other activities. Our examination is selective; it does not, for instance, extend to broad government policies such as monetary and fiscal policy, even though these may have implications for economic efficiency.

The second major problem considered here is that of the international aspects of competition policy. Hitherto, the aspect that has engaged most public discussion has been that of the extraterritorial reach of one country's competition policy into the domain of another. Recently, however, additional and more important economic aspects have been coming to the fore, suggesting a need for new forms of international co-operation and perhaps eventually for a new international agency or institution.

COMPETITION POLICY IN RELATION TO GOVERNMENT REGULATION AND OWNERSHIP

If efficiency in the use of resources is to be the main objective of competition policy as applied to the "market sector" of the economy, it should be fully as relevant an objective for the government-regulated and government-owned sectors, notwithstanding

the different arrangements for social control there in effect. A great deal has been said about the need for efficiency in the ordinary departmental operations of government, although critics have not always made clear whether they desire a contraction of governmental functions, a more efficient discharge of existing functions, or some combination of both. At all events, growing concern over rising governmental expenditures and tightness in capital markets has added impetus to the development within governments of goal-oriented, planned and programmed budgeting systems, whose purpose is to clarify policy objectives and to improve the efficiency with which those objectives are attained. But little attention has thus far been paid to the role that government-owned enterprises and government regulations may play in enhancing or diminishing the efficiency of resource use in the economy as a whole.

Most public discussion of government regulation, for example, has centred on the judicial authority for regulatory decisions, on the relationship between regulatory agencies and the legislature, and on the protection of the civil liberties of those affected by regulation. These are important issues, but so too are the economic effects of regulation. The hidden costs to the economy of poor regulatory performance provide, in our view, a strong justification for applying the underlying principles of competition policy, in suitably modified form, to the regulated sector of the economy, the more so since some parts of this sector, such as regulated communications activities, are likely to grow rapidly in relative economic importance over the next few years.

Objectives of Regulation

Among the most common reasons for instituting economic regulation is the desire to control business conduct and performance in industries with an inherent tendency towards natural monopoly. Presumably, regulation is here introduced in an effort to achieve what the market plus competition policy cannot do in the way of ensuring efficiency in the use of resources, the protection of consumers from exploitation and the preservation of the health and safety of the public. However, not all economically significant regulations are formulated exclusively on economic-efficiency or consumer-protection grounds. At times, governments

have imposed regulations designed to achieve other objectives such as safeguarding national culture, ensuring a national presence in institutions considered vital to sovereignty, or limiting hours of work and the number of outlets offering particular goods and services in given locations. These may be valid objectives, but their pursuit may impose economic costs, which should as far as possible be estimated, publicly discussed, and taken continuously into account as the regulatory process goes forward.

At times, regulation may involve a complex mixture of socio-political and economic objectives. For example, much of the widespread regulation in agriculture appears designed to ease the impact on farmers of sharp, short-term price fluctuations and of longer-term structural adjustments. Unfortunately, some though not all of the regulation appears to operate more as symptomatic relief than as an effective means of bringing about, as smoothly as possible, essential changes in the industry. The danger that regulation may work more as a brake than a shock absorber must be constantly guarded against.

Regulatory Agencies

A particular regulatory statute may spell out in some detail the various regulations that are to be imposed on an industry. Alternatively, it may contain only broad guidelines, the details of which are to be filled in by the Governor in Council or by a regulatory agency. The immediate reasons for which a legislature delegates its authority to semi-independent boards and commissions are various. The nature of the activity to be regulated may be so complex that the task must devolve upon experts. Or there may be a need to insulate regulation-making from short-term political pressures, or to relieve government departments from an administrative burden. The delegation of broad and substantial powers to a semi-independent board may be a legitimate response to a situation where regulation is extending into a new and complex area, necessitating an ad hoc approach while experience is being accumulated. On the other hand, it may at times amount to little more than an attempt by the legislature to pass on to someone else awkward political decisions that should really be part of the legislature's own responsibility.

Competition Policy

Although regulatory boards may be responsible to a designated minister or to the legislature itself, the regulations they promulgate are seldom subjected to searching scrutiny. Publication of regulations in the appropriate federal or provincial gazette is frequently required, but this normally fails to reach the broad audience necessary for adequate public debate, which should in any case be instituted at an earlier stage, before decisions have hardened. Frequently, the only voice heard is that of the affected industry, which may help to explain the oft-noted tendency for regulatory bodies increasingly to reflect the interests of the industries they regulate. The lack of more generalized and more effective public debate may stem from a widely held but highly questionable assumption that government action always works to the public benefit. As one British writer puts it:

> The situation can be explained by the widespread public belief that the state is the impartial servant of the public good, distinguished from all other economic units by reason of its altruism in a world dominated by self-interest....
> So activities which would be viewed unquestioningly by the public as vices, when encountered in the private sector, are not merely transformed into virtues when practised by the state, but are compounded and extended through the ballot box and the fiscal process.[1]

The absence of clear-cut objectives and the lack of public attention to the regulations themselves have created many problems in the course of the long history of regulation in Canada. One of these involves the relationship between a regulated industry and those nonregulated industries whose goods or services provide close substitutes. In any dynamic economy, new institutions, new industries and new products are constantly springing up, sometimes providing competition in areas previously considered to be the preserve of natural monopolies and therefore subjected to fairly close regulation. Unless a continuing lookout is kept for the emergence of new competition, the regulations may prevent the established firms from responding appropriately to this new competition. Such was the observation of the MacPherson Commission, appointed to inquire primarily into problems afflicting the railways.

The Commission found it necessary at the outset of its study to enlarge the immediate scope of its work and to relate the role of the railways to the competition that emanated from other types of transportation. This was a significant departure from the focus of previous inquiries into the performance of the railways.

Competing modes of transportation that had emerged in response to the development of secondary industry, particularly trucking and water carriers, were not subject to rate regulation "in any real sense" in the words of the Commission. They could set their prices at levels that attracted some of the traffic formerly carried by the railways. Imposed in the mid-nineteenth century when the railways exercised a substantial monopoly, the existing regulation restricted the freedom of the railways to vary rates in the face of competition. In its Report, the Commission noted:

> But the more competition is limited, the more the pricing of any individual movement will tend to be opportunistic, unrelated to the costs properly associated with the service performed. This, as a matter of course, finds its effects in the misallocation of resources in transportation, and distorts to a greater or lesser degree resource allocation in the rest of the community.
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> Public action, therefore, in developing a National Transportation Policy, must seek to encourage competitive forces where the structure of the industries permits pervasive and effective competition to operate, and to regulate where it does not. In practice this amounts to developing agencies of regulation which recognize that freedom of pricing will bring efficiencies in those sectors of the transportation industry where the firms can be numerous and achieve satisfactory economies with commitments of capital small in relation to the total market.[2]

The Commission then went on to design a policy (subsequently embodied in considerable measure in the National Transportation Act of 1967) that attempted to limit rates only "where evidence of monopoly exists" but which in other areas did nothing to inhibit the "free play of competition or cushion the rough blows of competition in that segment of the whole transportation

industry where a large number of firms will bring efficiency and flexibility".

One cannot help but be struck by the similarity between the recommendations advanced by the MacPherson Commission and the Porter Royal Commission on Banking and Finance. Both were established to study the problems faced by particular industries in the 1960's, and both foresaw that by weakening regulatory bonds and allowing competitive market forces to be given their head, governments would help to bring about a situation where these industries would serve the public more efficiently.

The Regulatory Process

The most economically significant direct government regulations that may be imposed on a line of business activity are those bearing on prices or rates, on conditions of entry, and on the amount and standard of services provided. Prices or rates may be fixed directly by the regulatory authority, or indirectly through restrictions on profits or rates of return on investment. The entry of new competitors into a line of activity may be regulated by licensing or other devices. Finally, regulation may require an enterprise to provide services (for example, railroad branch line services or airline feeder services) to a degree and of a standard that would not otherwise be provided.

In Canada, prices and rates are today set by regulatory bodies in such fields as agriculture, transportation, public utilities, telephone services, and publicly operated insurance schemes. To carry out their functions, the regulators must have access to detailed knowledge of the particular industry whose rates are being set: its revenues, its costs and the value of its assets, together with some conception of what might constitute a reasonable rate of return on investment in the industry. They must also have insight into the problems of the industry and be prepared to consider how these problems relate to the public interest. Even where the regulators' expertise and analytical ability are of a high order, however, they are likely to be confronted with substantial difficulties. Regulation of prices and rates of return may reduce the industry's incentive for efficient operation at the lowest possible cost. This is not invariably so; in some cases, the public-spiritedness and progressiveness

of the industry's managers may go far to compensate for the lack of the usual market incentives. As a general rule, however, it has to be recognized that so long as a comfortable level of profits is being earned below the ceiling of the fixed price, management may be insufficiently stimulated to install new cost-saving technology.

When profits come to be squeezed, more interest in cost-saving technology naturally becomes apparent, but even then much managerial energy may flow into an attempt to persuade the regulatory authority that a rate increase is needed. The existence of a ceiling may, of course, benefit consumers if prices would otherwise be forced upwards under pressure of rising costs. But such benefits are short-lived and result in misallocation of resources not only in the regulated area, but in other sectors of the economy as well.

Essentially similar problems are encountered when rates of profit or return on investment rather than prices as such are regulated. Often, in situations of this type, much will be said about the "reasonableness" of prices and profits, but it must be asked whether costs are "reasonable" also, and what standards of reasonableness are being employed. Lacking any thoroughly trustworthy standards, one is left only with a suspicion that under more competitive conditions, prices and profits, or costs, or all three, might be appreciably lower than they are.

As was noted earlier, the MacPherson Commission advocated a policy of rate-setting only where competitive pressures were lacking. This seems to us an appropriate guiding light. The imposition of fixed rates by regulatory bodies should normally be considered a last resort, to be employed only where other means of social control appear certain to be ineffective.

Another type of regulation -- that affecting the entry of new competitors into an industry -- commonly involves governmental licensing of participants in certain economic activities. In some instances, the licensing is comparatively routine and permissive, and mainly of significance as a source of government revenue. In other instances, however, it may so operate as to restrict appreciably the number of competitors in a line of activity.

Such restriction is sometimes made necessary by technical considerations. Thus the limited number of radio and television frequencies unavoidably restricts the number of stations that may be allowed to operate (although technological advances may raise the limit from time to time), and competition is to that extent constrained. But restrictive licensing is not confined to this type of case. Municipal licensing of barber shops and taxis is an example of a widespread form of licensing whereby the number of competitors is restricted on grounds that have little or nothing to do with technology. Among these other grounds may be the desire of the licensing authority to ensure that participants in the licensed activity are of good character, adequately trained and capitalized, and generally likely to maintain appropriate standards of competence, cleanliness and vehicle repair. But mixed with this, or independent of it, may be a more general view that in the absence of restrictive licensing, the activity is likely to be characterized by chronic oversupply and a high rate of bankruptcies.

This view finds a certain cautious support in the literature of professional economics. It is recognized that a number of industries, constituting a relatively small proportion of total industry, have a chronic tendency to be overcrowded or "sick". The resulting situation does not necessarily work to the advantage of the consumer nor does it always further the objective of maximizing economic efficiency. Sometimes, for example, numerous small and inefficient producers may charge comparatively high prices and divide the business, rather than compete on a price basis.

There are, then, some few situations, including that of the skilled professions treated in the previous Chapter, where some degree of restrictive licensing can be justified as being in the public interest. But the decision to resort to such licensing should be based on careful observation and analysis of the activity in question. Moreover, the standards by which applicants for licences are to be judged should be clearly and publicly spelled out. Where no health, safety, technology, or "sick industry" considerations are involved, it should be a general policy of licensing authorities to license all comers. Finally, the work of the licensing agency should be subjected to periodic

public review in order to ensure that the public interest continues to be promoted.

In addition to imposing rules in respect of rates and entry, regulatory agencies may stipulate that certain services must be provided even on an uneconomic basis. This type of regulation is frequently to be found in the transportation industry where certain privileges may be accorded to railways or airlines on condition that transportation facilities are made available to certain regions at a price that does not cover costs. Since regulatory bodies normally allow industries under their jurisdiction to earn a reasonable rate of return, however defined, on their overall operations, the provision of unprofitable services involves the pricing of other services at levels higher than would otherwise obtain. The users of profitable routes are thereby paying an indirect subsidy to uneconomic lines. Subsidization of this kind, and other more direct subsidies including farm subsidies, depletion allowances and the like, put federal and provincial governments squarely in the field of determining resource allocation among various claimants. There should be a careful and continuing examination of whether such subsidies are provided in a fashion that minimizes the costs involved, maximizes the opportunities for private decision-making, and places the burden of the subsidy where it belongs -- sometimes on the public at large, but sometimes on that part of the public receiving the major benefit from the subsidy.

Mergers in Regulated Sectors

When mergers occur in regulated industries, they may or may not require the approval of the regulatory authority. In the previous Chapter, for example, we noted that under the Bank Act, banks proposing to merge required the approval of the Minister of Finance but that the Act did not specify the criteria to be considered in assessing merger proposals. We believe that the process of arriving at decisions regarding mergers in regulated fields could well be improved if the views of the Department of Consumer and Corporate Affairs and the Competitive Practices Tribunal were sought out.

A provision in the National Transportation Act provides a useful precedent. The Act requires that notice of merger between companies in transportation

fields under federal jurisdiction must be given to the Canadian Transport Commission, and the Commission must in turn give notice to the Director of Investigation and Research under the Combines Investigation Act. We strongly urge that this precedent be adopted by all regulatory bodies, and that the procedures be more formalized; the mere giving of notice does not necessarily ensure that the Department of Consumer and Corporate Affairs will have enough time to make an adequate assessment, or that its views will be received by an attentive audience. We recommend that the Department have and be seen to have a major role in respect of all mergers, including those within industries under the jurisdiction of a regulatory agency such as the Canadian Transport Commission, and those involving one company under such jurisdiction and another outside its scope. In many instances, the latter type of merger is not subject to the approval of the regulatory authority, despite the fact that such mergers may frustrate the attempts of the authority to achieve its basic objectives and in this and other ways work to the public detriment.

Economic Assessment of Regulation

On the whole, the process of economic regulation is difficult, cumbersome and time-consuming. These are characteristics that can be very disadvantageous in a fast-growing and fast-developing economy. To regulate an economic activity effectively, in such a way as to encourage a maximum contribution towards the achievement of overall efficiency in the economy, can be a highly demanding task. Precisely for this reason, the regulatory process stands in need of careful outside assessment.

