The Great Financialization

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I am honoured and delighted that the Progressive Economics Forum has awarded me the John Kenneth Galbraith prize, and I am especially pleased that it is shared with my friend and colleague Mel Watkins. We go back a long way and we have come through many struggles together. Clearly, Mel Watkins is prima inter pares of Canadian political economists as we have witnessed in the outstanding presentation to this panel and your decision to honour him with the Galbraith award.

In the course of the last few days, I have not been able to attend the Canadian Economics Association conference because it conflicted with the sessions of the Canadian Association for the Study of International Development. Over the years, my areas of work, of research, of interest and of reflection have shifted to the global south. For these reasons, I am particularly moved to receive the Galbraith award because I have not been able to engage with Canadian issues for many years. So, I would like to take this opportunity to express my appreciation and thanks to colleagues at Canadian Centre for Policy Alternatives, to Duncan Cameron who is with us here this afternoon, and so many others for carrying on the good fight in the arena of Canadian political economy so effectively. As Canadian progressive economists, they may be small in numbers compared to mainstream academics but their critique of Canada's drift to deep integration with the American empire has loud resonance among ordinary Canadians.

Unlike John Kenneth Galbraith and Mel Watkins, truly sons of the soil of Canada, born and raised in rural Ontario, I came to this country in 1947, as a delayed war bride. Joe Levitt served with a Canadian Tank Regiment which suffered heavy casualties in Normandy and later fought in Italy. We met in London and married in Toronto in 1950. Joe became a Professor of History at the University of Ottawa and was an active member of Veterans against Nuclear War.

I am sorry that Jamie Galbraith could not be here. It is quite true that we have much in common, among other things, we have illustrious fathers whose heritage of thought we attempt in our various ways to preserve and to promote. When I read Jamie's account of his father's work, I was struck by our common generational experience. Jamie referred to his father's expertise in two matters: price and wage controls during World War II and the effects of allied strategic bombing on the German war economy.

During the war, I was an undergraduate at the London School of Economics, temporarily located in Cambridge, where we enjoyed freedom from archaic restrictions imposed on Cambridge students, while attending courses by Joan Robinson and other Cambridge personalities as well as our own LSE lecturers, largely comprised of European foreigners and so-called colonials. It was my great fortune that the introductory course in economics was taught by W. Arthur Lewis, and in the second year of economics, the courses were given by Nicolas Kaldor and Friedrich Von Hayek.

In two long summer vacations, I worked in war factories operating a large semi-automatic lathe with six tools that in turn would shape long bars of steel into parts and components of airplanes, and rather enjoyed the atmosphere of sociability. In third summer vacation, I participated in a large survey organized by the Ministry of Food to monitor the nutritional levels of the industrial workforce. This was of course at a time when all men in good health were in the armed forces and the industrial workers were those who were less fit or who were older and of course women. Teams of students fanned out all over the country to designated towns where we had to obtain permission from factory management to weigh the workers on scales, whether available in the factories or at coin-operated machines in neighbouring pharmacies. My assignments were in Coventry and Nottingham. It was found that the nutritional levels of the population in wartime England, without the fittest and the youngest of its men, had improved. Food rations enabled the entire population to access basic foods. In addition to the ration, all other food items, when available, were strictly price controlled, as was clothing and other essential consumer goods. Vitamins and orange juice were available free of charge to expecting and nursing mothers and infants. Taken together these measures delivered a more nutritious diet than many families could afford before the war. The merchant marines who transported food across the dangerous seas of the Atlantic contributed significantly to the supply of food, but it was the effective implementation of the principle of equity in its distribution which achieved these remarkable results. The effective mobilization of resources in wartime Britain and the Unites States contrasted with the waste of mass unemployment of prewar years. Under Roosevelt's leadership, the American economy was mobilized for the mass production of tanks, aircrafts and ships as a contribution to the allied war effort. This extraordinary increase in output, with no inflation, was achieved by the administration of price and wage controls. Full employment became the principal economic objective of the post-war international order. This was a personal experience I shared with John Kenneth Galbraith and many millions of others.

