Claudia Maya*

Brief Review Of the Canadian Economy's Financialization

Introduction

The Canadian economy's trade and financial opening, plus its increasingly radical pro-free-market policies rooted in the 2007-2008 financial crisis, sped up the country's integration into the U.S. economy's logic of financialization. Financialization requires growing deregulation, particularly of the financial system, supported by economic policies completely committed to macroeconomic equilibrium, the free market, and continual budget cuts. The heterodoxic literature states that all this restricts economic and employment growth and promotes social inequality and the indebtedness of economic sectors, including households, to favor the free flow of foreign investment capital.

This deregulation process brought about important changes in the economy, increasingly oriented toward the service sector and dependent on greater and greater foreign investment, prompting a rapid expansion of credit, which causes the aforementioned indebtedness. It should be mentioned that the reduction in public budgets has sparked great debate in both the public and the private sector, above all in academia, since the 1990s. The discussion has centered on the economic and distributive effect of these austerity policies (budget cuts, managing interest rates to control inflation, and controlling the exchange rate to favor the entry of capital and foreign direct investment [FDI]).

* Claudia is a researcher at CISAN, UNAM; you can contact her at clmaya@unam.mx.

The Opening of the Canadian Economy and the Road toward Financialization

Canada is North America's second economy and possesses enormous natural resources. Given its proximity to the United States, Canada's economy has become closely intertwined with its neighbor to the south. This is due to U.S. corporations' huge investments, making Canada one of its main suppliers of raw materials and non-renewable energy, along with Mexico. The commodities sector and the strengthening of others such as auto and energy have been fundamental for Canada's development in recent decades. However, it has transitioned toward the service sector, particularly financial services. This follows its partner and neighbor's trend, as well as the global financial markets, demographic changes, and the financing needs of an increasingly suburban population.

With the drop in oil prices and increased inflation in the 1980s, Canada faced certain difficulties that brought into question protectionism as an economic model. This gave rise to accelerated economic and financial opening, fostered by Ronald Reagan's free-market and integrationist policies (1981-1989) and those of the U.S. Federal Reserve (FED), which left behind the post-war "consensus" for a welfare state characterized by the Canadian economy. As a result, Canada pro-actively implemented free trade, less regulation, and austerity policies that reduced budget deficits at the three levels of government, clearly slimming down the state apparatus and slashing social welfare measures. Strictly speaking, this structural adjustment concentrated on privatization, deregulation, and guaranteeing macroeconomic stability, favoring the corporate agenda.[1]

This Canadian turn was expressed in the Foreign Investment Review Agency, which led to Investment Canada, dedicated to attracting foreign investments instead of blocking them, which it had done in the past to protect the domestic market. By the mid-1990s, Canada had negotiated the Canada-US Free Trade Agreement (1989) and the North American Free Trade Agreement (NAFTA) (1994) with a clear eye to opening its economy. As mentioned above, this would require a change in the design of its macroeconomic policies, whose guiding principles would be controlling the interest, exchange, and inflation rates, plus careful handling of government deficits given lower public spending. All this brought profound consequences in its citizens' living standards, particularly those of wage earners and indigenous people.

Before NAFTA came into effect, Canada sent a little over 80 percent of its exports to the United States, and, despite the accelerated trade opening and the advance of globalization, it did not opt to diversify its exports. On the contrary, it focused its trade and investment decisions on its neighbor's economic cycle requirements.

In the context of NAFTA, Canadian banks developed strategies to compete in financial markets. It should be mentioned that North American integration took place not only in trade, but also involved establishing a network of financial institutions and intermediaries that required the constant deregulation of domestic financial and banking sectors. Thus, services expanded massively throughout the region. Therefore, the three economies connected to each other mainly through a monetary circuit whose center and dynamism were the United States and its currency.[2]

I should point out that the emerging vulnerabilities linked to the free-market and financial deregulation model lie in financialization or funding in foreign currency, particularly in U.S. dollars. For this reason, as a result of the cross-border trade and financial transactions, Canada is highly dependent on the U.S. economy. For its part, its Central Bank has promoted monetary policies that favor the financial practices offering the highest profits to corporations and that have fostered the use of other speculative financial instruments, simultaneously with traditional banking services. All this is part of the logic of financialization.