Such an assessment is of course notably required at the very outset, when the question of whether or not to regulate is still being debated. Believing as we do that competitive market forces, where available, provide the surest stimulus to the efficient production of goods and services, we suggest that governments should regulate only those activities where competition would be either extremely feeble or overly wasteful of resources (the natural monopoly and "sick industry" cases); where genuine and important issues of health and safety, standardization, disclosure of information or fraud are involved; or where other well-defined non-economic or quasi-economic objectives are at stake and can only be furthered through regulation. The selection

of the particular activities to be regulated should be done with great care and consideration, in such a way as to provide the public with the fullest possible information regarding the criteria to be used with respect to entry and prices and the likely amount of any economic costs that may be incurred.

We especially urge that all legislation setting up economic regulation contain as clear-cut as possible a statement of objectives, both to give guidance to the regulators and to provide a standard against which their performance can be assessed. The excellent preamble to the National Transportation Act of 1967 is a model to be emulated in this regard.

Once regulation has commenced, there should be established a procedure for periodic review to determine, firstly, whether the need for regulation persists, and secondly, if it does persist, whether the regulatory process is working in the direction and conforming to the objectives that the legislators intended, with as little damage as possible to economic efficiency. The prime responsibility for instituting such a review should lie with the legislature itself. With regard to broadcasting, for example, the general nature of the legislature's responsibility for regulations was conceived by the Committee on Broadcasting (1965) in the following terms:

> It is for Parliament to define the goals of the public enterprise and to ensure that the goals assigned to a public agency are achieved. It is not, we believe, possible for Parliament to supervise the details of the productive process or its administration without damaging the performance that Parliament itself has stipulated.
>
> Specifically, for the control of a public broadcasting system -- and in this context, we regard the public control of the privately owned broadcasters and that of the publicly owned agency as equally important -- the first task of Parliament is to set the goals. It must say clearly what it wants the broadcasters to do. In the past, Parliament has not stated the goals and purposes for the Canadian broadcasting system with sufficient clarity and precision, and this has been more responsible than anything else for the confusion

> in the system and the continuing dissatisfaction which has led to an endless series of investigations of it....
>
> Having set clear goals for the broadcasting agencies and delegated to an autonomous agency responsibility for the detailed supervision and control of the broadcasting system, it only remains for Parliament to establish a procedure to ensure that the goals it has set are in fact being met. The delegation of responsibility to the broadcasting agency is not, of course, any permanent surrender of Parliament's jurisdiction. Parliament remains supreme and can at any time redefine the goals or revise the form and powers of the agency. Until it does so by appropriate legislation, the goals remain and the powers of the agency remain, but Parliament should hold the agency accountable for the attainment of the specified goals.[3]

At the federal level, a committee of the House of Commons or Senate, or a joint committee of both, is the device that springs most readily to mind for the purpose of carrying out regular reviews of regulation and regulated activities. The House of Commons Special Committee on Statutory Instruments will no doubt be giving some attention to this matter, inasmuch as its terms of reference direct it to consider "procedures for the Review by this House of instruments made in virtue of any statute of the Parliament of Canada". These terms embrace regulatory activity by government departments as well as by semi-independent agencies.

Various arrangements for the review of regulation are clearly possible, and it will be for Parliament to decide what arrangements best suit particular activities. We would urge only that review arrangements make adequate provision for a consideration of the economic aspects of regulation.

Some industries (the construction industry is a good example) are governed by regulations imposed by all three levels of government, and it would be desirable to find some way of inquiring into the overall effects of existing pyramids of regulation, including their consequences for efficiency and consumer satisfaction. A suitable federal-provincial forum for this purpose might be set up as an ad hoc offshoot of

regular federal-provincial meetings on other topics. At the very least, some simplification and rationalization of the three-level regulatory structure might be achieved.

In view of its fields of expertise and its particular interest in the maximization of economic efficiency, it would be logical for the Department of Consumer and Corporate Affairs to be called upon for its views whenever economically important regulatory policies are being formulated or reviewed within the federal government. Further than this, the powers of general inquiry given to the Department and to the Competitive Practices Tribunal under the proposed new legislation should be broad enough to permit study, where appropriate, of government-regulated and government-owned activities in the economy, even though the other clauses in the legislation may not in practice be applicable to these activities. While delicate situations may sometimes arise, the Department and the tribunal should consider it part of their duty to draw attention to remediable situations in respect of government-regulated and government-owned activities that are clearly at variance with the objective of maximizing economic efficiency. The Department should dedicate some specialized part of its research resources to this class of problem.

Government Enterprises

A third type of social control over industrial activities, occurring sometimes in conjunction with and sometimes independently of direct regulation, is the ownership of business enterprises by governments. In Canada, some of these enterprises are in the position of competing with privately owned enterprises in the same industry. Their performance as competitors may exert a significant influence on standards of efficiency in the industry as a whole. In some of their activities they may be pace-setters for the industry; in others they may be followers.

Some of the corporations now operating in Canada under federal or provincial ownership are subject to a certain degree of scrutiny and review with regard to efficiency, but the focus is almost exclusively on expenditures. At the federal level, for example, some enterprises may be required to submit their capital and/or operating budgets to Treasury Board, while a

year-end audit of their financial statements is undertaken by the Auditor General. Others may operate with a much greater degree of independence on a purely commercial basis with no particular efficiency requirement by the legislature that has established them other than that they pay their way out of earned revenues.

We strongly urge the federal government to commit itself to the principle that the door be left open as widely as possible for the objectives of competition policy to permeate all of its activities, including those of its own enterprises. How far this door can be pushed open depends of course on the constraints imposed by objectives other than efficiency which influence the conduct of government activities. But to the fullest extent possible, acceptance of such a commitment not only by ministers but by heads of government enterprises and those down the line is highly to be desired.

Unless a federally owned enterprise has been specifically charged by Parliament to act otherwise, its use of practices such as refusals to deal or discriminatory buying (for instance, giving arbitrary preferences to domestic suppliers) should be subjected to the same tests in respect of efficiency as those appropriate for private enterprises. In cases where expenditures of federal government enterprises are scrutinized by Treasury Board and the Auditor General, the responsibility for ensuring that such enterprises do not engage in anticompetitive practices should be shared by these officials and the minister to whom the enterprise reports. The Department of Consumer and Corporate Affairs should draw to the attention of appropriate officials such evidence of the existence of undesirable practices by government enterprises as may come to light through its contacts with businessmen and consumers.

We urge provincial governments to accept a similar commitment and to make appropriate arrangements for ensuring that their enterprises uphold the efficiency objectives of competition policy wherever other objectives specified by the legislature do not intervene.

Government Departmental Activities

Government purchasing policies and contracts have a direct bearing on resource allocation and efficiency within the economy. Here again, certain procedures for review and scrutiny are already in place. Funds required to finance a particular program operated by a federal department go through several stages of examination, beginning with Treasury Board approval of the necessary appropriation, and ending with the Auditor General's examination and report to the Public Accounts Committee. But there is rarely, if ever, a watchful outside eye kept on the intervening period between appropriation and outlay. No one subjects departmental business dealings to the same criteria in respect of anticompetitive practices as apply to the dealings of private businessmen, nor can it be safely assumed that government purchasing policies are at all times bent on the achievement of efficient resource use. Again, objectives other than competition policy may intervene, but it is desirable that these other objectives should be clearly and publicly specified and that their possible detrimental effects in terms of economic efficiency should receive recognition. Subject to whatever constraints these other objectives may impose, it is important to ensure that the effect of departmental expenditure programs is not such as to distort the efficient use of resources. By unjustifiable discrimination among suppliers of goods and services or by favouring the large "reliable" firm to the exclusion of smaller and quite possibly more efficient suppliers (the letting of contracts by tender by no means necessarily guards against such a bias), government purchasing programs may not only impose unnecessary charges on the taxpayer, but also give uncalled-for encouragement to industrial concentration or other structural changes detrimental to the spirit of competition policy.

Treasury Board, the Auditor General and the Public Accounts Committee should actively concern themselves with an examination of the means by which federal departmental purchasing programs are carried out. Departmental officials should not hesitate to call upon the Department of Consumer and Corporate Affairs for whatever assistance that Department might furnish in measuring the effects of particular purchasing policies on economic efficiency. The Department, in turn, should pass on whatever information or complaints

it may come across in respect of purchasing programs to the officials of the department concerned.

INTERNATIONAL ASPECTS OF COMPETITION POLICY

No discussion of competition policy would be complete without taking into account economic decisions and activities that are undertaken outside Canada. The relative efficiency of resource allocation in the rest of the world, taken as a whole, influences directly the well-being of Canadians, as does the degree to which our own resources are used to enhance or detract from the possibility of achieving an efficient use of human and physical resources on a world-wide basis. These are difficult questions, bearing not only upon the efficiency with which existing productive resources are now being used, but upon the pattern of production and the geographical location of productive facilities in the future.

The rise of the international corporation, controlling productive and distributive facilities in a number of countries, is an indication that there exists a recognizable entity called the world economy. In its present-day form, the international corporation is able within its own organization to make a variety of choices as to where it will expand production and sell output, and as to which outputs and inputs it will move internationally and in what proportions. Placing notable emphasis on the movement of technical information and other business information, it has become a major vehicle for so-called "technological transfer" between countries.

It is by no means naive to look on the world as such corporations do and to consider issues of the locus of productive and distributive facilities, the maximization of economic efficiency and other matters relating to competition policy from an international as well as a domestic standpoint. The fact is that if nations fail to pursue policies designed to promote more efficient resource use on a world-wide basis, and to act upon a recognition of the many different channels through which goods and services, including information, can with advantage be transferred, they will incur, both individually and collectively, a heavy cost in forgone output.

Obviously, these are questions on a scale and of an importance vastly transcending the typical day-to-day preoccupations of competition policy and the practicable administrative purview of the Department of Consumer and Corporate Affairs. The whole field of trade policy, for example, is involved. For many of the relevant areas, the prime responsibility lies and must continue to lie with other departments and agencies of government. But the Department of Consumer and Corporate Affairs should be kept informed on matters significantly related to its own major policy objectives and should be afforded the opportunity to make a timely and useful contribution to interdepartmental discussion of such matters.

Some of the main policies in respect of which there appears a reasonable prospect of obtaining fruitful international co-operation, and so promoting more efficient international resource use, may be enumerated. Conditioning resource use in a very fundamental way, tariff policies have from the beginning done much to shape the need for competition policy in Canada. What further reciprocal tariff reductions can be negotiated internationally will therefore be crucial. Already, however, the progressive reduction of tariffs in the postwar period has helped to throw into sharper relief the importance of various *non*tariff barriers to the international movement of goods and services. We leave for consideration in later reports of this Reference barriers associated with national patent, trademark and copyright systems, but mention here certain other barriers that might well be the subjects of international negotiation. These include regulations affecting such things as health protection, the grading and labeling of products, and construction standards -- all areas where national governments have legitimate regulatory functions, but where regulation can too often be employed as a protective device against foreign goods and services. The answer to this problem would seem to lie in patiently negotiated *common* international regulations, coupled with understandings that countries would not use such measures restrictively and would consult on the basis of well-defined codes affecting each area of regulation. This aspect of international competition gets little attention, primarily because it is so tedious. But agreement here would make it possible to facilitate competitive international trade flows, by reducing barriers and granting to the buyer a greater degree of

assurance that he was not comparing one country's apples with another country's oranges.

Another apt candidate for international negotiation would be the purchasing policies followed by governments and their utilities and other enterprises. It is often the practice for these policies to discriminate in favour of domestic suppliers. The course of negotiations here might run from the provision of information on existing practices to the reaching of standstill agreements, and eventually to the signing of mutual undertakings to reduce domestic preferences.

In this broad landscape of policies affecting the efficiency of resource use on the international scale, national competition policies as usually conceived occupy a significant if hardly dominating part of the picture. They give rise to certain policy problems at the international level, in part because, although competition policies have been more widely adopted in the postwar period, their vigour and comprehensiveness vary markedly from country to country.

Two broad types of international problems in this area may be distinguished:

(1) unwanted extraterritorial impacts of one country's competition policy upon the economy of another; and

(2) problems calling for competition policy action that are beyond the scope of any one country's policy to resolve.

The principal mechanisms by which such problems are or might be dealt with appear to be three in number. The first mechanism involves bilateral consultative arrangements between countries, of which the 1959 Fulton-Rogers agreement between Canada and the United States is an example. Arrangements in effect between countries participating in the OECD Committee of Experts on Restrictive Trade Practices represent a small and tentative first step towards a second type of mechanism: that of multilateral agreements for consultation and co-ordinated policy action. A third mechanism, which a truly international competition policy would call for in dealing with problems beyond the capacity of any one country or even small group of countries to resolve,

would be some form of supranational agency. This must realistically be regarded as lying some distance in the future, although some of the elements of such an agency may be discerned in that section of the European Economic Commission which is concerned with the administration of the clauses of the Treaty of Rome dealing with restrictive practices.

With regard to the first type of problem cited above (the unwanted extraterritorial impact of another country's competition policy), this has at various times been examined by Canadians both as a problem of economics and as a problem of national sovereignty, with the United States of course the other country chiefly in mind. We do not feel that we can usefully comment here on the sovereignty aspect; we note only that this aspect was treated in the Report of the [Watkins] Task Force on the Structure of Canadian Industry.[4]

So far as economic considerations are concerned, it may be said that impacts of any significance on the Canadian economy as a result of U.S. antitrust decisions have up to now been few and far between, and that there do not appear to be any strong reasons for supposing that the Fulton-Rogers procedures for advance consultation will not be adequate to head off possible unwanted impacts in the future. One new problem that might conceivably arise would be as a result of a scheme to rationalize one of the "miniature replica" sectors of Canadian secondary industry -- a sector characterized by too many plants and too short production runs in relation to the size of the market. If some of the firms involved in the prospective rationalization were subsidiaries of large U.S. companies, would the parent firms prevent their participation for fear of getting into trouble with U.S. antitrust? No categorical answer is possible to this question, but it has been a practice of U.S. antitrust authorities not to penalize companies for actions they or their subsidiaries undertake abroad at the formal behest of host governments. Assuming the continuation of this practice, a Canadian rationalization scheme that was largely or wholly embodied in a statute or government regulation would seem to be free of U.S. antitrust consequences, although it would no doubt be wise to utilize the Fulton-Rogers procedures if only as a means of demonstrating to U.S. representatives how the scheme made economic sense in Canadian circumstances.

Turning now to problems calling for competition policy action which may be beyond the capacity of Canadian policy to resolve alone, we pass into an area where lack of solid information and analysis prevents any very firm statements from being made. Indeed, it is precisely this lack of information that would seem to be the first matter requiring international action. Further than that, the two major classes of problems worth discussion, however tentative, are those relating to international cartels and large international corporations.

