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**HEGEMONY, STATE, AND THE ROLE OF FINANCE IN EARLY
CANADIAN INDUSTRIALIZATION**

by

KEVIN SKERRETT, B.A.

**A thesis submitted to
the Faculty of Graduate Studies and Research
in partial fulfilment of
the requirements for the degree of**

Master of Arts

Institute of Political Economy

Carleton University

Ottawa, Ontario

April 11th, 1994

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HEGEMONY, STATE, AND THE ROLE OF FINANCE IN
EARLY CANADIAN INDUSTRIALIZATION

submitted by
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in partial fulfilment of the requirements
for the degree of Master of Arts

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ABSTRACT

Established accounts of the role of the financial system in early Canadian industrialization are in need of modification. The main analysis of this sector of the Canadian economy emerged during the rise of a "new" Canadian political economy, and it emphasized the political and economic dominance of financial capital in Canadian development. However, this paper shows that the material power of the financial sector did not go unchecked, and that the developmental impulses of the Canadian state were often the driving force behind the growth strategies of the early period. Moreover, to perform such a role demanded the coordination of various class interests into a hegemonic balance which would enable the state to pursue a costly, but in the long term relatively successful (albeit dependent) industrialization. The recent period of financial deregulation and governmental instability is underlining the central importance of national control over the investment function.

ACKNOWLEDGEMENTS

I would like to take this opportunity to extend heartfelt thanks to two people who helped to see me through this project. First of all, my supervisor, Professor Manfred Bienefeld, who, for two years now, has consistently displayed supreme patience in assisting a non-economist's mind to view a world of ambiguities through many different windows. I would also like to retrospectively acknowledge Professor Linda Freeman, who first exposed me to a sophisticated political economy analysis, and left me hungry to understand it better.

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To understand the adjustments the advanced countries are attempting to make to the current economic troubles, we must eliminate the artificial dichotomy that separates the study of markets from the study of politics. Though traditionally viewed as different means of coordinating activities, political command and market prices in fact melt together in the actual workings of the advanced economies. In each case, it is important to determine the character of the mix. Market positions are a source of political power and government choices shape the operations of the market. Thus, any analysis must begin from the understanding that there are no markets apart from politics, that markets were in fact political creations, and that political life is entangled with the workings of markets and market institutions.

John Zysman, Governments, Markets, and Growth

CHAPTER I

Political Economy and Canadian Industrial Policy

Introduction

As extensive restructuring proceeds in the whole of the Canadian economy, from the deindustrialization of Ontario to the devastation of the resource-based industries of the Maritimes and the West, the traditional concerns of Canadian political economy take on a renewed relevance. On the other hand, after several modest attempts to re-assert their national economic sovereignty (in measures such as the National Energy Program and the Foreign Investment Review Act), Canadian governments have recently shifted back to a more familiar continental development strategy, centred recently by the negotiation of trade agreements with the United States (the FTA) and then the United States and Mexico (NAFTA). While admitting that the "adjustments" required by this further economic integration would prove painful and that there would be "some job loss", the federal government that was controlled between 1984 and 1993 by a Conservative majority, continued to insist that Canadian policy makers had "no choice".

In response to their political critics, former Prime Minister Mulroney and his senior cabinet ministers advanced the claim that the popular movements of the political left - organized labour unions, environmentalists, and other social activists - fail to offer any viable alternative strategies for successful Canadian economic development. In a

more competitive global economic environment Canada could compete fully only if it was prepared to take some risks and make some sacrifices.

There are several reasons why the fiscal and monetary conservatism of the last two decades, and especially the policies developed under the Mulroney governments (1984-1993), found such powerful political expression. Political leaders throughout the Western capitalist economies have faced a new and different set of problems since the 'crisis' of the 1970s and the onset of the major economic downturns of 1981-82 and 1990-92. Because growth rates fell precipitously while real interest rates soared throughout this period, the need to finance government deficits by accumulating debt has risen significantly in almost every country. This increasing reliance on the world's financial markets has meant that the success of more general economic policies, of individual political leaders and of party programmes, is increasingly dependent upon the actions and reactions of national and international financial markets.

These changes have had powerful effects, both on Canada's business community and on public consciousness. Along with the heavy emphasis on 'globalization' there has been an increasing insistence, on the part of business leaders, that 'political' interference in international trade and investment will no longer be tolerated. Indeed, one recent government-commissioned study describes the current period as an "era of increasing choice for companies".¹ At the same time, with unemployment in Canada remaining above 7% for almost two decades, it has also been an era of diminishing choices for Canadian workers and their communities. Moreover, while some Canadian companies

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¹ Michael Porter, Canada at the Crossroads: The Reality of a New Competitive Environment (Ottawa: BCNI and ISTC, 1991) pp. 9-11

have been able to take advantage of the associated changes in the global market environment, it seems highly unlikely that the increasing options for companies will result in increased opportunities for entrepreneurs with an attachment to specifically Canadian economic development.