This brings me to another, more exclusively shared experience regarding the effects of Allied strategic bombing on the German war economy. As they swept across Germany in the spring of 1945, British and American forces seized the records of German war factories and brought them respectively to London and Washington. The British study was directed by Nicholas Kaldor. The staff consisted of three persons: an experienced statistician, myself engaged in reading and recording the German records in microfiche, and a messenger/tea boy. Kaldor would appear from time to time and he resolved the aggregation problem of how to produce a production index of outputs varying from tiger tanks to small ammunition by simply adding up the weight in tons. The response of German war production to allied strategic bombing of industrial targets and populations was a steady increase in output. The American study directed by Galbraith had a larger staff and produced a more comprehensive report which arrived at the same conclusion. The more we bombed them, the more efficiently their industries were organized and the harder people worked. Just as in Britain, where a twelve-hour shift and seventy-two hour week were not uncommon. In the last few months of the war, German production declined not because of allied bombing but because they ran out of fuel when the Russians recaptured the oil fields and the Luftwaffe was grounded.

In James' talk, he referred to his father's expertise on the subject matter of these studies as highly unfashionable. This is a pity because there are surely lessons to be learned. In the case of the Germans, the effects of waging war against civilian populations and the infrastructure that sustained them only consolidated national support for their war effort.

These personal experiences made a profound impression more enduring than most of the lectures I attended as a student with a notable exception of a brilliant Introduction to Economic Analysis by Prof. Kaldor. In the last two years of the war, I was employed in the Research Department of the Amalgamated Engineering Union, located in one of the most bombed boroughs of South London, whose small staff consisted of four women. My intention was to specialize in labour research after having completed my studies.

On arrival in Canada in 1947, it was expected that I would pursue graduate studies at the University of Toronto. But I found the institution to be quiet dreary, and the most enjoyable experience of that year was a teaching assistantship in a course on English economic history where the professor was content to let me teach a good part of the course. As a means of escape, I lied about my educational attainment and obtained employment at the Acme Screw and Gear Company on Old Weston Road in Toronto, where the work and the social environment were familiar. I was a proud member of UAW-CIO Local 984, predecessor of the CAW. This pleasant experience did not last long, when it became known that I was trained in labour research. I was persuaded to leave the factory for office work. After several years in research, journalism and left wing political activism, I returned to academic study as a graduate student at the Department of Political Economy of the University of Toronto in 1957.

It was here where I first met Mel Watkins as a junior faculty member. Watkins' seminal article "The Staple Theory of Economic Growth," published in 1963 remains the best concise summary of Harold Innis' account of Canadian economic development. At that time, the influence of Innis in economics curricula had not yet gone into decline in the University of Toronto. I had to study in detail the history and the geography of the fur trade, the Atlantic fishery, and the role of timber and wheat in the construction of the Canadian national space as an export economy at the margin of civilization to use the terminology of Innis. Innis was complemented by Donald Craighton's account of political development in the Commercial Empire of the St. Lawrence. Mercantilist ties between the Canadian colony and the English metropole nourished and fed a Canadian business class. The commercial nature of this Canadian elite was inherent in this pattern of development.

In addition to Canadian political economy, courses on mathematical economics; including input-output analysis and linear programming, and a course on economics of underdevelopment, which may well have been the first such course in Canada, attracted my interest.

Professor Burton Keirstead conducted a stimulating seminar on capital theory. He was an original thinker and a challenging teacher. When I brought Joan Robinson's recently published Accumulation of Capital into the class, he suggested it would be a good topic for a Masters' thesis. When I ran into difficulties and sought help from Keirstead, his reply was "When you have understood the argument of the book, please come and explain it to me." He was passionate about the Maritime Provinces of Canada, from whence he came. He encouraged me to study the Atlantic Provinces as a case of regional underdevelopment, a project which eventually became a major statistical study of inter-industry economic flows for each of the four Atlantic provinces. His most fateful influence on my professional trajectory, however, came in 1960, when he introduced me to the West Indies and encouraged me to accept an appointment in the Department of Political Science and Economics at McGill.

In the West Indies, the prospect of political decolonisation raised hopes and dreams of new trajectories. The participants in these animated discussions were principally economists. The question was how to transform the colonial structure of economies which produced what they did not consume, and consumed what they did not produce. The essence of economic development in this view was to reduce the degree of external dependence; to transfer the locus of decision-making from metropolitan to local actors. None of the economic models on offer, whether neo-classical, Keynesian or Marxist, corresponded to the realities of these Caribbean economies dominated by the legacy of centuries of sugar and slavery, and the operations of large foreign companies. In collaboration with Lloyd Best, we sought to develop an economic planning model which could capture the mechanisms of the principal economic flows of a typical Caribbean economy. The legacy of the slave plantations has not been extinguished in the English speaking Caribbean: it hangs most heavily over Jamaica.