It is unfortunate that the most recent published information of any comprehensiveness regarding the effect on the Canadian economy of international cartels dates back to 1945, when F. A. MacGregor, Commissioner of the Combines Investigation Act, undertook a study. In it, he documented the effects on Canada of three types of private cartels: arrangements between foreign suppliers of goods imported into Canada, arrangements by which Canadian subsidiaries of foreign companies were allotted exclusive access to the domestic market, and arrangements in which Canadian exporters participated with producers in other countries. Commissioner MacGregor noted that the short-term balance of national advantage and disadvantage from such arrangements was difficult to assess, and added:

> Any such balancing of national advantage and disadvantage from the operation of cartels is, however, misleading. Canada has a more serious interest in the totality of cartelization than in the mere sum of the effects of particular cartels. For cartel agreements are simply one important part of a network of restrictive practices, private and governmental, which spread over the world in the period between the two World Wars. For example, high tariffs, import quotas, discriminatory currency practices, exchange controls, subsidization of exports, contributed to the division of world markets and prevented the efficient use of world resources. National and private restrictive practices which impede the use of new technology, divide up markets and limit output are obstacles in the way of expansion in the flow of goods and services which, in the words of the Lend Lease Agreement, "are the material foundations of liberty and welfare of all peoples". Any narrow gains

> through such restrictive practices are lost in the curtailment of employment and production when such devices are extensively adopted. The interest of Canada in the revival of world trade and in the adoption of policies of expansion transcends any such balancing of possible advantages and disadvantages. The importance of an effective international policy to remove the serious restrictive elements in cartel operations as part of a general attack on all hampering trade restrictions is of much greater significance than the direct effect of the elimination of each separate undesirable cartel agreement.[5]

Although 24 years have passed, and much of the structure of restrictions described by the Commissioner has happily been dismantled, it cannot be assumed that significant international cartel arrangements affecting Canada no longer exist. It does appear that a combination of the increased importance of U.S.-based international companies in world business and the reluctance of such companies to enter into cartels, for fear of U.S. antitrust consequences if not for other reasons, may have reduced the scope for such arrangements. But there is information, including some contained in written briefs to the Economic Council, that suggest the persistence of noteworthy international cartels.

In formulating our recommendations in Chapter 6 on the subject of registered export agreements, we made what we believed to be a realistic assumption: that concerted international action to weaken or break up international cartels will be slow in coming. If and when it does come, the qualifications for registered export agreements will have to be re-examined in the light of whatever obligations Canada assumes as a participant in multicountry competition policy action.

For the immediate future, it would seem well for the Department of Consumer and Corporate Affairs to devote some of its resources to discovering from available sources as much as possible about the effects on Canada of present-day international cartels. The subject might lend itself to a contract study. Once the areas where vital information was lacking had been established, steps could be taken within appropriate international bodies to see if some of the gaps might be filled with the aid of other countries. These bodies

would include, as well as GATT and OECD, the United Nations Commission on Trade and Development (UNCTAD) which has evinced an interest in restrictive practices. The launching of a formal general inquiry in Canada by the Competitive Practices Tribunal might also be considered if this seemed likely to add substantially to the stock of available information.

The subject of the large international corporation has only rather recently engaged the attention of serious analysts, and the time is far from ripe to make definitive pronouncements on the nature and behaviour of this class of institution, if indeed it can really be said to constitute a single class. Whatever its true nature, it does appear to have impressive potentials for both good and ill. Its capability for acting as a high-speed mechanism for the transfer of knowledge and as an otherwise useful and efficiency-maximizing component of a truly international economy has already been noted. However, its size and geographical spread naturally raise concerns about the possibilities of market power and abuses of that power on a scale too great to be effectively countered by the competition policy of any one country. Some projections done by Professor J. N. Behrman are quite startling: they suggest that the output of international corporations might rise from about one-eighth of the non-Communist world's GNP in 1967 to about one-third in 1987. By the latter date, the output of the non-Communist world might be about equally divided between international corporations, the United States (excluding international corporations), and other countries.[6] This would indeed seem to imply great market power, and if serious abuses of that power took place, this could well be the circumstance that called into being a supranational agency in the field of competition policy.

In the shorter run, however, the main need would again seem to be for information, including particularly information concerning the extent to which international corporations pose problems for Canadian competition policy significantly different and harder to deal with than problems emanating from domestically owned parts of the economy.

In general, it seems clear that the future holds a likelihood of gradually increasing international action in respect of competition policy -- at first

mainly in the realm of consultation and information-gathering, then later perhaps in the domain of agreed action to deal with problems international in their scope. Canada should participate in this development and urge it forward in those areas of particular interest to her. Because of intercountry differences in approaches to competition policy, progress on a broad front may be slow. But this need not prevent smaller groups of like-minded countries from reaching arrangements on problems of concern to them. The nonparticipation of only a few major countries in an international cartel or other anticompetitive practice may be enough to weaken greatly its restrictive effects.

Notes and References

[1] C. K. Rowley, "Monopoly in Britain: Private Vice but Public Virtue?", *Moorgate and Wall Street,* Autumn 1968, pp. 37-38.

[2] *Report of the Royal Commission on Transportation,* vol. II, Ottawa, Queen's Printer, 1961, pp. 15-16.

[3] *Report of the Committee on Broadcasting,* Ottawa, Queen's Printer, 1965, pp. 91-93.

[4] *Report of the Task Force on the Structure of Canadian Industry,* "Foreign Ownership and the Structure of Canadian Industry", Ottawa, Queen's Printer, 1968. The Task Force recommended that three steps be taken: (1) legislate to prohibit the removal of commercial records and data from business concerns within federal jurisdiction by reason of a foreign court order; (2) use a "guiding principles" questionnaire to elicit information on the operational impact of foreign antitrust legislation on the Canadian subsidiaries of foreign corporations; and (3) enact legislation to prohibit Canadian compliance with foreign antitrust orders, decrees or judgments.

[5] F. A. MacGregor (Commissioner, Combines Investigation Act), *Canada and International Cartels: An Inquiry into the Nature and Effects of International Cartels and Other Trade Combinations,* Ottawa, Queen's Printer, 1945, pp. 54-55.

[6] J. N. Behrman, *An Essay on Some Critical Aspects of the International Corporation*, Economic Council of Canada, Special Study (forthcoming).

CHAPTER 9

IMPLEMENTATION AND ADMINISTRATION OF COMPETITION POLICY

It would be a misallocation of resources if we attempted to make comprehensive and highly detailed recommendations concerning the administration of competition policy by the Department of Consumer and Corporate Affairs and the proposed Competitive Practices Tribunal. To a very considerable extent, proposals for day-to-day administrative arrangements should be worked out by those who have had long experience in administering this type of policy. We cannot, however, entirely neglect the subject of administration. The point was made earlier that the effective operation of competition policy involves some very special and acute problems of administration and enforcement, problems that are often not adequately appreciated by policy critics. The significant changes in the philosophy, structure and application of Canadian competition policy which we have proposed will clearly require substantially altered administrative arrangements. There is some obligation, therefore, to provide at least a general idea of the possible shape of these arrangements.

To begin with, there should be in the background some reasonably coherent view of the overall mission of the Department of Consumer and Corporate Affairs and its appendages. Taken purely at its face value, the name of the Department might well give rise to an impression that it embraces the larger part of those functions of the federal government that are of major interest to consumers and corporations. Such an impression would be false. In our *Interim Report on Consumer Affairs*, we recognized the impossibility of assigning all federal functions affecting the consumer to the Department of Consumer and Corporate Affairs, and, accordingly, recommended the actual transfer to the new Department of only a small proportion of such functions. However, we did urge most strongly that the Department play, in the field of consumer affairs, "a central co-ordinating role within the federal government".

Would it be a logical extension of this recommendation that the Department should play a similar co-ordinating role in the field of corporate affairs? We think not. Examined closely, most of the functions affecting corporations that have been assigned to the

Department have in common a rather special character. To a large extent, they deal with areas where government intervenes in the relations between corporations and consumers in order to play a mediating and in some instances a policing role. The nature of the role is clear enough in such fields as consumer protection and competition policy, although in the latter area the consumer interest may be at one or more removes, as in a case under the Combines Act involving relations between a manufacturer and a supplier of raw materials. The role is not so evident in respect of such things as the Bankruptcy Act and the Companies Act. Here, surely, the concern is with the relations between corporations, creditors and investors. But the ultimate individual investor and depositor in corporations and their creditors is really none other than the consumer in one of his many economic roles, so that the provisions of the Bankruptcy Act and the Companies Act which endeavour to safeguard the interests of investors and creditors may be regarded as being, in the final analysis, forms of consumer protection. In a similar vein, our later report on patents, copyrights, trademarks and registered industrial designs will attempt to point out the significant relationship between these responsibilities of the Department and the consumer interest.

We continue, therefore, to view the mission of the Department of Consumer and Corporate Affairs as being primarily the advancement of the consumer interest -- conceived, however, in very broad terms. The dominant underlying theme of the present Report has been the desirability of directing competition policy towards the maximization of economic efficiency, real income and consumer welfare. This objective should serve as a guide not merely for competition policy, but for all the activities of the Department of Consumer and Corporate Affairs.

Despite the fact that many federal government functions of great relevance to the consumer are not direct responsibilities of the Department, the Minister and staff of the Department should feel themselves to have, and should be generally recognized to have, a useful and relevant point of view to bring to bear upon Cabinet and other intragovernmental discussions of these functions. Accordingly, when policy is being reviewed or formulated in areas such as tariffs, taxes, subsidies, government purchasing policies, and activities of

regulatory agencies and government-owned enterprises, where there are likely to be significant effects on the consumer interest in an efficiently performing Canadian economy, provision should be made for the Department of Consumer and Corporate Affairs (and in appropriate cases, the Competitive Practices Tribunal) to participate in a timely and effective way. The Department of Consumer and Corporate Affairs should take the initiative in suggesting the creation of new machinery of interdepartmental consultation (and in some cases, intergovernmental consultation) wherever this seems to be required.

Internal Organization of the Department of Consumer and Corporate Affairs

Turning now to administrative arrangements within the Department, we propose only to recommend some broad changes designed to bring the structure of the Department more into accord with the concept of a unified departmental mission and with our recommended changes in Canadian competition policy.

For the present, our proposals chiefly concern the types of activity now carried out by the Combines Investigation Branch and the Consumer Affairs Branch. We leave for later reports administrative proposals affecting such other units as the Patent and Copyright Branch; however, our present proposals have been designed to provide a structure to which the other branches of the Department could, in due course, be appropriately related.

Under existing arrangements, the Combines Investigation Branch and the Consumer Affairs Branch have a number of functions in common. Both engage in research and informational activities. Both also have operating functions including the investigation of possible breaches of the law and associated regulations, and the setting in motion, whether through the courts or otherwise, of appropriate enforcement machinery whenever breaches are discovered.

The Consumer Affairs Branch is a relative newcomer to the scene and is still in the process of building, notably on the side of economic research. It will be essential for the effective discharge of consumer affairs functions to have available a strong research base. As for the Combines Investigation Branch,

a major implication of our proposals for competition policy is that, here too, there should be some enlargement of the research base, this notwithstanding the provision of some research resources to the Competitive Practices Tribunal. We have opted for a competition policy directed more clearly and predominantly than in the past to the achievement of economic ends, a policy that will require for its success a first-rate job of economic fact-gathering and analysis.

A real danger in the present administrative arrangements, it seems to us, is that the Consumer Affairs Branch may tend to be regarded by people not closely in touch with it as a kind of poor relation (a glorified "hot line" or consumers' complaint bureau), in contrast with a Combines Branch that addresses itself to serious economic and legal problems. This would be a travesty of the conception of consumer affairs that underlay our *Interim Report* on that subject. It would also be completely at variance with our conception of a basic economic mission for the Department. The responsibilities of the present Consumer Affairs Branch and of the Combines Branch are directed towards what in the final analysis are common economic ends, and the means that they employ for attaining those ends have many similarities also.

One way of dissipating this danger would be simply to amalgamate the Consumer Affairs Branch and the Combines Branch. This would have the advantage of pooling available resources of legal and economic talent, with the result that the use made of those resources could be more flexible and efficient. They could be deployed to deal with the most pressing problems of any given time, regardless of the distribution of these problems between the consumer affairs sector and the competition policy sector.

It seems to us, however, that such an amalgamation would create too large and unwieldy a unit. Moreover, it would not deal with a second danger which is apt to threaten any organization in which major research and operational functions must co-exist. This is the danger that research resources will be largely taken up with the day-to-day needs of the operational side for information and analysis, with the result that more basic, longer-term research, ultimately just as necessary for the support of operations, does not receive adequate attention.

We therefore propose a different arrangement under which the present Combines Branch and Consumer Affairs Branch would disappear and be replaced by two new units organized along different functional lines. One unit or branch, to be called the Research and Information Branch and to be headed by a Director, would be concerned with the provision of economic research and informational services in relation to competition policy and other aspects of consumer affairs. It would also furnish economic research and informational services, as required, to the Patent and Copyright Branch and other parts of the Department. An important longer-term aim of the research unit would be the gradual accumulation of a body of knowledge about many aspects of the workings of the Canadian economy at the industry level. Priorities would need to be established and a long-term research plan adhered to which was insulated from the day-to-day needs of the enforcement authorities.

A second branch, to be called the Legal Proceedings Branch and also to be headed by a Director, would be concerned with enforcement functions. It would address itself to all aspects of legal proceedings. Among other things, it would be responsible for the preparation of cases to go before either the Competitive Practices Tribunal or the ordinary courts. Following somewhat the example of its opposite number on the research side, it would provide necessary legal services to other parts of the Department. We would regard it as important so to arrange matters that as many as possible of the Department's competition policy and other cases were handled by government lawyers. Provincial bar regulations in some provinces may stand in the way of this, but it may well be that any such impediments could be discussed at one of the regular federal-provincial meetings of Attorneys General, and appropriate action agreed upon. There appears to be no advantage and considerable inefficiency in the present arrangements whereby lawyers in private practice are briefed to take combines cases. The procedure is not only time-consuming, involving as it does considerable duplication of effort, first inside then outside the Combines Branch, but also tends to inhibit the development of a high degree of specialization and legal expertise in combines cases.

Although most of the Department's economists would be located in the Research and Information Branch, there would have to be some economic expertise in the Legal Proceedings Branch also, in order to provide the necessary economics "back-up" for the immediate preparation of cases. Obviously, there would have to be extremely good co-operation and communication between the two branches, and the structure of their interrelations would have to be worked out with care. Steps would also have to be taken to continue certain public safeguards. The present right and responsibility of the Director of Investigation and Research to publish an annual report, for example, might in future be held jointly by the Directors of the new branches.