Moreover, on Canada's political stage the grassroots politics which have emerged from this economic turbulence have partly been reflected in the election of social democratic provincial governments in three provinces. However, in the recent wake of another recession and mass layoffs in the manufacturing sector, many Canadians have reacted to austere economic times by throwing their support behind the even more conservative fiscal and monetary programme of the western-based Reform party, which has begun to channel a growing political alienation in particularly ominous directions. The "stakes" in the current period have clearly been raised.

Policy Debate in the 1990s

Coming to terms with the current interaction of politics and economics is, as always, the essential task for the ongoing renewal of the Canadian political economy (CPE) debate. Were the challenges of today's world anticipated? Are familiar prescriptions still relevant or can they be reformulated? One of the most interesting shifts of recent years is an increasing recognition on all sides that a serious structural problem does exist in Canada. Most analysts recognize that the staple resource basis of the Canadian economy has run into major, and perhaps terminal, difficulties which have

particularly devastated those communities (and even provinces) which depend directly on one or two primary commodities. David Wolfe points out that

Despite widespread concern over rising commodity prices in the early 1970s, by the mid-1980s raw-material prices relative to those for manufactured goods and services had fallen to their lowest levels on record - in some cases, actually lower than prices recorded at the depths of the Depression. This trend is rendering the primary- or raw-materials-producing sector of the economy increasingly marginal to developments in most of the rest of the economy.²

As the gravity of this shift is appreciated, there is also some increasing agreement regarding the nature of Canada's structural economic 'problem', as even analysts of the political right point to such issues as technological dependence, the continuing failure to develop 'forward linkages' through the value-added processing of resources, and an ever-increasing dependence on one major trading partner - the United States (issues many on the left have raised for many years). Thus, ten years ago, the (now-defunct) Science Council of Canada published studies with dire warnings about the need to act:

Over the next decade, the challenge for Canadians will be to transform the economy structurally in order to compete effectively in what can only be called a radically altered world-trade environment. There is no alternative to significant structural change. Our continued reliance on staple exports, combined with the weakness of much of our manufacturing sector, and our relatively underdeveloped capacity to innovate successfully, places us in a highly vulnerable position. We are unlikely to benefit from even the current, let alone future shifts, in the pattern of international trade.³

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² David Wolfe, "Trade and Technology," in Debating Canada's Future: Views from the Left Eds. Simon Rosenblum and Peter Findlay, (Toronto: Lorimer, 1991) p. 107

³ Michael Jenkin, The Challenge of Diversity: Industrial Policy in the Canadian Federation Background Study No. 50, Science Council of Canada, (Ottawa: Supply and Services, 1983) p. 169.

On the other side of the political coin, there is also a growing realization that the mounds of debt accumulated by recent provincial and federal governments have reached dangerous and unsustainable proportions - with the result that even the social democratic governments of Saskatchewan, Ontario, and British Columbia have resorted to the conventional choices of cutting or 'downsizing' public services in efforts to balance their books.

While there remain differences of interpretation as to the best ways of addressing these problems, the growing agreement on the existence of a serious problem is notable. However, while the general objectives of the free market right and the social democratic left appear quite similar in emphasizing increasing employment, improving technological capacities and the establishment of globally-competitive firms, strong differences remain regarding the meaning of these terms and the choice of policy instruments to attain them in the context of Canada's current "growth with unemployment" crisis. To this end, the last twenty-five years have witnessed the relative failure of various efforts to increase national control over the economy - and in particular the foreign-controlled manufacturing sector - via some form of industrial strategy. This approach has found political expression in the "Waffle" movement of the early 1970s, the anti-Free Trade Agreement mobilization around the 1988 election, and even the recent formation of a federal National Party of Canada, devoted to "Canadianizing" the economy.