My principal contribution to Canadian political economy, *Silent Surrender: The Multinational Corporation in Canada* would never have seen the light of day without Mel. The project began when Charles Taylor asked me to draft a paper on the issue of foreign ownership for a policy committee of the, then recently founded, New Democratic Party. Influential economists close to the NDP argued that foreign capital of any kind was obviously beneficial because it would increase national output, and the gains of economic growth could be redistributed by fiscal measures. They maintained that concerns regarding the loss of cultural identity were misplaced because revenue from economic growth could enhance government support to Canadian cultural industries. The most influential proponent of this conventional wisdom was the Canadian economist, Harry Johnson, commuting between Chicago and the LSE.

In the course of several meetings, including a weekend retreat with members of the national executive of the NDP, I explained that the essential difference between incoming portfolio capital and foreign direct investment was one of control. A subsidiary or affiliate of a multinational corporation located in Canada is not simply a firm whose owners are non-resident. It is an integral part of a larger enterprise and subject to its strategic considerations. A Canada dominated by subsidiaries and branch plants of mainly American companies, could not undertake coherent long-term strategies of industrial development, and thus was destined to remain dependent on primary resource exports.

As I amassed more material to strengthen my argument, the initial policy paper became a small monograph published by my colleague Lloyd Best in 1968 in the *New World Quarterly*, under the title “Economic Dependence and National Disintegration: the Case of Canada.” This little known Caribbean publication began to circulate among Canadian students and was reprinted by Cy Gonnick in Winnipeg. With additional material it was submitted to Macmillan of Canada. The manuscript was sent to a University of Toronto economist, who rejected it with comments that it was ideological, it was not economics, and it had no value. By this time, the publisher rather liked the manuscript and asked me to name another reader. I suggested Mel Watkins and the rest is history. Mel wrote a wonderful introduction and a second one when the book was reissued in 2002.

Mel will surely remember Lloyd Best. We all met at the invitation of Chilean economist Osvaldo Sunkel at Hamburg in a remarkable workshop in 1970. Scholars from diverse places of the world who did not know each other but were working in one form or another with concepts of dependency, were brought together: from Canada, Watkins, myself and the brilliant Stephen Hymer who died far too young in a tragic accident; Lloyd Best from the West Indies; Arghiri Emmanuel known for his "unequal exchange"; Giovanni Arrighi then recently returned from East Africa, and later associated with Wallerstein, Frank and Amin; and Froebel, Heinrichs and Krey, we called the three musketeers, who jointly published a pioneering study on the migration of manufacturing activity to the third world. It was the best workshop I have ever attended. There were no papers but just the excitement of the exchange of ideas. Stephen Hymer kept us up until three in the morning in animated discussion.

The chapter in *Silent Surrender*, entitled "From the Old Mercantilism to the New," suggested that the foreign operations of multinational corporations resembled in some respects those of the old chartered companies in extending the territorial reach of the metropole into foreign lands, a comparison also made by other authors. Although foreign mining companies with concessions over vast territories employing private militias with de facto judicial power do indeed resemble the old chartered companies, corporate manufacturing has no counterpart in the preindustrial era.

Historically, the United States was a high wage economy compared to Europe. The modern cooperation whether horizontally or vertically integrated was an innovative organizational response to these special conditions of continental expansion in the large domestic economy of the United States. Because labour was scarce in relation to land, businesses were motivated to undertake constant technological improvement, and unionized labour was able to share the gains of increased productivity. In the post war era, the typical multinational manufacturing corporation engaged in Schumpeterian strategies of innovation in process and product, and the creation of new consumers for these products by advertising and marketing. Corporations had long-term planning horizons; strategies were designed to increase sales and market share; profits were generally reinvested; dividend payments were conservative; and shareholders of blue-chip stock considered it a long-term investment. Increased sales and market-share and not shareholder value of assets was the objective pursued by the managerial technostructure. This was well described in Galbraith's then recently published *The New Industrial State.* What I found particularly interesting in this work was his insight into the mutually supportive relationship between the managerial technostructure of the corporations and their counterparts in the bureaucratic apparatus of the state.