The administrative position of the Competitive Practices Tribunal vis-à-vis the Department would have to be thought through in some detail. It would be absolutely essential for the Tribunal to have, and to be seen to have, a high degree of independence in its decision-making. It should be in nobody's pocket -- least of all that of the Department, whose lawyers would be appearing before it. This crucial requirement of independence is one of the reasons why we have recommended that the Tribunal have an adequate economic research staff of its own.

At the same time, independence need not and should not mean isolation. Expertise in the field of competition policy will always be limited, and the Tribunal and its staff should have no hesitation in communicating informally with the available experts, whether these be located in business firms, in universities, in the Research and Information Branch of the Department, or wherever. The proposed civil law basis for the Tribunal's operations and the large content of persuasion and public education in its approach to competition policy problems should make such contacts easier to arrange with propriety. Where a general inquiry was being carried out, a large measure of co-operation between the Tribunal's staff and the Research and Information Branch of the Department would be essential.

Enforcement of the Law: The Primacy of Prevention and Deterrence

The cheapest and most efficient way in which a law can promote the ends envisaged for it by the legislators is for that law to be so administered and enforced, and so understood and accepted by the public, that the fewest possible infractions occur. Prevention and deterrence, rather than convictions, are the elements to be maximized in the long run, even though convictions may make an indispensable contribution to deterrence, particularly during the early history of the law. The only proper way in which to judge how well a law has been administered and enforced is to examine, as best one may, how much progress has been made towards achieving the law's fundamental objectives. The number of cases brought to court, and the percentage of those cases won, may be very unreliable guides to this. Depending on circumstances, high numbers and percentages may just as well be an indication of poor administration and enforcement as they are of good.

Criminal Offences

It will be recalled that we have proposed the following five offences for essentially *per se* treatment under criminal law:

(1) collusive arrangements between competitors to fix prices;

(2) collusive arrangements between competitors to allocate markets;

(3) collusive arrangements between competitors to prevent the entry into markets of new competitors or the expansion of existing competitors;

(4) resale price maintenance; and

(5) misleading advertising.

The problem of obtaining maximum deterrence in respect of these offences should be relatively straightforward. In the first place, the law should be clear and its objectives widely appreciated. What

it prohibits and, of equal importance, what it does not prohibit, should be known. Both potential offenders and those who may be injured by offences should be aware of the law and of the remedies and sanctions that it provides.

A continuing program of publicity is obviously desirable if public understanding and acceptance of the purposes of competition policy is to be achieved. The present Director of Investigation and Research under the Combines Investigation Act has done an outstanding job of publicizing the legislation to lawyers and businessmen through the medium of speeches, lectures and seminars. While this program should certainly be continued, more attention now needs to be given to acquainting the general public, partly through the mass media, with the nature and purpose of competition policy and its relation to other policies affecting consumers.

The compliance program conducted by the Director of Investigation and Research has provided an effective means of helping businessmen to avoid infractions of the law. The need for it would not be entirely eliminated by the changes that we have proposed. In continuing such a program, however, care should be exercised to avoid stepping over the fine line which divides stating what the law *is* from a *de facto* creation of new jurisprudence in the course of a private interview. (We have no reason to believe that this line has been transgressed in the past; we note it only as a persisting hazard of any compliance procedure.) Where there exists uncertainty about the boundaries of the criminal part of the Combines Investigation Act as revised, but where the officers of the Crown are convinced that this uncertainty can be reduced, they should bring a case in the boundary area on the first appropriate occasion. It should be a high-priority objective to give the courts full opportunity to clarify the interpretation of the law where it needs clarifying.

Programs of publicity and compliance, then, can do much to help bring about prevention and deterrence. They must, however, be supported by a widespread belief that infractions of the law stand a heavy risk of being detected and proceeded against, and for this to exist there must be a credibly vigorous and comprehensive program of enforcement. From the points of view of both deterrence and equity, it is not good for people

to think that either they or others have a considerable chance of "getting away with it". It is to be hoped that strong enforcement in the first instance will fairly quickly produce a state of affairs where chances of flouting the law undetected are generally rated as low, with the result that less enforcement activity will be necessary from that point on.

Sanctions should continue to consist of fines, imprisonment and prohibition orders, the latter being necessary to ensure the discontinuance of the anticompetitive behaviour. Fines, to be meaningful, should be large enough to hurt, having regard to the size of the enterprise or enterprises involved. Where provincial practices permit, the lawyers of the Legal Proceedings Branch should suggest fines rather than wait upon the request of the court. It might be well also to follow the practice of the Food and Drug Directorate, which makes publicly available lists of convicted offenders under the legislation for which it is responsible.

An important element of deterrence in the U.S. antitrust laws is provided by the possibility that conviction on antitrust charges may lead to civil suits by private parties believing themselves to have been injured by the anticompetitive behaviour for which the defendants have been convicted. If successful, complainants in such suits may recover treble the amount of damages which they are judged to have sustained. It would seem to be worth exploring whether the deterrent effect of the criminal law portions of Canadian competition policy could be enhanced by opening up an avenue for single-damage suits by private parties.

Civil Offences

Enforcement of that part of competition policy assigned to the Competitive Practices Tribunal would necessarily evolve somewhat differently. Again, prevention and deterrence would be major long-run objectives, but they could only develop gradually. As of the day on which the tribunal opened its first hearing, no offences, in any strict sense, would exist. Only as the tribunal's decisions accumulated and consistent patterns emerged would it become clear that certain kinds of mergers and trade practices, in certain circumstances, stood a high likelihood of being found

undesirable by the tribunal and subjected to injunctive or other remedies. In this fashion, and assuming appropriate diligence on the part of the Directors of Legal Proceedings and of Research and Information in locating and bringing before the tribunal instances of the kinds of merger and practice in question, a deterrent effect would build up.

It is to be hoped that the tribunal would in fact achieve much of its effectiveness through techniques of public education and persuasion. To this end, it would be important that the tribunal put much effort into reporting fully to the public on its decisions and explaining their economic rationale. Some sort of compliance procedures would be very likely to spring up naturally in respect of mergers and trade practices. This could be a useful adjunct to other educative techniques, provided the rule suggested earlier (that a compliance procedure should seek to explain existing law but not in any sense to create new law) was faithfully followed. The tribunal should be expected to feel a strong obligation fully to publicize and explain any important jurisprudential development -- any real or apparent change of line. The device of issuing general guidelines, as advance public notice of the view which the tribunal intended to take in the future in respect of certain types of merger or trade practice, might occasionally be utilized. Here again, the tribunal would be expected to lay out a suitable economic analysis as a basis for its decision.

If, in the face of hopes to the contrary, it became apparent that a practice which the tribunal had found to be undesirable in a number of cases continued to be repeated and that, therefore, deterrence was not operating effectively, the tribunal could inquire more generally into the practice, seeking to determine why it was so prevalent and what more effective remedies might be recommended to the government.

Importance of Adequate Resources

The proper carrying out of the proposals in this Report would require an increase in the annual cost to the federal treasury of administering Canadian competition policy -- now approximately one million dollars. We believe that the potential benefits to the Canadian economy of a competition policy more effectively

oriented towards the achievement of economic efficiency would justify an increase of reasonable proportions in the resources available. As a form of social control of industry, well-working competitive markets supported by competition policy are remarkably cheap by comparison with alternatives such as direct regulation.

Review and Assessment of Competition Policy

Law must be kept up to date if the public is to retain respect for it, and to this end we have recommended a decennial review of competition policy. This should not be taken to imply, however, that no interim review should be contemplated. On the contrary, a virtually continuous review should take place, with particular attention being devoted to how new departures in the policy are working out in practice. Some of this review should be internal, within the Department of Consumer and Corporate Affairs, but the greater part should be public and external. Parliament, consumer and producer groups, and interested private citizens should be given every opportunity to observe and understand the workings of the policy. We would particularly commend to the Canadian Association of Consumers and the Canadian Consumer Council the view that competition policy deals with matters of central importance to consumers, and that the administration of the policy by the Department of Consumer and Corporate Affairs and by the Competitive Practices Tribunal should accordingly be subjected to close and critical scrutiny by consumer representatives, assisted as required by economists and other qualified experts. The communications media should make every effort to fulfil their role so that this continuous debate is brought to the attention of all elements of the public. We urge lawyers, academics and other experts to offer constructive criticism of the work of the tribunal, not just to readers of learned journals but also to a broader audience.

Care should be taken to assess the policy in a really meaningful way. It is all too easy to become heavily concerned with conviction statistics and other relative trivia of enforcement. What really counts (and is unfortunately much more difficult to assess) is the extent to which the policy is furthering the public interest in the efficient use of resources by the Canadian economy.

CHAPTER 10

CONCLUSION

In this final Chapter, it is perhaps useful to draw together, even at the risk of repetition, the main principles that have guided us in formulating our recommendations for an effective Canadian competition policy. In the first place, we have taken the view that the general set of competition policy should be one that aims at the achievement of efficient resource use in the Canadian economy. Second, we believe that some form of social control should be exerted over all commercial activities, and that over the greater part of the Canadian economy, efficient resource use will be more readily brought about through policies that maximize the opportunities for the free play of competitive market forces. The use of other forms of social control, namely, government regulation and government ownership, should be brought to bear only on those activities where monopolistic tendencies have all but eliminated competitive market responses, or where the protection of the consumer interest in matters such as health, safety, fraud, disclosure and standardization, among others, requires the implementation of explicit government regulations.

To put at least some flesh on the bones of these principles, we have recommended that an important part of Canada's competition policy legislation be on a civil rather than a criminal base, and that a specialized tribunal be created. Uppermost in our minds in suggesting these changes is the view that certain features of criminal law and procedure, such as the onus of proof beyond a reasonable doubt and the handling of charges by ordinary courts in ways that do not permit a full exploration of economic facts and analyses, are ill-suited to the effective treatment of some situations and practices relevant for competition policy. For this reason, it is suggested that only five business practices should continue to be regarded as criminal offences, and that the language of the statute invest the definition of these offences with a greater degree of certainty and fair warning than is now the case. For the rest, we have made the asssumption that it would prove constitutionally possible for the federal government to establish a civil tribunal, perhaps under the power to regulate trade and commerce. This tribunal would

address itself to mergers, business practices and export and specialization agreements. Unlike the five instances where criminal law still appears to be a valid approach, most of the practices to be referred to the tribunal are capable in some circumstances of working to the public advantage, but the distinction between likely good and bad effects may require a difficult weighing of relevant economic circumstances and probabilities, and therefore a kind of expertise that only a body of mixed professional disciplines could provide. The tribunal would be armed with injunctive remedies, with the power to recommend other remedies, and with a power of general inquiry.

Consistent with the principle that some form of social control over commercial activities is highly to be desired, competition policy should be extended to those service industry activities not already covered by it. This area is of increasing economic importance, and it no longer seems logical, if indeed it ever did, to exempt service activities from competition policy.

We have also invited provincial governments to interest themselves in the civil law aspects of competition policy and to participate in its implementation and administration.

These, then, form the major elements of our approach and our recommendations. Some readers of this Report will undoubtedly be disappointed that we have not dealt with all of the suggestions that we have received for detailed changes in the Combines Act, that we have not "solved" such particular competition policy problems as those associated with the relations between oil companies and service stations and with conglomerate mergers, and that we have not tried to fill the large and distressing gaps that presently exist in the stock of thorough and reliable studies of individual Canadian industries. We would indeed like to have done all these things, but given the limitations of time and resources which applied, we felt it best to concentrate our efforts on devising a new framework for competition policy within which matters of the sort mentioned could be more effectively handled.

Some critics, by contrast, may fault us for doing too much by way of extending competition policy well beyond the activities of those private entrepreneurs

to whom the Combines Investigation Act now chiefly applies. But our view is that the proper objectives of competition policy extend far beyond the Act and beyond the federal Department of Consumer and Corporate Affairs. A concern for the public interest in efficient resource use should properly extend to other federal government departments, to provincial and municipal governments, and to the great array of government enterprises and regulatory agencies.

Our concept of the role that can usefully be played by an effective and properly administered competition policy has laid great emphasis on efficiency. In doing this, we may have conveyed an exaggerated impression of the power of competition policy to promote efficiency. In fact, sole reliance on competition policy would not be nearly enough. Mention has been made in this Report of the great importance of other policies in promoting efficient resource use. Among such other policies are those relating to taxation, tariff, manpower, government purchasing, and the regulation of transport and other activities. In some of these policies, objectives other than efficiency may at times take a higher priority, and such objectives are by no means necessarily to be disparaged. Nevertheless, all levels of government could well pay increasing attention to the degree to which programs and policies, frequently designed for different purposes and set in place to meet short-run situations, affect the efficiency of resource use. In this Report we have put forward for consideration by governments some possible approaches by which the objectives of competition policy can come to take a more prominent part in their decision-making. In the next Report on this Reference, we will be concerned with another group of government policies -- those relating to patents and copyrights -- which also have a significant part to play in efficient resource allocation and which are closely tied to some elements of competition policy.

The implementation of a new approach to competition policy will require that the public be well informed concerning objectives, methods and limitations. We have made several recommendations in respect of the need for a *continuing* flow of information to the public. Since at the outset there will be no body of case law pertaining to matters coming before the tribunal, close attention will have to be paid to its work if the public

is to be informed as to what practices, under what circumstances, are likely to be struck down or altered. To assist in this process of public education, we have invited all sections of the Canadian public to actively interest themselves in the work of the tribunal and have suggested that wide publicity be given to its reports.

The success of our recommendations will depend fundamentally on two things. Reference has been made to the assumption that the proposal for the transfer of a large part of Canada's competition policy to civil law will be found constitutionally valid. But of equal importance, appointments to the tribunal and its staff, and to the professional staff of the Department of Consumer and Corporate Affairs, must be of the highest calibre. Great care must be taken to ensure that appointments are based solely on the high qualifications that the effectiveness of this new body will demand, and that tenure is sufficiently long to enable experience to be built up and an effective unit created. On the other side of the coin, it is of equal importance that those best qualified to serve on this body of experts should be willing to make themselves available and to shoulder the burden of the very difficult tasks which our proposals would place upon them.

Arthur J. R. Smith,
Chairman
David L. McQueen,
Vice-Chairman and Director
Sylvia Ostry,
Director

Paul Babey
W. J. Bennett
François E. Cleyn
Robert M. Fowler
Arthur R. Gibbons
David L. Kirk
Walter C. Koerner
William Ladyman
Stanley A. Little
Donald MacDonald
Ian M. MacKeigan
Maxwell W. Mackenzie
William Mahoney
Hugh A. Martin
J. R. Murray
Marcel Pepin
Charles Perrault
Mrs. A.F.W. Plumptre
Alfred Rouleau
Gabriel S. Saab
Lucien Saulnier
William Y. Smith
Graham Ford Towers
William O. Twaits
Francis G. Winspear

F. Belaire,
Secretary

APPENDIX I

PRESS RELEASE, PRIVY COUNCIL OFFICE, JULY 22, 1966

The President of the Privy Council, the Honourable Guy Favreau, Q.C., today announced that the Government has requested the Economic Council of Canada to undertake a study of certain important aspects of the responsibilities of the Registrar General of Canada and his department under the Government Organization Act, 1966, which is awaiting proclamation.