On the other hand, the more influential mainstream neoliberal analysis continues to suggest that the crisis is itself largely a result of Canada's history of pursuing tariff-protected (ISI) industrialization, through an "involved" public sector and the formation

of its "Keynesian" welfare state apparatus. This conservative position became the dominant voice in the Canadian policy debate, as reflected in the Macdonald Commission's endorsement of a continental "free trade" strategy as the appropriate response to Canada's economic crisis:

The [Commission's] acknowledgement that there was a structural problem did not...lead the mainstream to support demands for government policies designed to strengthen the technological capabilities of specific Canadian firms or sectors in non-resource areas of the economy. Instead, it became the occasion for a neoconservative counter-attack, which argued that the "crisis" had arisen only because the tariff and the government's various social and economic policies had introduced rigidities into the economy over time.⁴

Thus, while views on the most important problems facing the Canadian economy have converged somewhat across political lines, widespread disagreement remains as to how these arose, and how they might be most effectively addressed. In this context, the familiar political struggles over the appropriate role of government in providing public goods and services and in regulating trade and investment continue unabated.

The most difficult challenge in making these judgments lies in fairly weighing the evidence and in projecting a future based on a perceptive reading of history. We argue here that the market-based adjustment model so aggressively endorsed by the MacDonald Commission and adopted by recent Canadian governments may well have been a serious mistake. Certainly the impact that the Canada-US Free Trade Agreement (FTA) on the manufacturing sector appears to have been both severe and negative, as manufacturing employment has fallen approximately 17 per cent between June 1989 and December 1992

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⁴ M. Bionefeld, "A Trade Strategy for a Social Democratic Canada," Debating Canada's Future: Views from the Left Eds. Simon Rosenblum and Peter Findlay, (Toronto: Lorimer, 1991) p. 97

- the first few years of implementation.⁵ But potentially more important is the fact that the FTA, and now NAFTA, have combined to effect a general reduction in the latitude - the array of choices - open to governments in formulating future policy decisions which do not coincide with the choices and interests of an increasingly mobile transnational capital. In this sense, those political economists who had in the past voiced concern over Canada's eroding sovereignty and its dependence on foreign technology and manufacturing firms are proving to have been especially prescient as Canada is now forced to adjust to "new conditions" because "we have no choice".

This negative conclusion has been elaborated in detail elsewhere⁶, and serves primarily as a backdrop for the following discussion. Most of these critics are calling for the Canadian state to embark on a far more publicly-directed (and politically accountable) strategy to guide Canada's adjustment to the world of the 1990s. And such a project does appear to be badly needed if Canada is to make that adjustment with a minimum of welfare loss to its population.

However, such a conclusion raises several difficult questions. Is such an active industrial policy still an option under current conditions? Are the policy tools needed to implement such a strategy available to Canadian governments, should they be interested? And is there sufficient political support for such an approach? Certainly there are major

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⁵ Andrew Jackson, "Manufacturing," Canada Under Free Trade Eds. Duncan Cameron & Mel Watkins, (Toronto: James Lorimer & Co., 1993) p. 109

⁶ See Daniel Drache and Meric Gertler, eds. The New Era of Global Competition: State Policy and Market Power (Montreal: McGill-Queen's UP, 1991) esp. chapters 3 to 6; Duncan Cameron and Mel Watkins, eds., Canada Under Free Trade; and Mel Hurtig, The Betrayal of Canada (Toronto: Stoddart, 1991)

obstacles standing in the way of such an approach which have long been emphasized, both in general and specifically for Canada's situation. The Science Council study cited above suggested that Canada's relatively decentralized federal structure poses a severe constraint because concerted action by the federal government inevitably gives rise to complaints that unequal attention is being paid to the needs of different regions. Others have identified Canada's relatively weak network for supporting industrial research and development, its lack of experience in coherent government-business-labour cooperation in meeting a set agenda, and its domination by an international business class with no particular commitment to a "Canadian" development strategy as further obstacles to an "activist" state policy.

These are clearly important concerns deserving of the recent attention they have received. This paper is set within the context of these concerns in that it examines a specific obstacle to the implementation of a more effective industrial policy, namely, a private financial system with little experience or expertise in the kind of long-term industrial finance required for the successful development of a strong and technologically sophisticated manufacturing sector.

Why is this an important component? First and foremost, it is widely and persuasively argued that an active strategy that is to overcome significant structural problems requires a capacity to direct savings and profits into productive and efficient investments within a politically-defined framework. This has particularly been true for economies, such as Canada's, which have been 'followers', in the sense that they have been forced to undertake such efforts while strongly influenced (geographically and

economically) by technologically more advanced economies. In his classic account of 'late-follower' industrialization, Gerschenkron demonstrated the significance of active states which, in many such cases, effectively replaced the role of the private capital market in the long term finance of extensive indigenous industrialization.⁷ According to him, in such follower economies the private capital market was generally not a viable option for development finance, because the dynamic externalities and the scale economies that lie at the heart of such a strategy could only be reaped with coherent and concerted state support. While private capital markets proved adequate for the industrialization of "lead" economies like Britain and the United States, their success was contingent upon specific historical and social conditions, including, in particular, a lack of pressing external competition from economically and politically more powerful adversaries. In successful follower economies, the private capital market was, thus, generally supplemented, guided and encouraged by active state bureaucracies.