On the other hand, the growing influx of FDI and portfolio investment has caused the gradual appreciation of the Canadian dollar. Practically since the 2007 crisis, Canada has situated itself as one of the main destinations for foreign investment. However, this makes local financial markets vulnerable to speculation and the reversal of financial flows due to devaluation or FED interest rate changes. It should be underlined that, behind the incessant quest for macroeconomic stability and appropriate conditions for attracting both foreign direct and portfolio investment, is the growing dependency on those flows to expand domestic credit, leverage corporations, and guarantee their profitability on Canadian soil.[3]

Reducing Public Deficits and Economic Growth

Since Canada opened up to the global economy and integrated into the U.S. economy, its gross domestic product (GDP) growth has been unstable, with a clear tendency to decrease. While some years have seen important growth, it has been affected by the negative effects of the international crisis. In addition, as explained above, that opening and integration demanded a constant reduction in public spending in order to control inflation, with the resulting collateral damage due to the substitution of large amounts of public investment received in the decades prior to NAFTA with foreign investment, creating a slowdown in recent years. Also, the decreased U.S. demand since the 2007 crisis has affected Canadian exports, reducing its GDP even more, while austerity policies have imposed trade deals that have been responsible for a contraction of real wages. The national austerity policy translates into wage deflation, through the real reduction in wages and the threat of unemployment due to wage differentials and the exchange rate in the North American trade zone.[4]

Development of the Financial Sector In Canada in the Face of Deregulation

This system has gone through a liberalization of its economy to become what we know today. To do this, mechanisms were adopted that involved the suppression of controls on capital, the adoption of a kind of flexible ex-

Canada implemented free trade, less regulation, and austerity policies reducing budget deficits at the three levels of government, slimming down the state apparatus and slashing social welfare measures.

change rate, and the liberalization of interest rates. Thus, it has been characterized as an open economy with a financial system dominated by six large banks. Today, the main activities of this kind are concentrated in Ontario and Quebec, while the rest of the country is integrated and harmonized into these financial processes.

The intense deregulatory process strengthened financial services in an increasingly competitive global context focused on reinventing financial practices, led mainly by the United States. In this way, Canada began a process oriented to opening financial markets that was clearer after the 1991 changes in the Bank Act, which went into effect the following year. Their aim was to eliminate federal restrictions limiting banking operations throughout the country. This law gave them greater freedom for developing and exploiting their comparative advantages in the creation of financial services and innovations in a context of growing competition among banks, particularly U.S. banks, in order to operate in equal conditions with the latter.

Starting at that time, the Canadian banks' goal was to make inroads into international financial markets, particularly in the North American region. Domestically, they concentrated their presence in sectors such as small and medium-sized firms, households, and mortgages. It is important to mention that, like their main trading partner, they began entering securities markets in the late 1980s, actively participating in securitization, although much less than their U.S. counterparts.

In the twentieth century's post-war period, the banking and financial system was at the service of companies or industry. But that changed with the processes of financialization that began in the 1970s, accompanied by growing instability and economic and financial deregulation. This emerged after the break between the banking system and industry, when financial markets began to predominate over industry and the traditional economy as a whole. However, what happened was a change in the way they related, based on which non-banking financial institutions became very active.[5]

In accordance with this, it can be said that Canada's growing financial deregulation defines the behavior of financial intermediaries and their operativity in stock markets to the detriment of the use of credit as a primary source of financing. Financialization accelerates the process in which financial markets have taken on a central role in economies, previously dominated by banks and banking credit. Starting in the 1990s, Canadian businesses became more dependent on financial markets as their primary source of external funds, leaving bank loans to one side. Since 2006, non-banking financial intermediation has almost doubled. Investment banks and other funds have taken over the creation and feeding of speculative bubbles, through the direct use of financial innovations to make profits and ensure liquidity, always taking high risks with negative effects for the economy as a whole, a distinctive trait of financialization. VM

Further Reading

International Monetary Fund, "World Economic Outlook, April 2017: Gaining Momentum?" IMF, Washington, D. C., https://www.imf.org/en/Publications/WEO/Issues/2017/04/04/world-economic-outlook-april-2017.

Notes

1 See Teresa Gutiérrez-Haces, "La crisis económica que socavó al Estado benefactor de Canadá," in *Canadá Hoy* (Mexico City: CISAN, UNAM, 2016), pp. 47-74.

2 Eugenia Correa and Mario Seccareccia, "The United States Financial Crisis and Its NAFTA Linkages," *International Journal of Political Economy*, vol. 38, no. 2, December 2014, pp. 70-99, https://www.tandfonline.com/doi/abs/10.2753/IJP0891-1916380203.

3 See Jane D'Arista, *All Fall Down: Debt, Deregulation and Financial Crisis* (London: Edward Elgar, 2018), pp. 129-131.

4 For more information on this point, see Mario Seccareccia, "¿A dónde va la política monetaria desde la crisis financiera global y qué debe hacerse?" *Ola Financiera*, vol. 13, no. 35, May-August 2020, pp. 1-31, http://www.olafinanciera.unam.mx/new_web/35/pdfs/PDF35/SeccarecciaOlaFinanciera35.pdf.

5 See Mario Seccareccia, "Financialization and the Transformation of Commercial Banking: Understanding the Recent Canadian Experience before and during the International Financial Crisis," *Journal of Post Keynesian Economics*, vol. 35, no. 2, December 2013, pp. 277-300, https://www.tandfonline.com/doi/abs/10.2753/PKE0160-3477350206.