The terms of reference are as follows:

"In the light of the Government's long-term economic objectives, to study and advise regarding:

(a) the interests of the consumer particularly as they relate to the functions of the Department of the Registrar General;

(b) combines, mergers, monopolies and restraint of trade;

(c) patents, trade marks, copyrights and registered industrial designs."

In making the announcement, the Minister recalled that on May 24, 1966, on second reading of the Government Organization Bill, the Prime Minister informed the House of the Government's intention to ask the Economic Council of Canada to look at the field of consumer affairs along with some of the other functions now to be undertaken by the Registrar General under the new legislation, with a view to providing advice as to the courses of action that seem best suited to meeting the needs of the Canadian people and the Canadian economy in the consumer field.

The Government has decided that as part of this study, the whole question of combines, mergers, monopolies and restraint of trade should be referred to the Economic Council for a fundamental review in the light of current and prospective needs of the Canadian economy; and furthermore, that another aspect of the work of the new department, namely, patents, trade marks, copyrights and registered industrial designs, should also be included in the fundamental economic study to be undertaken by the Council.

Mr. Favreau further stated that the importance of this study cannot be overestimated as a first and necessary step in the determination of a cohesive economic policy in relation to these important matters considered as a whole and in relation to each other with a view to bringing the policy in these matters into harmony with the overall economic policy of Canada and the needs of the consumer and other important segments of the economy.

The Council will be requested to press forward with this comprehensive study as swiftly as is practicable in order that appropriate legislation may be prepared thereafter with a minimum of delay. To expedite this process it is also the intention that officials shall press forward their study in those aspects of these fields which may be advanced without duplication or interference with the work of the Economic Council. In this way it is the Government's intention that the soundest policy may be developed and translated into legislation as speedily as is possible consistent with the clarification of the constitutional position and the proper role of the federal authorities.

The Economic Council will be free to make interim reports on such particular aspects of the study as the Council deems appropriate to enable the Government to consider taking initial steps consistent with the general review.

With particular reference to proposals for amendments to the Combines Investigation Act that have been the subject of discussion in Parliament and the press, and of submissions by individuals and groups, the Minister stated that it is most important that this legislation should not be amended piecemeal. Any amendments to the legislation ought to be in keeping with its fundamental philosophy and in furtherance of it. When consideration is being given to reviewing the general structure and philosophy of the Act, it would be very unwise to enact immediate temporary and piecemeal amendments to correct particular situations. At a time when a general review is in contemplation, such particular measures ought to be taken up and considered in the context of the whole review and any revision that may take place in the light of the findings and recommendations of the Economic Council.

Referring to the Report of the Restrictive Trade Practices Commission concerning the Distribution and Sale of Automotive Oils, Greases, Anti-Freeze, Additives, Tires, Batteries, Accessories, and Related Products (1962) (T.B.A. Report), the Minister said that in studying the recommendations of the Commission the Government has viewed most sympathetically the recommendations in that report which are intended, if possible, to improve the situation which has given rise to much concern on the part of the service station dealers in their relations with their oil company suppliers, particularly in relation to the practices of exclusive dealing and tying arrangements, as well as consignment sales. The Government has given a great deal of careful thought to the whole matter and is of the opinion that the recommendations of the Commission, if implemented, would be unlikely to give the relief sought by the service station dealers if the legislation must be drafted in terms of criminal law as is the case at present in view of the constitutional law decisions of the courts. It is therefore the intention of the Government that this particular recommendation for amendment of the legislation should be taken up and considered as part of any revision of the Act as a whole in the light of both the views of the Economic Council and the constitutional position as it may emerge.

APPENDIX II

SELECTED READINGS -- U.S. ANTITRUST POLICY

An attempt is made in this list to present a variety of viewpoints. From an economic policy viewpoint some of the most useful writings are to be found in some of the Law Journals of U.S. universities. This list is intended to provide material additional to that cited in the notes and references in this Report.

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APPENDIX III

THE STRUCTURE OF THE CANADIAN ECONOMY (CHAPTER 5) -- ADDITIONAL DATA

A. Summary of a Survey of Concentration in Canadian Manufacturing Industries, 1964

In attempting to quantify the degree of concentration that exists in an industry, economists have relied mainly on two kinds of measures, both of which take account of the number of firms and their relative size. The first provides an answer to the question: what percentage of total sales in an industry (or of some other size indicator such as employment, or value of shipments) is accounted for by a specified number of firms? The second approach employs what is called an inverse measure of concentration, and answers the question: how many of the largest firms account for a specified percentage (usually 80) of an industry's sales or employment or shipments? This study uses the latter measure, which was also employed by Rosenbluth in his study "Concentration in Canadian Manufacturing Industries".[1] More than a desire for comparability is reflected in this decision. The number of the largest firms accounting for 80 per cent of shipments is a good indicator of the number of effective competitors; the remaining 20 per cent usually represent fringe competitors.

In this Report, the data on concentration are divided into five classes, with each class consisting of a range of the number of firms required to account for 80 per cent of an industry's shipments. The class intervals are: 1-4; 4.1-8; 8.1-20; 20.1-60; and more than 60 firms. Similar calculations were made for the number of establishments or plants. The results are summarized in Table A-1 below.

A technical note about these calculations is in order here. To obtain concentration levels for firms, the individual industry bulletins of the Dominion Bureau of Statistics, which are on an establishment basis, were examined to obtain the number of establishments in an industry operated by the same company. The calculation was then made on the assumption that in arriving at 80 per cent of shipments for a given

industry one must include all the establishments of multi-establishment firms. Although this may result in a downward bias in the number-of-firms figure in some industries, this assumption is consistent with Rosenbluth's findings that establishments operated by multi-establishment firms tend to be larger than those operated by companies with only one plant. Furthermore, in all industries where it was felt that this assumption might be too strong, a check was made by DBS on the basis of unpublished 1962 employment figures. In cases where the employment figures placed the industry in a different concentration category than the calculation based on shipments, the former classification was the one used.

The concentration levels for establishments had, of necessity, to be estimated, since the DBS grouped data could not be disaggregated. The method used was one developed by Rosenbluth whereby maximum and minimum estimates are obtained, then averaged to yield point estimates.

To return to the Table, it is obvious that the level of plant concentration, while fairly high, is considerably lower than the level of firm concentration. The significant differences between plant and firm concentration, particularly in the more concentrated industries, may result from the exploitation of economies of scale arising outside the confines of a single plant. For example, potential economies of scale may be achieved by larger firms in such "extra-plant" areas as marketing, finance, research and development and the use of managerial talent. However, until further research provides more definitive answers, these "extra-plant" economies remain largely uncharted territory. It is also essential to recall at this stage the cautionary statement contained in the body of this Report: that concentration is only one of many determinants of market power. The presence of exports and imports, the narrowness or breadth of the industry delineations, and the division of a number of industries into local and regional markets, all mean that the levels of concentration sometimes overstate and sometimes understate the potential market control of the largest firms. However, the major conclusions are not affected in a significant way when a more carefully selected set of industries is examined.

Table A-1

ESTIMATES OF INDUSTRIAL CONCENTRATION LEVELS:

181 STANDARD INDUSTRIES, 1964

Number of Establishments and Firms Required to Account for 80 Per Cent of Shipments		Cumulative Percentage Distribution of the Number of Industries		Cumulative Percentage Distribution of the Value of Shipments	
		Establishments	Firms	Establishments	Firms
Up to:	4	6.6	14.4	1.4	11.9
	8	25.9	37.0	14.2	33.8
	20	57.4	63.5	42.9	55.2
	60	81.7	82.8	72.7	74.7
More than:	60	100.0	100.0	100.0	100.0

Table A-2

FIRM CONCENTRATION IN 77 INDUSTRIES IN 1948

AND IN 81 INDUSTRIES IN 1964

Number of Firms Required to Account for 80 Per Cent of Employment (1948) or Shipments (1964)		1948	1964
Up to:	4	13.9	17.2
	8	22.5	38.7
	20	37.4	55.1
	60	57.0	73.8
More than:	60	100.0	100.0

Source: The 1948 figures are based on Rosenbluth's study and those for 1964 on the industry bulletins of the Dominion Bureau of Statistics.

The changes in the level of concentration in Canadian manufacturing industries over time are shown in Table A-2. The proportion of economic activity accounted for by the industries with high levels of concentration -- i.e. industries where eight or fewer firms account for 80 per cent of employment or shipments -- increased from 1948 to 1964. However, the comparison is subject to the serious reservation that different size variables were used in the two years. Firm sizes for 77 of the 96 industries investigated by Rosenbluth in 1948 are based on number of employees, while for the 81 industries in 1964 which matched the 77 in 1948 the size variable used was the value of shipments. As Rosenbluth pointed out, using the number of employees to measure firm size as a general rule results in a lower level of concentration than when shipments are used. This deficiency in the data prevents us from arriving at more than a tentative conclusion regarding the trend of concentration over this 16-year period.

Bearing in mind this warning about differences in measurement, the data on concentration were examined to select from the 1964 data those industries that were reasonably comparable with measured industries in 1948, thus permitting an inter-year assessment of change in concentration. These numbered 64. There was an increase in concentration in 36 and a decrease in 23, while in 5 there was virtually no change (within five percentage points). Looking at the value of shipments of these 64 industries in 1964, the 36 industries in which concentration increased accounted for 40 per cent of the total, while 39 per cent came from the 23 industries of decreasing concentration and 21 per cent from the 5 industries in which there was virtually no change.

B. Summary of Merger Activity in Selected Industries in Canada, 1945-61

The Combines Branch of the Department of Consumer and Corporate Affairs conducted a questionnaire survey of publicly reported acquisitions made by corporations whose activities fell within the scope of the Combines Investigation Act. Acquisitions covered the period from 1945-61 and were defined as the purchase of the whole or part of an operating business capable of sustaining an independent operation and costing in excess of $10,000. Coverage of mergers where the acquiring company was engaged in manufacturing, mining and trade was virtually complete but, because of the limited extension of the Act, the survey covered in only a fragmentary way acquisitions by firms in the service industries.

In the body of this Report, mention was made that annual variations in the number of acquisitions undertaken over this 16-year period bore a close statistical relationship to the average level of stock market prices. To be more precise, acquisitions by Canadian-controlled companies were positively related to average Canadian stock prices, and acquisitions by foreign-controlled companies were most closely related to the level of merger activity in the United States, which was in turn positively related to the average level of stock prices in that country.

The distribution of the acquired companies by major industrial sector is shown in Table A-3 below. Because of large differences in the size of acquired companies, the relative importance of various industries as sources of acquisitions depends on whether one looks at the numbers of companies or their values. In either case, the manufacturing sector emerges as being of paramount importance. The trade sector, on the other hand, only merits a large weight when merger activity is measured in terms of the *number* of firms acquired.

Table A-3

PERCENTAGE DISTRIBUTION OF ACQUIRED COMPANIES

BY MAJOR INDUSTRIAL SECTOR, 1945-61

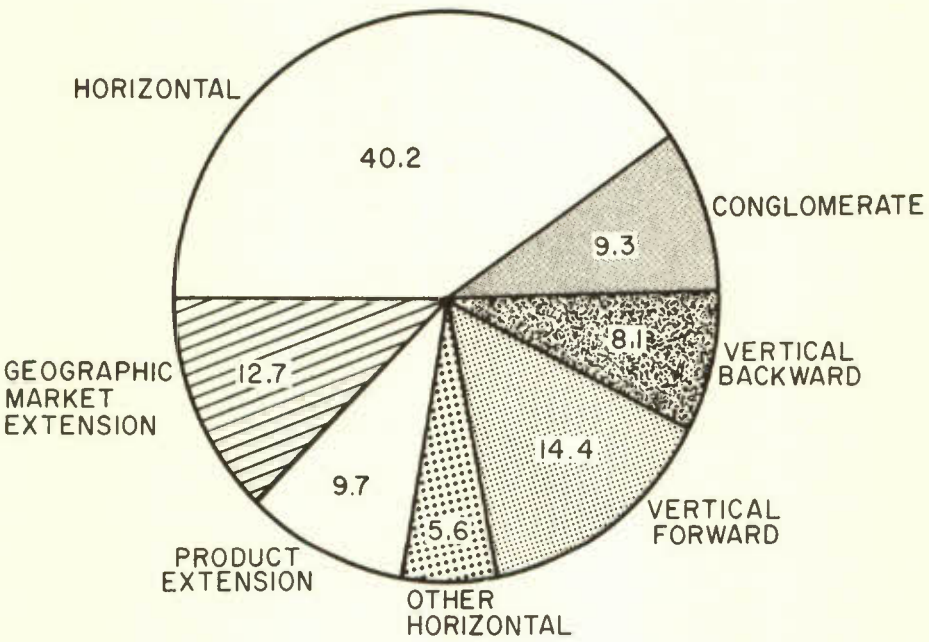
	Number	Assets
	(Per cent)	
Agriculture, forestry, fishing and trapping	1.9	0.9
Mines, quarries and oil wells	6.9	8.2
Manufacturing	49.1	68.3
Transportation, communication and other utilities	7.5	9.6
Trade	29.0	8.7
Finance, insurance and real estate	0.9	2.8
Community, business and research service industries	3.3	0.8
Construction	1.3	0.7

One of the important characteristics of mergers that must be taken into account in gauging their impact on the structure of industries is the market relationship between the merging firms. Chart A-1 summarizes the distribution of the acquisitions by market relationship.

Chart A-1

TYPES OF ACQUISITIONS, 1945-61

(Percentage distribution)



Source: Questionnaire survey carried out by the Director of Investigation and Research, Combines Investigation Act.

The types of acquisitions were established by first examining the market relationship between the main activities of the acquirer and acquired. This relationship was used in all save those cases where no

clearly defined relationship -- i.e. where the relationship was conglomerate -- was present. Where, however, there was no clearly defined relationship between firms' *main* activities but one did exist between *subsidiary* activities, the latter relationship was employed as the criterion. The resulting classification of merger activity is of necessity somewhat arbitrary. There is seldom, for example, a clearly defined line between ordinary horizontal relationships, geographic market extension relationships and product extension relationships. Moreover, many of the acquisitions labeled as geographic market extension took place in industries where the acquirer had, in effect, entered the acquired's market area before the acquisition through his sponsorship of national advertising campaigns. Other problems of classification arose in cases where the acquiring firms were already vertically integrated or where they were active in more than one industry.