Since Canada was such a follower economy, many political economists have focused on the role played by the state in addressing Canada's economic development, especially on general economic policy "packages" such as Macdonald's National Policy tariffs of 1879 and the same government's strategic railway projects. In the same way, those attempting to define an effective industrial strategy for the 1990s continue to focus on the need to maintain or improve the state's capacity to actively channel investment to strategically important sectors or firms. Thus, in discussing the public sector's role in

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⁷ Alexander Gerschenkron, Economic Backwardness in Historical Perspective: A Book of Essays (Cambridge: Harvard UP 1962). Gerschenkron argued that, in contrast, the 'lead' economies were able to finance their industrialization out of private equity markets without the reliance on large-scale institutional support.

the development of new technological capacities, David Wolfe emphasizes such allocative powers, and argues that the public sector is best suited to exercise them.

A critical role for the public sector involves the process of gathering information, targeting potential high-growth areas in the economy, and effectively allocating public resources to a range of activities from funding basic scientific research to enhancing the capabilities of the educational system in the critical areas...The growing knowledge-intensity of industrial production makes it infinitely more difficult for individual firms, or even industrial sectors, to mobilize the resources needed to focus the innovation process successfully. Only the public sector can play this role.⁸

When we consider the policy mechanisms required for such a project, it becomes clear that in the Free Trade era the government is not well equipped to pursue such an expanded role in the allocation of investment. Historically, one of the central elements in such strategic allocative process has been a financial system which is either willing to support a longer-term industrial development path (and willing to accept the increased risk) or able to accommodate government concerns with longer-term national objectives, even though these may betray the short-term logic of the free market.

Moving Canadian public policy in this direction today would involve a markedly different kind of state action, and would seem to depend on two preconditions: First, the formation of a stable and relatively unified base of political support sharing certain common goals. The second precondition is the existence, or the creation, of policy instruments that a strategy-minded government could use to "systematically mobilize the nation's domestic savings for investment in Canada's long-term economic future."⁹

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⁸ D. Wolfe, p. 119

⁹ M. Bienefeld, "A Trade Strategy..." p. 90

In order to determine whether these conditions could be met, Canadian political economy must further develop its analysis of the financial system by seeking to answer several questions. Why, for example, has the Canadian financial system apparently failed to provide long term investment of an adequate level? How well has it supported industry in the past? And how might an active industrial policy interact with, and utilize, existing financial institutions? In order to answer these questions we require an improved understanding of Canada's financial and economic history; one which involves an adequate theorization of the pattern of its evolution and an understanding of the social and economic dynamics which have shaped it.

The 'Merchant Capital' Thesis

It is interesting to find that within the Canadian political economy tradition, there has not been a sustained interest in the role played by the financial sector. Financial concerns, like other sectoral issues, have tended to be secondary to the long-standing - albeit very valuable - analytical emphasis on the significance of the staples and the branch plant as strong determinants of Canada's overall industrial structure. We do, however, inherit several classic works from the "new" Canadian political economy of the 1970s which deal with the role played by Canada's "merchant-financiers" - primarily in the work of Naylor and Clement.¹⁰ This work was a step forward in the field, since it

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¹⁰ See R.T. Naylor, "The Rise and Fall of the Third Commercial Empire of the St. Lawrence," Canadian Capitalism and the National Question, ed. Gary Teeple (Toronto: U of Toronto P, 1972); R.T. Naylor, The History of Canadian Business 1867-1914 (Toronto: Lorimer, 1975); Wallace Clement, The Canadian Corporate Elite: An Analysis of Economic Power (Toronto: McClelland and Stewart, 1975); and Wallace Clement, Continental Corporate Power (Toronto: McClelland and Stewart, 1977)

provided a theoretical basis for the suggestion that a staples-based economy like Canada's was saddled with a class configuration that lacked the 'transformative' dynamic of a true national bourgeoisie, intent on creating an expanding industrial economy. The value and significance of this work is not in doubt, but certain qualifications are in order if we are to continue to enrich our understanding of Canada's economic history. These contributions will therefore be extensively reviewed in the following chapter, in order to develop a stronger, more nuanced theoretical framework through which to re-examine Canada's early financial history.