These "mighty engines of capitalism" as they were once referred to by Mr. Henry Fowler with their networks of production facilities in many countries contributed positively to the US balance of payments by the backflow of profits and interest and the generation of demand for US exports. For the host country, the outflow of interest and profit exceeded the inflow of FDI. Firms established as affiliates could not engage in research and development, they were not permitted to compete with the parent company and did not have the decision-making power to engage in national industrial strategies. My analysis of the effects of increasing foreign control over Canada's manufacturing industries, was not essentially different from the Watkins' report commissioned by Walter Gordon on behalf of the Privy Council of Canada. The Watkins' report was shelved. Walter Gordon resigned and established the Committee for an Independent Canada. The national energy policy proposed by Prime Minister Trudeau was resoundingly rejected by the Canadian business elite. With few exceptions like Walter Gordon and Eric Kierans, the Canadian business elite did not have a long-term view of developing independent national industries or a coherent Canadian national economy. Nor did the labour movement.

By and large the Canadian labour movement did not support policies of economic nationalism. The Canadian subsidiaries of major U.S. manufacturing corporations, like General Motors or General Electric generated substantial employment at good wages. They were unionized. Workers could expect employment in one company for a lifetime; real wages increased annually. Working conditions in U.S. affiliates were usually better than those in Canadian owned companies. Leftist critics of Canadian economic nationalism saw no advantage in Canadian ownership or control of industry. A capitalist is a capitalist. What is the difference?

The Auto Pact of 1965 was a unique legally binding international agreement negotiated between the Big Three American automobile companies and the governments of United States and Canada. In this continental rationalization of production facilities, Canada secured provisions for 60 percent domestic content favouring the Canadian production of parts and components. Skilful negotiation and good luck in the choice of production of popular models in Canada yielded substantial gains for Canadian autoworkers. There was a large increase in Canadian production and exports of cars, trucks and parts accounting for approximately one-quarter of Canadian merchandise exports—exclusively to the United States.

But, the ultimate result of opting for a "special relationship" with the Big Three, rather than encouraging a genuine Canadian industry, was vulnerability to decisions by American companies to scale down their operations in Canada, with attendant loss of employment. The implicit decision not to opt for an indigenous car industry because it would have been more costly and risky, was characteristic of the mercantile nature of the Canadian business classes. Among developed countries, Canada is unique in not having even one national brand. Almost all the developed and many developing countries, much poorer than Canada, established genuinely independent automobile industries gaining a competitive advantage in the uniqueness of their products.

Canadian autoworkers and communities dependent on the industry are now paying the price of the special relationship. In the course of the past ten years, there have been plant closures, and major reductions in employment. In Ontario, where most of the industry is located, 30,000 jobs have been lost since 2001 with 10,000 more scheduled to disappear. The share of transportation equipment in Canada's exports has decreased from 21 percent in 2003 to 16 percent in 2007. Within this total, all the sub-sectors of the industry have declined. There is speculation that in the future there may not be a single assembly plant remaining in Canada. Only the independently owned auto parts industry has a chance of survival. The desperate situation of the Canadian auto workers was signalled by the recent agreement between the CAW and the largest auto parts producer, who guaranteed security of employment in exchange for the abrogation of the right to strike.

Ontario has suffered a loss of 200,000 manufacturing jobs in the past four years and the trend continues. Ontario, the industrial heartland of Canada, with the largest population, has historically been the richest province. No longer so. Its GDP per capita is now $1000 below the national average; $30,000 below that of Alberta, and $12,000 below Newfoundland. For years, Ontario attracted migrants from poorer provinces. For the first time since records were kept, there has been a net out migration from Ontario to other provinces. Some people maintain that the loss of manufacturing jobs is no cause for alarm because there has been a compensating growth of employment in the service sectors, which now employ more than 5 million people in Ontario. But no country can sustain a decent standard of living for its working population without dynamic, nationally owned, enterprises engaged in manufacturing. The recent sale of what is left of iconic Canadian business to foreign megacorporations or private equity funds is cause for serious concern. The critical importance of policies favouring nationally owned enterprise is the lesson of successful economic development both in Europe and in Asia. In countries which have succeeded in maintaining employment in manufacturing, governments have engaged in strategic industrial policies which offer assistance to innovative technological development in business and educational institutions. This is better understood in Quebec—which has successfully nurtured Quebec-based world-class manufacturing and engineering corporations—than in the rest of Canada. Indeed, it is questionable whether Canada still has a national economy in any meaningful sense of the term. We have to ask how it can be that Canada, the largest supplier of petroleum to the United States at a time when oil prices are at record high, is experiencing a melting down of its industrial heartland? In any rationally organized national economy, the rents from the resource sector would be invested in the long term development of human resources and cutting edge technologies of manufacturing activity.