In Chapter 5 of this Report, attempts were made to estimate, however crudely, the number of mergers undertaken in the 1945-61 period which might have been brought before the proposed Competitive Practices Tribunal, had it been in existence, for examination as to possible detrimental effects on the public interest. It will be recalled that in arriving at a rough figure of 17 per cent out of the total number of takeovers of manufacturing firms that took place in this period, only those mergers that involved the acquisition of firms in highly concentrated industries (industries in which up to eight firms accounted for 80 per cent of the total shipments of the industry) were selected. The relevant data from which this estimate was made and which was depicted in Chart 5-2 are shown in Table A-4.

The questionnaire survey included one question that was put to the acquiring companies in an attempt to elicit the proportion of merger activity that was undertaken in order to realize cost reductions through maximizing economies of scale. The precise question was: "Detail the economies, if any, secured by the merger which were not otherwise obtainable." One possible interpretation of this heading is that only economies resulting from acquisitions that could not be realized by internal growth should be reported. However, the nature of the responses suggests that firms reported on *all* economies, whether or not they could be obtained by other methods of growth.

Table A-4

TYPES OF MERGERS AND LEVEL OF CONCENTRATION (1964) OF MANUFACTURING INDUSTRIES WITHIN WHICH ACQUIRED FIRMS WERE OPERATING,[1] 1945-61

Level of Concentration	Type of Merger							
	Horizontal	Geographic Market Extension	Product Extension	Other Horizontal	Vertical Forward	Vertical Backward	Conglomerate	Total
1-4 Number	28	9	7	0	1	1	7	53
Assets in $ million[2]	*121.2*	*165.6*	*37.1*	*0*	*1.2*	*10.0*	*7.1*	*342.1*
4.1-8	36	9	3	6	11	7	11	83
	125.0	*32.5*	*3.8*	*12.1*	*274.5*	*201.0*	*22.1*	*671.1*
8.1-20	54	17	27	9	9*	13	27	156
	97.3	*55.6*	*51.1*	*9.1*	*9.7*	*14.0*	*45.8*	*282.6*
20.1-60	73	9	22	8	6	10*	23	151
	223.5	*8.4*	*16.5*	*15.4*	*12.1*	*8.5*	*164.8*	*449.2*

Table A-4 (cont'd.)

60.1 and more	101*	33	40	11	6	16	27	234
	55.3	*38.2*	*69.8*	*7.2*	*16.6*	*42.1*	*18.9*	*248.1*
Total	292	77	99	34	33	47	95	677
	622.3	*300.2*	*178.4*	*43.7*	*314.1*	*275.6*	*258.9*	*1,993.1*

* Includes one acquisition for which neither assets nor amount paid was reported.

(1) Only includes those acquisitions where both the acquiring and acquired firms were classified in manufacturing and where the industry within which the acquired firm was operating could be determined at the narrowest industry level for which concentration figures had been estimated. There were numerous instances in which the acquired firm could only be placed in a three-digit industry that contained several four-digit industries. The 677 acquisitions included in the Table capture 76 per cent of all the acquired firms classified in the manufacturing sector.

(2) Where assets were not reported but the amount paid was, the assets were estimated from the amount paid.

Source: Questionnaire survey carried out by the Director of Investigation and Research, Combines Investigation Act.

There is another factor that might explain the rather surprising results that emerged from the tabulation of the responses. The validity of the responses rests on the assumption that responsibility for completing this part of the questionnaire was placed with someone who had the knowledge to give a complete answer or who was willing to do some research. Even the person most familiar with a particular acquisition may have had difficulty remembering the details if it was a small acquisition that had taken place as long as 17 years earlier. Some of these difficulties are reflected in a nonresponse rate of about 36 per cent on this question. In addition, firms that did respond did not try to provide quantitative information. This made their task manageable, since it is much easier to isolate areas where economies had occurred than to estimate their extent. However, this factor is both a strength and a weakness of the tabulation shown in Table A-5. While it may lend some reliability to the responses in those areas reported to be the most important sources of economies, the crucial question of *how* important still remains unanswered.

There was one questionnaire for each acquisition. In tabulating the responses, problems arose quite frequently when more than one economy was mentioned, since the answers were in essay form and were not ranked. In such cases the economies were ranked on the basis of the impression conveyed to the questionnaire editors of their relative importance. The distribution in Table A-5 is based on the economies that were ranked first. This permits a one-to-one correspondence between, on the one hand, the number of times *any* economies were reported and the number of times *no* economies were reported, and, on the other hand, the number of acquisitions covered. The response rate varied among each of the three categories. In the case of mergers involving a horizontal relationship between manufacturing firms, 71 per cent of the questionnaires attempted to detail reported economies; the response rate covering all acquired manufacturing firms fell to 67 per cent while the broader tabulation for all mergers covered by the survey elicited answers on only 64 per cent of the questionnaires. Nonresponses were eliminated from the tabulations.

Table A-5

PERCENTAGE DISTRIBUTION OF REPORTED ECONOMIES IN ALL ACQUISITIONS AND IN THOSE WHERE THE ACQUIRED FIRM WAS CLASSIFIED IN THE MANUFACTURING SECTOR, 1946-61

Reported Economies	Manufacturing Industry		All Industry
	Horizontal	All	All Acquisitions
Administration and management	33.5	27.2	24.7
Integration of plants and use of raw materials	15.2	9.5	6.5
Volume buying	2.7	2.8	5.4
Cheaper to buy than build	2.7	3.5	4.3
Promotion, selling and distribution	3.1	3.3	4.6
Transportation	4.0	3.2	2.9
Improved position in selling	1.8	1.5	1.9
Integration of nonmanufacturing establishments	1.3	0.7	1.8
Cheaper financing	0.0	0.2	0.9
Now cheaper to produce than purchase commodities	0.9	1.2	0.6
Negligible or no realized economies	34.8	46.9	46.4

Several figures in Table A-5 are worth noting. First, there is the large percentage of acquisitions that, in the opinion of the acquiring company, yielded negligible or no economies. However, the percentage of cases where this occurred was substantially lower for horizontal acquisitions within manufacturing. This is to be expected, since the closer the market relationship between the merging firms, the larger is likely to be the number of points where the same or similar operations are carried on and the greater is the potential for economies to be realized. Conversely, one would expect negligible or no economies to be reported where the merger involved firms having no clearly defined market relationship between their main activities. And in fact this was so in almost 60 per cent of the acquisitions of manufacturing firms that fell into our definition of conglomerate. If those

conglomerate mergers involving a broadly horizontal or vertical market relationship between the firms' *subsidiary* activities were included, the actual percentage of conglomerate mergers in which no economies were reported would be even higher.

A second point that stands out is that administration and management were considered to be far and away the most important sources of economies. It is of interest that this was the case not only for all acquisitions but for horizontal market relationships within manufacturing. Given the attention that has been focused on scale and specialization in manufacturing, one might have expected, in looking at reasons for horizontal acquisitions, that responses would have clustered more heavily on economies achieved through the integration of plants and the better use of raw materials. That economies in administration and management were reported more frequently must be regarded as a surprising finding.

Some of the difference in the importance attached by the acquiring firms to these two reasons may be due to the difference in the speed with which they yield cost savings. If plants are too small to fully exploit scale economies, placing them under common ownership will not suddenly make them bigger. Only over a period of years may it be possible to consolidate production in larger plants. However, if the merging firms are duplicating the production of more than one product, they may be able to lengthen production runs by specializing output within the different plants. This should take much less time to accomplish than the building of new facilities. But very little detail was offered in the replies when integration of plants was given as a source of economies, and increased specialization was mentioned in only a small number of cases.

We can only repeat that too much should not be read into these results and that a good deal of further exploration and analysis is required in this area.

C. R&D Expenditures by Firm Size

One aspect of corporate behaviour with which public policy has concerned itself in Canada is research and development. But as Chapter 5 pointed out, competition policy cannot and should not be administered on the basis of any such easily conceived assumption that the larger the size of a firm, the greater the amount of R&D and innovation that will be undertaken, or that a larger volume of R&D expenditures will always necessarily produce benefits commensurate with the resources absorbed. Instead, there will be required a case-by-case approach in the examination of those aspects of market structure, behaviour and performance where R&D plays an important role.

Table A-6 presents an analysis of R&D expenditures undertaken intramurally by 684 companies in 21 broadly defined industries in 1965. Again it is necessary to inject a warning about the limitations of this analysis in light of the lumpiness of the industrial categories. But a count of the size classification of the largest spenders serves at least to refute any simple notion that R&D expenditures rise with firm size. As Table A-6 reveals, in nine industries the highest relative R&D expenditures were incurred by the smallest size class, while middle-sized firms predominated in seven industries and the largest is only five industries. Any assessment of the benefits produced by the expenditures undertaken is beyond the scope of this analysis.

Table A-6

CURRENT INTRAMURAL R&D EXPENDITURES
PER ONE HUNDRED DOLLARS OF SALES,
BY INDUSTRY AND COMPANY SALES, 1965

Industry	Company Size (Sales in millions of dollars) Less than 10	10 to 49.9	50 or More	Total
Mines	1.3	1.5*	0.8	1.0
Gas and oil wells	0.5	0.9*	0.4	1.2
Manufacturing:				
Food and beverages	0.6*	0.1	0.2	0.2
Rubber	0.6	0.6	1.2*	1.2
Textiles	1.6*	1.3	0.6	1.0
Wood	0.2	0.4*	0.1	0.2
Furniture and fixtures	0.4*	0.2	--	0.3
Paper	0.8*	0.5	0.4	0.6
Primary metals (ferrous)	--	0.2	0.5*	0.5
Primary metals (nonferrous)	3.3*	0.2	0.8	0.9
Metal fabricating	1.0*	0.5	0.2	0.5
Machinery	1.1*	0.9	0.9	0.9
Aircraft and parts	3.5	17.0	17.8*	16.7
Other transportation equipment	0.7*	0.3	0.1	0.1
Electrical products	5.1	3.4	5.5*	4.8
Nonmetallic mineral products	0.5	0.7*	0.1	0.5
Petroleum products	--	0.8*	0.6	0.6
Drugs and medicines	3.0	7.0*	--	4.5
Other chemical products	1.5	1.2	2.0*	1.7
Scientific and professional instruments	4.5	7.6*	--	6.7
Other manufacturing	2.9*	0.6	0.2	0.6
Manufacturing -- Total	2.1	1.3	1.1	1.3

* Indicates the size classification of companies undertaking the *largest* volume of R&D expenditures in relation to sales in an industry.

Source: Dominion Bureau of Statistics, *Research and Development Expenditures in Canada*, Table 33.

Notes and References

[1] Gideon Rosenbluth, *Concentration in Canadian Manufacturing Industries*, National Bureau of Economic Research, Princeton, Princeton University Press, 1957.

APPENDIX IV

THE INTERDEPENDENCY OF THE CANADIAN ECONOMY

In Chapter 6 of this Report, we recommend that steps be taken to open a road for the federal government to enact civil legislation in the field of competition policy. In doing so, we explicitly disavow any desire to establish exclusive federal occupancy of this field; on the contrary, we express the hope that the provinces will come to play a useful role in the field under the constitutional powers already available to them. But we must recognize at the same time that the federal government has hitherto been the sole *de facto* occupant of the field, that certain industrial activities international and/or interprovincial in their scope would be impossible to subject effectively to any provincial competition policy, and that there exists a valid concept of the Canadian economy as a coherent whole with numerous links of interdependence between its various parts. In the light of these considerations, and of the severe constraints which the exclusively criminal law basis has imposed on Canadian competition policy in the past, we conclude that it is essential to have a federal "presence" in the field based partly on civil law.

The purpose of this Appendix is to document somewhat further the concept of the Canadian economy as an interdependent organism. This is necessarily done in terms of available statistics, which, though highly suggestive, are far from complete and ideal for the purpose. They cannot, for example, be readily adjusted to give greater weight to "basic" industries such as transportation, banking, steel and cement. Such a weighting might well be justified on the grounds that links of interdependence involving such industries are more strategic than other interindustry relationships.

The particular statistical evidence given here related to the extent to which plants in any province or region (a) draw from suppliers, and (b) sell to customers, located in other provinces or regions or in foreign countries. This covers only one aspect of interdependence, and it does not of course clearly isolate the reasons why the degree of interdependence varies from industry to industry. The reasons are many and varied; a few only may be suggested here. A firm's

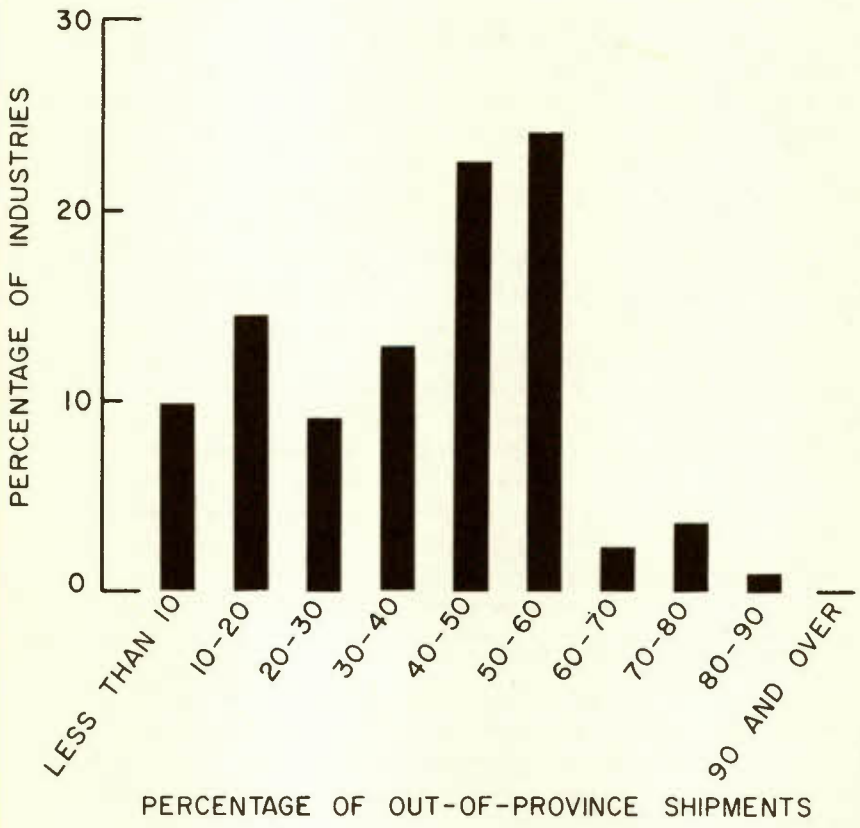
output may be of such a nature that it must locate close to either or both of its sources of supply and its market outlets. As was pointed out in Chapter 5, many service industries, industries producing perishable products, and industries where the bulk or weight of the product is high relative to its value, fall into this category. Some firms not producing for sales direct to consumers may be so strategically located that the bulk of their output may be efficiently produced and distributed within the region in which they are located. Under former tariff and other arrangements, this was to a large extent the situation of the complex of automobile parts and accessory plants serving the major automobile assembly plants in Ontario. Now, however, with the institution of the North American automobile agreement and the growth of assembly operations in Quebec, markets outside Ontario have become relatively more important.