The Canadian national economy constructed in the nineteenth century on an east west corridor, was a political project known by historians as the Canadian National Policy. Its three principal instruments were a trans-continental railway, commercial policy to promote industrialization in Ontario and Quebec, and assisted immigration and land grants to develop the agricultural resources of the Prairie. Over the years, this east west economy based on a special relationship with Britain was transformed by north south links of trade and investment with the United States along the 3000 miles of shared border. The political fragmentation implied in these changing patterns of trade required deliberate policy measures by the federal government to counteract the disintegrating effects of the pull of economic forces. Canada emerged from the second world war with a strengthened industrial base in Ontario and Quebec. The introduction of social security measures including old age pensions and universal health care, financed by progressive taxation; transfer payments from richer to poorer provinces; welcoming immigration policies; federal expenditures on communication and the arts, including the National Film Board and the Canadian Broadcasting Corporation; and participation in all aspects of the United Nations system, gained

Canada international respect. Expo ‘67 marked the high point of Canadian post war achievement.

This model of ‘embedded liberalism’, which yielded three decades of high growth, was underpinned by an institutional framework which regulated and restricted both the power and the mobility of capital. Finance was subservient to production. Financial institutions channelled savings to investment and were strictly regulated. Central banks served as instruments of the government, with full employment as primary objective; price stability was secondary. Banks were not permitted to charge more than six percent interest on loans or to engage in mortgage or investment banking. There were exchange controls, and no private trading in foreign currencies. Social expenditures were financed by progressive income taxation. In Canada, the highest tax brackets was 80 percent; in the United States it was even higher at 94 percent.

From 1945 to the mid 1970s, the distribution of income in North America was more equitable than ever before or since. At that time, in the United States, the average earnings of the super rich 0.01 percent of families was only 200 times greater than the average earnings of 90 percent of American families. In the 1980s, this measure of income disparity increased from 300 to 500, and continued to increase throughout the 1990s. In 2006 the income of the super rich was 976 times greater than that of 90 percent of American families. Income inequality is now even more extreme than it was in 1929, when the ratio was 1 to 892. In the United States, median family income has increased by only $8000 since 1980, and this increase is primarily due to more family members contributing to family income. In Canada, trends are similar. Median family income has increased somewhat, but Statistics Canada reported that median earnings of full-time wage and salary earners have stagnated in the 25 years since 1980. Median earnings of the top quintile rose by 16 percent, while the highest .01 percent of wage and salary earners doubled their income from 3 to 6 million in the same period. The bottom quintile suffered a decline of 21 percent. In these 25 years, GDP has doubled, but the gains from economic growth have largely accrued to high-income earners, while low income earners have been impoverished. These statistics stand in strong contrast to the prevailing trends from 1950s to the 1980s, when GDP growth in the US and Canada was accompanied by rising real earnings of full-time wage and salary earners.

So what has happened to the good unionized jobs in iconic corporations like General Motors or General Electric? These companies today are not the same as they were in the 1960s and 1970s. For all the faults we found with them those times were good compared with the present. Why does productivity increase no longer result in higher labour incomes? How have the gains of labour been rolled back since the 1980s? How has the power of labour so declined that the once mighty UAW/CAW negotiated a no-strike agreement? How has the distribution of income so deteriorated, with similarities to the ‘dance of the millions’—now billions—which preceded the crash of 1929? How have we arrived at a financial crisis which threatens to project the real economy into a deflationary spiral of rising unemployment and increasing poverty? Why have democratic institutions in Canada and the U.S. failed to protect the economic security of the majority of the population?

For the last two hundred years and most spectacularly in the three decades following the Second World War, investment in productive capacity achieved remarkable increases in the material standard of living. Although profitability was the criterion for success in the private sector, it was by innovation in the production and marketing of useful goods and services that profit was earned and reinvested. Capital had a stake in the communities, indeed in the countries, in which its production facilities were located.