Still other firms may show only a very insignificant degree of reliance on other regions or countries because they are faced with barriers to entry into these areas which frustrate attempts to expand their markets.

It must also be appreciated that the statistics document only what might be called "primary interdependence". They reveal nothing about the secondary effects of firms' purchases and sales. The activities of a firm that buys all its requirements within the region in which its plant is located may still have a very significant, although less direct, impact on other regions from the effect of its purchases on firms that rely on outside sources of supply. Similarly, shipments immediately destined for the same province in which they are produced are often reshipped after further processing to manufacturers outside the province, for use as inputs into their products, or move on directly to consumers in other provinces. Any study of the degree to which industries or parts of industries in any province are related to the economy outside the province should in principle take into account all relationships between industries, both within the province and outside it. Unfortunately, the information with which to make such detailed analysis is not available. The input-output data that are at hand provide, nevertheless, a useful starting point.

Chart A-2

INTERPROVINCIAL AND INTERNATIONAL SHIPMENTS AS PERCENTAGE OF TOTAL SHIPMENTS BY ESTABLISHMENTS IN 132 FOUR-DIGIT MANUFACTURING INDUSTRIES IN CANADA IN 1967(1)



(1) Figures for Quebec are for 1961. The results of the 1967 survey of Quebec establishments have not yet been released. The percentages of inter-provincial and international shipments for Quebec and the rest of Canada were combined using the respective shares of each in total Canadian sales in each industry. Where weights were not available, Quebec was given a weight of 35 per cent and the rest of Canada 65 per cent.

The first source of information is data on the destination of shipments made in 1967 by establishments in 132 manufacturing industries in Canada taken from a survey conducted by the Dominion Bureau of Statistics. Based on this tabulation, we have calculated the percentage of the total output of these industries shipped outside the province in which the production facilities were located. As Chart A-2 shows, close to 30 per cent of the manufacturing industries sold over 50 per cent of their output in other provinces and in international markets. In only 10 per cent of the industries tabulated did shipments outside the production region account for less than 10 per cent of the sales of the industry. There were 13 manufacturing industries in this group: feed, wooden boxes, corrugated boxes, engraving and duplicate plates, cement, lime, concrete products, ready-mix concrete, stone products, poultry processing, ice cream, embroidery, and men's clothing contractors. It should be noted that this list is probably incomplete. If the data had incorporated all Canadian manufacturing industries rather than just the 132 manufacturers for which information was available, one might also expect a relatively low percentage of reliance on extraprovincial and international markets to have shown up in such industries as soft drinks, bakeries, flour mills and milk pasteurizing plants. On the other hand, some of the other industries excluded might well have shown above-average degrees of dependency on other regions and other countries.

Table A-7, which supplements Chart A-2, indicates that the picture of dependency on outside markets is not substantially altered if the classification is done on the basis of the *value of shipments* rather than the number of industries.

It is difficult to draw a clear line between "high" and "low" dependence on a purely statistical basis. A firm might sell as little as 5 per cent of its output outside its own province or region; yet the sudden loss of that 5 per cent would be a highly distressing event.

An analysis of the destination of shipments is only one aspect of interdependence. Another concerns the source of raw materials and other inputs used in the productive process. The relevant data on this subject are available only for each of the Atlantic

Provinces. For purposes of a sample presentation here, Nova Scotia -- the largest Atlantic province in terms of economic activity -- has been selected. The basic figures are data for 1960 on the degree to which 58 Nova Scotian firms relied on sources outside the province for their supplies of material inputs. First, however, to provide a reference point for comparisons with Chart A-2, extraprovincial shipments made by these same industries, which include some nonmanufacturing as well as manufacturing industries, are shown in Chart A-3. The higher degree of reliance on interprovincial and international markets shown by manufacturing industries, as compared with nonmanufacturing industries, is one of the significant features of this Chart.

Table A-7

INTERPROVINCIAL AND INTERNATIONAL SHIPMENTS AS PERCENTAGE OF TOTAL SHIPMENTS BY ESTABLISHMENTS IN 132 FOUR-DIGIT MANUFACTURING INDUSTRIES IN CANADA IN 1967(1)

Interprovincial and International Shipments as Percentage of Total Shipments	Percentage of Industries and Shipments Accounted for by Industries in Each Decile Range	
	Industries	Shipments(2)
0- 9.9	9.85	13.52
10- 19.9	14.39	11.34
20- 29.9	9.09	5.53
30- 39.9	12.88	15.06
40- 49.9	22.73	18.26
50- 59.9	24.24	28.94
60- 69.9	2.27	1.16
70- 79.9	3.79	5.33
80- 89.9	0.76	0.79
90-100.0	--	--

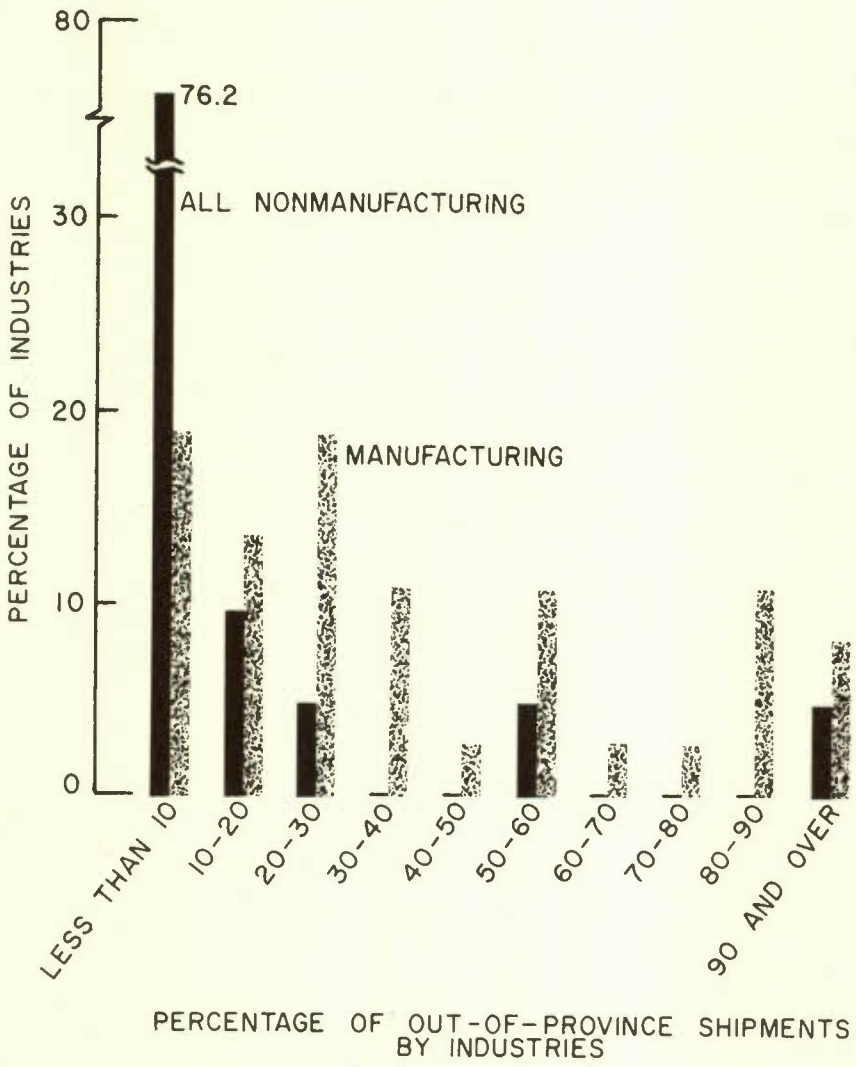
(1) See footnote to Chart A-2.

(2) Based on value of shipments in 1961.

Source: Dominion Bureau of Statistics and Quebec Bureau of Statistics.

Chart A-3

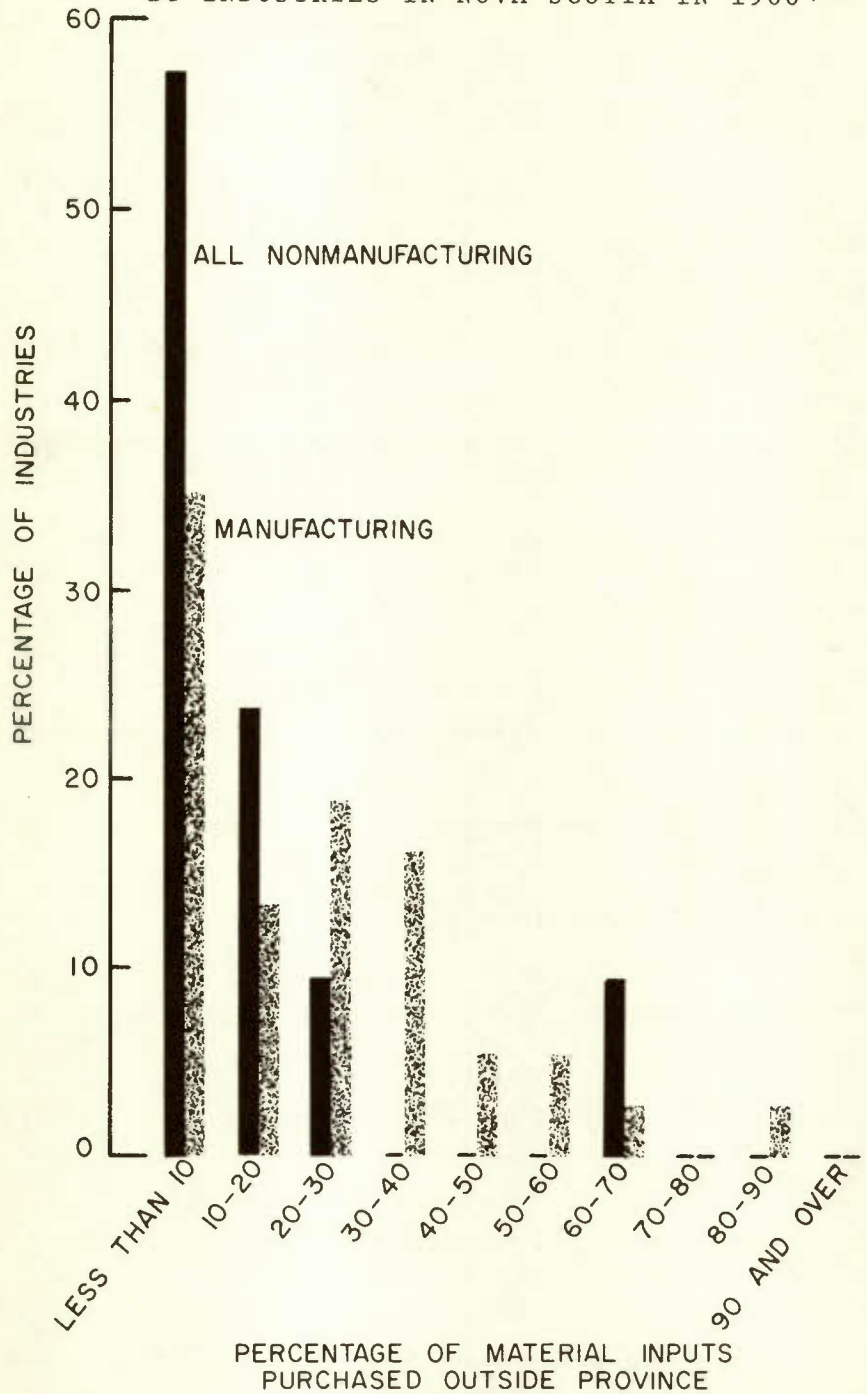
PERCENTAGE OF
INTERPROVINCIAL AND INTERNATIONAL SHIPMENTS AND SALES
FOR INDUSTRIES IN NOVA SCOTIA DURING 1960(1)



(1) The data included here cover 37 broadly defined manufacturing industries, 7 primary nonmanufacturing industries and 14 service industries.

Chart A-4

PERCENTAGE OF MATERIAL INPUTS
NOT PRODUCED IN NOVA SCOTIA
AND PURCHASED OUTSIDE THE PROVINCE
BY INDUSTRIES IN NOVA SCOTIA IN 1960(1)



(1) See footnote to Chart A-3.

Table A-8

PERCENTAGE OF
INTERPROVINCIAL AND INTERNATIONAL SHIPMENTS
CROSS-CLASSIFIED WITH PERCENTAGE OF
OUT-OF-PROVINCE MATERIAL INPUTS:(1)
NOVA SCOTIA INDUSTRIES,(2) 1960

	Shipments										
Inputs	Less than 10	10-20	20-30	30-40	40-50	50-60	60-70	70-80	80-90	90 & Over	Total
Less than 10	M:3 P:2 S:6	M:1 P:2	M:3 S:1			M:1 P:1	M:1		M:2	M:2	M:13 P: 5 S: 7
10-20	 S:4		M:2	M:2	M:1					P:1	M: 5 P: 1 S: 4
20-30	M:2 P:1 S:1	M:3	M:1						M:1		M: 7 P: 1 S: 1
30-40	M:1	M:1		M:1		M:1		M:1	M:1		M: 6
40-50			M:1	M:1							M: 2
50-60	M:1									M:1	M: 2
60-70	 S:2					M:1					M: 1 S: 2
70-80											
80-90						M:1					M: 1
90 & Over											
Total	M: 7 P: 3 S:13	M:5 P:2	M:7 S:1	M:4	M:1	M:4 P:1	M:1	M:1	M:4	M:3 P:1	M:37 P: 7 S:14

M: Manufacturing industries.
P: Primary nonmanufacturing industries.
S: Service industries.

(1) Inputs include only those not produced in Nova Scotia and purchased outside the province.

(2) 37 manufacturing, 7 primary nonmanufacturing and 14 service industries.

Chart A-4 indicates in a rough way the extent to which the materials and equipment required to produce the goods and services of Nova Scotian industry in 1960 came from sources outside the province. This, however, gives only a partial picture of the dependence on outside resources, because the "imported" materials and equipment include only those items that could not also be obtained from competing sources within the province. "Competitive" items obtained partly from within the province and partly outside it are not included, and this feature of the statistics is not readily remediable. Even on this understated basis, the Chart indicates that nearly a third of Nova Scotia manufacturing industries obtained 30 per cent or more of their material inputs wholly from outside the province. As in the case of shipments, the "external dependency" percentage for nonmanufacturing industries was markedly lower.

Table A-8 combines the data on shipments to other provinces and to international markets with the data on the material inputs not produced in Nova Scotia and purchased from outside suppliers. The first box in this input-output matrix shows that only 11 of the 58 industries tabulated here for the year 1960 were relatively independent of *both* outside markets *and* outside sources of supply. ("Relatively independent" is here defined to mean a degree of dependence on extraprovincial supplies and sales equivalent to less than 10 per cent.)

To sum up, these various figures indicate that even in terms of the two dimensions of interdependency for which some sort of statistics exist, it is possible to identify a major sector of interdependent industry in Canada. The concept of a national economy, characterized by important visible trade flows between itself and other national economies, and between its own provinces and major economic regions, is therefore a valid one. There seems no doubt that the concept would be reinforced if it were possible to delineate statistically some of the "invisible" or service flows between regions, including notably flows of banking, financial and federal government services. It is also worth observing, in the present context, that *potential* as well as *actual* flows between regions are of economic significance: the fact, for example, that a Nova Scotian user of steel made within the province could, if he wished, obtain tariff-free steel

from outside the province (subject, of course, to a freight rate) is highly likely to influence the price and other conditions under which he obtains steel locally. One could further develop this example to show how the efficacy of competition policy and the strength of competition in one province or region would affect the strength of competition and consumer welfare in other provinces and regions.

All this leads to the conclusion that an effective competition policy in Canada must be organized, at least in part, on a national basis. We have noted that while provincial governments have not hitherto participated to any important extent in competition policy, they could do so under their existing constitutional powers, and we would urge them to follow this course. But even if this were done, a federal component of competition policy, part of it based on civil powers, is clearly indispensable.

APPENDIX V

A. SELECTED SECTIONS OF THE *EXISTING* COMBINES INVESTIGATION ACT REFERRED TO IN THE TEXT OF THIS REPORT

2. In this Act, ...

(e) "merger" means the acquisition by one or more persons, whether by purchase or lease of shares or assets or otherwise, of any control over or interest in the whole or part of the business of a competitor, supplier, customer or any other person, whereby competition

(i) in a trade or industry,

(ii) among the sources of supply of a trade or industry,

(iii) among the outlets for sales of a trade or industry, or

(iv) otherwise than in subparagraphs (i), (ii) and (iii), is or is likely to be lessened to the detriment or against the interest of the public, whether consumers, producers or others;

(f) "monopoly" means a situation where one or more persons either substantially or completely control throughout Canada or any area thereof the class or species of business in which they are engaged and have operated such business or are likely to operate it to the detriment or against the interest of the public, whether consumers, producers or others, but a situation shall not be deemed a monopoly within the meaning of this paragraph by reason only of the exercise of any right or enjoyment of any interest derived under the *Patent Act*, or any other Act of the Parliament of Canada;

29. Whenever, from or as a result of an inquiry under the provisions of this Act, or from or as a result of a judgment of the Supreme Court or Exchequer Court of Canada or of any superior, district or county court in Canada, it appears to the satisfaction of the Governor in Council that with regard to any article there has existed any conspiracy, combination, agreement, arrangement, merger or monopoly to promote unduly the advantage of manufacturers or dealers at the expense of the public, and if it appears to the Governor in Council that such disadvantage to the public is presently being facilitated by the duties of customs imposed on the article, or on any like article, the Governor in Council may direct either that such article be admitted into Canada free of duty, or that the duty thereon be reduced to such amount or rate as will, in the opinion of the Governor in Council, give the public the benefit of reasonable competition.

30. In any case where use has been made of the exclusive rights and privileges conferred by one or more patents for invention or by one or more trade marks so as

(a) unduly to limit the facilities for transporting, producing, manufacturing, supplying, storing or dealing in any article or commodity which may be a subject of trade or commerce; or

(b) unduly to restrain or injure trade or commerce in relation to any such article or commodity; or

(c) unduly to prevent, limit or lessen the manufacture or production of any such article or commodity or unreasonably to enhance the price thereof; or

(d) unduly to prevent or lessen competition in the production, manufacture, purchase, barter, sale, transportation or supply of any such article or commodity;

the Exchequer Court of Canada, on an information exhibited by the Attorney General of Canada, may for

the purpose of preventing any use in the manner defined above of the exclusive rights and privileges conferred by any patents or trade marks relating to or affecting the manufacture, use or sale of such article or commodity, make one or more of the following orders:

(i) declaring void, in whole or in part, any agreement, arrangement or licence relating to such use;

(ii) restraining any person from carrying out or exercising any or all of the terms or provisions of such agreement, arrangement or licence;

(iii) directing the grant of licences under any such patent to such persons and on such terms and conditions as the court may deem proper, or, if such grant and other remedies under this section would appear insufficient to prevent such use, revoking such patent;

(iv) directing that the registration of a trade mark in the register of trade marks be expunged or amended; and

(v) directing that such other acts be done or omitted as the Court may deem necessary to prevent any such use;

but no order shall be made under this section which is at variance with any treaty, convention, arrangement or engagement respecting patents or trade marks with any other country to which Canada is a party.

32. (1) Every one who conspires, combines, agrees or arranges with another person

(a) to limit unduly the facilities for transporting, producing, manufacturing, supplying, storing or dealing in any article,

(b) to prevent, limit or lessen, unduly, the manufacture or production of an article, or to enhance unreasonably the price thereof,

(c) to prevent, or lessen, unduly, competition in the production, manufacture, purchase, barter, sale, storage, rental, transportation or supply of an article, or in the price of insurance upon persons or property, or

(d) to restrain or injure trade or commerce in relation to any article,

is guilty of an indictable offence and is liable to imprisonment for two years.

(2) Subject to subsection (3), in a prosecution under subsection (1) the court shall not convict the accused if the conspiracy, combination, agreement or arrangement relates only to one or more of the following:

(a) the exchange of statistics,

(b) the defining of product standards,

(c) the exchange of credit information,

(d) definition of trade terms,

(e) co-operation in research and development,

(f) restriction of advertising, or

(g) some other matter not enumerated in subsection (3).

(3) Subsection (2) does not apply if the conspiracy, combination, agreement or arrangement has lessened or is likely to lessen competition unduly in respect of one of the following:

(a) prices,

(b) quantity or quality of production,

(c) markets or customers, or

(d) channels or methods of distribution,

or if the conspiracy, combination, agreement or arrangement has restricted or is likely to restrict any person from entering into or expanding a business in a trade or industry.

(4) Subject to subsection (5), in a prosecution under subsection (1) the court shall not convict the accused if the conspiracy, combination, agreement or arrangement relates only to the export of articles from Canada.

(5) Subsection (4) does not apply if the conspiracy, combination, agreement or arrangement

(a) has resulted or is likely to result in a reduction or limitation of the volume of exports of an article;

(b) has restrained or injured or is likely to restrain or injure the export business of any domestic competitor who is not a party to the conspiracy, combination, agreement or arrangement;

(c) has restricted or is likely to restrict any person from entering into the business of exporting articles from Canada; or

(d) has lessened or is likely to lessen competition unduly in relation to an article in the domestic market.

33. Every person who is a party or privy to or knowingly assists in, or in the formation of, a merger or monopoly is guilty of an indictable offence and is liable to imprisonment for two years.

33A. (1) Every one engaged in a business who

(a) is a party or privy to, or assists in, any sale that discriminates to his knowledge, directly or indirectly, against competitors of a purchaser of articles from him in that any discount, rebate, allowance, price concession or other advantage is granted to the purchaser over and above any discount, rebate,

allowance, price concession or other advantage that, at the time the articles are sold to such purchaser, is available to such competitors in respect of a sale of articles of like quality and quantity;

(b) engages in a policy of selling articles in any area of Canada at prices lower than those exacted by him elsewhere in Canada, having the effect or tendency of substantially lessening competition or eliminating a competitor in such part of Canada, or designed to have such effect; or

(c) engages in a policy of selling articles at prices unreasonably low, having the effect or tendency of substantially lessening competition or eliminating a competitor, or designed to have such effect,

is guilty of an indictable offence and is liable to imprisonment for two years.

(2) It is not an offence under paragraph (a) of subsection (1) to be a party or privy to, or assist in any sale mentioned therein unless the discount, rebate, allowance, price concession or other advantage was granted as part of a practice of discriminating as described in that paragraph.

(3) The provisions of paragraph (a) of subsection (1) shall not be construed to prohibit a co-operative society from returning to producers or consumers, or a co-operative wholesale society from returning to its constituent retail or wholesale members, the whole or any part of the net surplus made in its trading operations in proportion to purchases made from or sales made to the society.

33B. (1) In this section "allowance" means any discount, rebate, price concession or other advantage that is or purports to be offered or granted for advertising or display purposes and is collateral to a sale or sales of articles but is not applied directly to the selling price.

(2) Every one engaged in a business who is a party or privy to the granting of an allowance to any purchaser that is not offered on proportionate terms to other purchasers in competition with the first-mentioned purchaser, (which other purchasers are in this section called "competing purchasers"), is guilty of an indictable offence and is liable to imprisonment for two years.

(3) For the purposes of this section, an allowance is offered on proportionate terms only if

(a) the allowance offered to a purchaser is in approximately the same proportion to the value of sales to him as the allowance offered to each competing purchaser is to the total value of sales to such competing purchaser,

(b) in any case where advertising or other expenditures or services are exacted in return therefor, the cost thereof required to be incurred by a purchaser is in approximately the same proportion to the value of sales to him as the cost of such advertising or other expenditures or services required to be incurred by each competing purchaser is to the total value of sales to such competing purchaser, and

(c) in any case where services are exacted in return therefor, the requirements thereof have regard to the kinds of services that competing purchasers at the same or different levels of distribution are ordinarily able to perform or cause to be performed.

33C. (1) Every one who, for the purpose of promoting the sale or use of an article, makes any materially misleading representation to the public, by any means whatever, concerning the price at which such or like articles have been, are, or will be, ordinarily sold, is guilty of an offence punishable on summary conviction.

(2) Subsection (1) does not apply to a person who publishes an advertisement that he accepts in good faith for publication in the ordinary course of his business.

34. (1) In this section "dealer" means a person engaged in the business of manufacturing or supplying or selling any article or commodity.

(2) No dealer shall directly or indirectly by agreement, threat, promise or any other means whatsoever, require or induce or attempt to require or induce any other person to resell an article or commodity

(a) at a price specified by the dealer or established by agreement,

(b) at a price not less than a minimum price specified by the dealer or established by agreement,

(c) at a markup or discount specified by the dealer or established by agreement,

(d) at a markup not less than a minimum markup specified by the dealer or established by agreement, or

(e) at a discount not greater than a maximum discount specified by the dealer or established by agreement,

whether such markup or discount or minimum markup or maximum discount is expressed as a percentage or otherwise.

(3) No dealer shall refuse to sell or supply an article or commodity to any other person for the reason that such other person

(a) has refused to resell or to offer for resale the article or commodity

(i) at a price specified by the dealer or established by agreement,

(ii) at a price not less than a minimum price specified by the dealer or established by agreement,

(iii) at a markup or discount specified by the dealer or established by agreement,

(iv) at a markup not less than a minimum markup specified by the dealer or established by agreement, or

(v) at a discount not greater than a maximum discount specified by the dealer or established by agreement;

(b) has resold or offered to resell the article or commodity

(i) at a price less than a price or minimum price specified by the dealer or established by agreement,

(ii) at a markup less than a markup or minimum markup specified by the dealer or established by agreement, or

(iii) at a discount greater than a discount or maximum discount specified by the dealer or established by agreement.

(4) Every person who violates subsection (2) or (3) is guilty of an indictable offence and is liable on conviction to a fine in the discretion of the court or to imprisonment for a term not exceeding two years or to both.

(5) Where, in a prosecution under this section, it is proved that the person charged refused or counselled the refusal to sell or supply an article to any other person, no inference unfavourable to the person charged shall be drawn from such evidence if he satisfies the court that he and any one upon whose report he depended had reasonable cause to believe and did believe

(a) that the other person was making a practice of using articles supplied by the person charged as loss-leaders, that is to say, not for the purpose of making a profit thereon but for purposes of advertising;

(b) that the other person was making a practice of using articles supplied by the person charged not for the purpose of selling such articles at a profit but for the purpose of attracting customers to his store in the hope of selling them other articles;

(c) that the other person was making a practice of engaging in misleading advertising in respect of articles supplied by the person charged; or

(d) that the other person made a practice of not providing the level of servicing that purchasers of such articles might reasonably expect from such other person.

42. (1) The Director upon his own initiative may and upon direction from the Minister or at the instance of the Commission shall carry out an inquiry concerning the existence and effect of conditions or practices having relation to any commodity which may be the subject of trade or commerce and which conditions or practices are related to monopolistic situations or restraint of trade, and for the purposes of this Act any such inquiry shall be deemed to be an inquiry under section 8.

(2) It is the duty of the Commission to consider any evidence or material brought before it under subsection (1) together with such further evidence or material as the Commission considers advisable and to report thereon in writing to the Minister, and for the purposes of this Act any such report shall be deemed to be a report under section 19.

B. AMENDMENT TO THE COMBINES INVESTIGATION ACT (RE THE TRANSFER OF SECTION 306 OF THE CRIMINAL CODE) AS PASSED BY PARLIAMENT IN JUNE 1969

33D. (1) Every one who publishes or causes to be published an advertisement containing a statement that purports to be a statement of fact but that is untrue, deceptive or misleading or is intentionally so worded or arranged that it is deceptive or misleading, is guilty of an indictable offence and is liable to imprisonment for five years, if the advertisement is published

(a) to promote, directly or indirectly, the sale or disposal of property or any interest therein, or

(b) to promote a business or commercial interest.

(2) Every one who published or causes to be published in an advertisement a statement or guarantee of the performance, efficacy or length of life of anything that is not based upon an adequate and proper test of that thing, the proof of which lies upon the accused, is, if the advertisement is published to promote, directly or indirectly, the sale or disposal of that thing, guilty of an offence punishable on summary conviction.

(3) Subsections (1) and (2) do not apply to a person who publishes an advertisement that he accepts in good faith for publication in the ordinary course of his business.

(4) For the purposes of subsection (2), a test that is made by the National Research Council of Canada or by any other public department is an adequate and proper test, but no reference shall be made in an advertisement to indicate that a test has been made by the National Research Council or other public department unless the advertisement has, before publication, been approved and permission to publish it has been given in writing by the

President of the National Research Council or by the deputy head of the public department, as the case may be.

(5) Nothing in subsection (4) shall be deemed to exclude, for the purposes of this section, any other adequate or proper test.

HC/115/.I57/1969
Economic Council of Canada
Interim report on
competition policy daes
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OCT 3 1 1969
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JAN 24 '73
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DEC 3 0 1987
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