Since the early 1980s we have witnessed a reversion to accumulation by dispossession, reminiscent of the old days of the mercantilist era that preceded industrial capitalism. Transnational corporations have increasingly secured monopolistic control over markets on a global scale. In many respects, they are more powerful than governments. The largest of these companies, such as Monsanto, do indeed resemble the old chartered trading companies. Millions of farmers are in bondage to this and similar companies and thousands have been dispossessed of their land. In the industrialized world, transnational corporations have outsourced production to cheap labour countries, and millions of workers have been dispossessed of good jobs. This is reflected in the declining contribution of manufacturing, and the increasing contribution of finance, distribution, and business services to GDP, most dramatically in the United States and Britain. Progressive financialization of capital has substituted short-term market based considerations of shareholder value for the long-term strategic planning horizon of corporations producing for mass markets. In this Anglo-American variety of capitalism, finance has become decoupled from production, and the capital market has lost its useful function of judging the long-term productive capabilities of different firms. Once the criterion of shareholder value became the objective of good management of a company, the capital market became a gigantic casino where people attempted to guess the market with confidence that it would maintain a secular rising trend. Of all the aspects of globalization, it is the financialization of capital, which has had the most profound consequences in the West.

Galbraith's most important book was *The Great Crash*. I suggest that the transformational process, which has unravelled the institutional framework that sustained the good times of the 1960s and 1970s, might be called The Great Financialization. It had its origins in the dissolution of the Bretton Woods financial order, gathered momentum in the 1980s, and exploded in the mid 1990s. Ever since dollar convertibility to gold was abandoned, the United States was able to sustain an ever-increasing external deficit by issuing ever-larger amounts of dollars. International liquidity increased and deregulation of financial institutions encouraged the progressive expansion of credit. Soon, cross border capital movements and trading in foreign currencies greatly exceeded the requirements of trade in goods and services. Short term capital movements rather than trade determined exchange rates, and have contributed to financial and banking crises in Mexico, Argentina, Brazil, Turkey, East Asia and Russia. These crises were more severe than anything previously experienced. Millions were plunged into poverty and private and state assets passed into foreign hands at fire-sale prices. In all of these cases, including a large intervention to save banks from the impending failure of the Long Term Capital Management hedge fund, overexposed international financial institutions were rescued by central bank and IMF intervention. The Asian Crisis threatened the stability of the global financial order but progressive financialization was able to sustain economic growth in the heartlands of capitalism. The real costs of capital account liberalization were born by the rest of world.

In the 1970s, inflationary pressures reduced the profitability of financial investment and full employment increased the bargaining power of labour. As anticipated by Michael Kalecki, Keynesian solutions became inoperative as the rate of return on capital declined. These economic trends, combined with rising radicalism in the Third World and the defeat in Vietnam, were countered by a political decision to institute an economic regime change to restore the discipline of capital over labour. Princeton economist and New York Times columnist Paul Krugman has drawn attention to the imbalance of political power within American democratic institutions which enabled a small number of conservative, wealthy activists, backed by antiunion businesses to redefine the policy direction of the government. Neoliberal policies, introduced by Thatcher and Reagan, were designed by economists in university research institutes and think-tanks financed by business interests. They were crafted with political skill and bated with promises of tax reduction. The doctrine of supply-side economics, which maintained that a reduction of income tax rates would induce an increase in output and thus increase total tax receipts, was a seductive ideological construct with populist appeal but no scientific validity.

Public expenditures were increasingly financed by the sale of securities to domestic and foreign creditors, and public sector savings were negative. Household savings were also negative and consumer expenditures were sustained by an increasing volume of mortgage and household finance including credit cards at usurious rates of interest. The volume of debt further ballooned by financial innovation of derivative debt instruments. If financial liberalization was the primary mechanism undermining the Keynesian historic compromise of capital and labour, the erosion of progressive income taxation both contributed to financialization and exacerbated inequality.

The burden of taxation was shifted from corporations and the wealthy to middle and lower income groups and regressive sales taxes were introduced. High-income earners with greater discretional income generated pools of capital seeking returns in emerging markets and other financial investments. Investment in infrastructure and productive capacity of the real economy stagnated, as returns in global financial markets exceeded those in the domestic economy. Iconic American corporations, which once engaged in mass production for mass consumption increasingly derived income from distributional, financial, and other business services associated with the import of manufactures from countries where labour costs are substantially lower. Wal-Mart, which directly produces none of the vast array of products it retails, and does not tolerate unions, is at the extreme end of this model. The prosperity of the United States has been increasingly sustained by military and consumption expenditures, financed by mountains of domestic and foreign credit. American consumers became the driving force of the world economy, but American producers have slipped from the predominant role they played in the early post-war years.

The financialization of capital is most extreme in Britain and the United States where incomes deriving from financial markets have contributed disproportionately to GDP growth, while the real economy has been hollowed out. This is reflected in changes in the relative contributions to GDP, of manufacturing on the one hand, and finance, insurance and real estate on the other. In Britain, value added by manufacturing declined from 32 percent in 1971 to 14 percent in 2006, while in the United States it declined from 23 percent to 13 percent in the same period. Income derived from finance, insurance, and real estate in the United States increased from 15 percent in 1970 to 21 percent in 2007. Finance and insurance alone doubled from 4 percent of value added to GDP in 1971 to 8 percent in 2007; as a proportion of value added in manufacturing, this represents an increase from 18 percent to 65 percent in the same period.

Once capital markets were deregulated, the initiative of macroeconomic policy passed from national governments to financial markets. Central banks were reconfigured to be "independent" of Ministers of Finance; they henceforth became instruments for the protection of creditor interests of financial institutions, and governments became more sensitive to their credit rating than to opinion polls or election results. Contending political parties dance to the same tune. Democracy is now in suspense, effectively hostage to financial markets.

For the past 25 years, financialization of capital has been encouraged by disinflationary policies of central banks, which systemically favour creditors over debtors. Neoliberal objectives of zero inflation and pressure on governments for fiscal surpluses contrast with previous commitments of central banks to macroeconomic policies designed to ensure full employment. Central banks have contributed to the sustained profitability of mushrooming global financial transactions, resulting in the increasing vulnerability of the real economy—private and public—to debt finance. As an increasing volume of capital has shifted into financial circuits by the lure of inordinate profits, manufacturing and other productive sectors have come under pressure to sustain profitability by mergers and acquisitions, downsizing, outsourcing and the search for new markets. International competitiveness has become the criterion of success for the private sector and the measure of responsible public policy by governments.

The liberalization of capital has been accompanied by measures to break down barriers to trade and investment on an international scale. It is important to note however that the dynamics of financial liberalization are significantly different from trade liberalization. Whereas the liberalization of capital proceeds by stealth as a progressive process of unilateral reduction of national regulatory constraint, the liberalization of trade requires negotiated agreement between governments. Where negotiations take the form of free-trade agreements, they are legally binding international treaties of indefinite duration.

Governmental and business elites fearing that Canada would be left out in a world of competing economic blocks, called on the "special relationship" with the U.S. to obtain exemption from American protectionism. Canada initiated negotiations for a Free Trade Agreement to secure American markets for Canadian products, which eventually resulted in the Canada-U.S. Free Trade Agreement of 1988. It is not accidental that Canada, the first industrialized country to host a massive inflow of U.S. direct investment, was also the first to negotiate an a new kind of free trade agreement, which went far beyond conventional commercial agreements to protect the interests of foreign investors from the exercise of sovereignty by the host governments. Canadian export dependence on the U.S. market increased from 65 percent in the mid-70s to some 85 percent by the end of the century, and American ownership of Canadian industry also increased significantly. My colleague, Dorval Brunelle has suggested that the Canada-U.S. Free Trade Agreement was the template for globalization.

Victory of the West in the Cold War gave a tremendous political lift to the doctrines of market fundamentalism. There appeared to be no alternatives to compliance with the demands for capital and trade liberalization. A new institutional regime of multilateral and bilateral treaties was launched in 1994 with the signing of NAFTA, the initiation of a Free Trade Area of the Americas, and the transformation of the GATT into the WTO. The WTO provides the framework for a consensus-based regime regulating world trade, with mechanisms to enforce compliance by member countries.

Trade liberalization has forced developing countries to open their markets to cheap—often subsidized—imports which had a destructive effect on their agricultural and industrial capacities and cut short the promises of development. Liberalization conditionalities attached to successive IMF programs, have almost completely destroyed the once flourishing domestic manufacturing industries in Jamaica. Factory shells are now warehouses where containers of imported products are repackaged for sale on the domestic market. Many developing countries have experienced similar loss of industrial capacity.

Trade liberalization is not the only, or perhaps not even the most important element in efforts to open economies to trade and capital flows. Concessions obtained in two decades of structural adjustment programs imposed on debtor countries, and in bilateral free trade agreements, guaranteeing the rights of investors, have gone far beyond WTO rules. Large and powerful developing countries, including Brazil, India, and South Africa, have refused to sign onto a WTO agenda which would include: granting national treatment to foreign investors, intellectual property rights, limitations on government procurement, and so-called unfair competition by state enterprises. The new style of free trade agreement, of which the Canada-U.S. FTA was the template, secures all of the above for foreign investors.

With increasing turbulence and uncertainty in financials markets, funds moved into commodities, including petroleum, copper and other minerals and more recently into food and land. Whereas biofuels have contributed to a secular rising trend in prices of corn and soy, only speculative forward purchases can account for the spike in rice, wheat and many other food products since 2007. The financial crisis is impacting in the first instance on the value of personal and institutional savings and threatens recession in the North; the global South appeared to be relatively insulated. However, speculative activity in commodity markets was directly responsible for the food crisis of 2008, which according to the World Bank plunged one hundred million people into dire poverty. Food prices doubled and tripled, and poor people in developing countries, where food expenditures account for some 70% of income, have been the victims of a crisis originating in the financialization of the major capitalist economies. Food riots erupted in 33 countries and the World Bank expressed concern regarding the social stability of the developing world. The FAO considered 37 countries in need of food aid, but the UN had difficulty in meeting its target of $500 million. Contrast this with Cargill's posted profit of $1.2 billion in the first quarter of 2008. Indeed the dominance of multinational agribusiness in world markets is a manifestation of the subordinate position of producers to corporations, which control access to inputs of high yielding seeds, pesticides and fertilizers, and access to markets including processing facilities. Their profits greatly exceed the incomes of agricultural producers. This is the case also in Canada, where a large increase in exports of agricultural products has failed to raise the net income of farmers, which has been stationary for the last twenty years.

But the disparity between agricultural incomes of farmers and the mega-profits of corporations are very much more extreme in developing countries. The food crisis of 2008 has extinguished the gains of poverty reduction programs and it has put the entire free trade agenda into question. According to Fred Bergsten, trade liberalization has come to a "screeching halt." Developing countries blocked the FTAA; they have suspended the WTO Doha round; and the objectives of food self-reliance will require some reversal of economic liberalization. India and many other developing countries have suspended the export of food to meet domestic demand, and food sovereignty has become an important objective of many developing countries. Programs to increase domestic production will require land reform and protection from the destructive effects of the imports of subsidized food and food products.

There are questions to be asked about the responsibility of economists and the relevance of economics. The fundamental tenet of economics is that the free market is the most efficient mechanism for the allocation of scarce resources. Over the past 25 years in which capital and commodity markets have been liberated from regulatory constraint, income inequality has greatly increased. In the 1970s, CEO compensation was 40 times greater than average worker salaries in the U.S. Since that time, free markets have revalued the services of CEOs to amount to 300 times those of worker salaries today.

Specifically, we must ask what has been the real contribution of the recipients of the explosive growth of financial incomes? The huge increase in incomes derived from financial services, contributed significantly to GDP growth. Our accounting conventions record incomes generated in finance, insurance and real estate as an addition to national production as measured by GDP. By these conventions the services of the top hedge fund managers are 40 times more valuable than those of the top corporate CEOs, and roughly 13,000 times more valuable than the highest paid members of U.S. Congress, who earn just under two hundred thousand dollars. Thus, individuals and corporations engaged in financial services, who receive one fifth of all incomes generated in the U.S., appear to have contributed one fifth of the value of all goods and services of the national economy. But what useful goods or services have been produced by the financial sector to merit this reward?

The actual contribution of financialization has been the ability to sustain economic growth by the ever-increasing volume of debt, facilitated by easy money from the Federal Reserve. The near doubling of GDP barely raised median family incomes, reduced industrial employment and earnings, while the physical and social infrastructure of the country deteriorated. The permissive condition has been the willingness of the rest of the world to finance the external payments deficits of 6-7% of GDP by purchasing U.S. securities and holding increasing amounts of dollar reserves. This situation is plainly unsustainable and is unravelling. According to George Soros the "current crisis is the culmination of a super-boom that has lasted for more than 60 years," and was aided by authorities who intervened to rescue the global financial system whenever it was at risk.

We need to rethink economics. More fundamentally, we have to rethink the real value of goods and services. The feminists have drawn our attention to the fact that the market assigns no value to the useful services performed in the household, principally by women. While personal services of caring are grossly undervalued, financial services have become grossly overvalued. We need to return to some basic questions of use-value and exchange value. Economics should abandon its a priori deductive methodology. It should study real economies in the context of the societies in which they exist and the power relations between private and public authority. This was the approach of John Kenneth Galbraith.