The remainder of the paper, chapters III to V, will examine the evolution of Canada's financial system, in order to develop a modified assessment of the banking sector's role in Canada's early industrialization. The theoretical point of departure for the paper remains Naylor's earliest (and most influential) argument¹¹, which assessed the role played by financial capital in early Canadian history and in the process, delivered a scathing political indictment. In seeking to flesh out a new explanation for Canadian underdevelopment, Naylor fused the established staples theory with a more explicit class analysis. Clearly using the more rapid and "indigenous" economic expansion of the United States as his reference point, he argued that Canada had lagged so badly behind because it had inherited, from its British colonists, a backward mercantile ruling class which had little interest in financing or fostering a thoroughgoing industrialization process. In fact, he saw this elite as openly hostile to the progress of Canadian industrial capital:

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¹¹ Naylor, "The Third Commercial Empire..."

Indigenous industrial capitalism in Canada was historically a weak force, stultified by the domination of merchant capital and the branch plant industry of the Tory group fostered to complement its mercantile scheme. Despite the impetus given Canadian industrialism by the Second World War, the generation gap between it and American corporation capital was enough to guarantee its submergence and assimilation into continental American capitalism.¹²

It is easy to see why this view struck a responsive chord - particularly as it emerged during the peak of the anti-imperialist protest movements of North America. Naylor's analysis fuelled the coalition of nationalists and socialists in Canada which sought to unite in a common front against the "problem" facing Canada from its inception: imperialism in the form of (transnational) American corporate capitalism. Moreover, it suggested that the "normal" capitalist development process had been consciously hijacked by Canada's self-interested elites, who had intentionally directed it away from a path that held far greater promise.

This view has been firmly challenged by other political economists, and particularly by Glen Williams, who contends that such an instrumentalist view fails to explain several key features of post-Confederation Canadian development. According to Williams, Naylor's argument particularly ignores the fact that "Canada's merchants and bankers either financed or directly participated in the establishment of many of the new post-1879 industries."¹³ Certainly, the question is one of degree, however, and not just "participation". Thus, the question is raised again: how extensive was this

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¹² Naylor, "The Third Commercial Empire..." p. 32

¹³ Glen Williams, "The National Policy Tariffs: Industrial Development through Import Substitution," *Perspectives on Canadian Economic Development: Class, Staples, Gender and Elites*, ed. Gordon Laxer (Toronto: Oxford UP, 1991) See also: Glen Williams, *Not For Export: Toward a Political Economy of Canada's Arrested Industrialization* (Toronto: McClelland & Stewart, 1983)

participation, and what was its character? Williams and other critics have exposed several other important weaknesses in Naylor's analysis, and these will be considered in greater depth in the following chapter.

After this exchange, the Canadian political economy debate appears to have abandoned the question of the role played by financial capital in the country's economic and social evolution. While there has been extensive discussion of the impact of branch plant industrialization and of the inflow of U.S. capital on Canadian sovereignty (by Mel Watkins, Williams, and others), what little explicit concern with Canada's financial system, has been largely confined to those working within the mainstream neo-classical framework. Indeed, one observer examining the recent deregulation of Canada's financial markets has suggested that the financial system may be "the least well understood and least well documented part of the economy."¹⁴

The challenge of addressing this gap in political economy research and commentary is daunting. We aim to contribute to this effort here by examining the Naylor argument, theoretically and empirically, in order to arrive at a more nuanced and balanced assessment. As later chapters will show, some of the analysis of the question must remain somewhat tentative, as a good deal of the statistical evidence for this period is unavailable. Nonetheless, the following will be guided by several central questions, including: Were Canada's financial elites hostile to the development of Canadian industrial capital, as Naylor suggests? Did Canadian manufacturers regard an indifferent or hostile financial system as a significant problem? And perhaps most importantly, did

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¹⁴ M. Bienefeld, "Financial Deregulation: Disarming the Nation State," Studies in Political Economy 37 (1992) p. 31

they - or did Canada's political leadership of the period - have feasible options which they either ignored or misunderstood?

The pursuit of these questions must not be conceived as merely an exercise in enriching our 'collective memory'. Many of the difficulties which the Canadian economy now faces are the fruit borne of earlier choices, actions and 'inactions'. To the extent that we improve our understanding of these choices and of this history, we will be better equipped to make similar ones in the present and the future.

CHAPTER II

Class, State, and Finance in the "New" Canadian Political Economy

Introduction

The suggestion of the last chapter that Canadian political economy has tended to neglect the financial sector is not intended to devalue the important insights generated by the earlier contributions that have dealt with this issue. But on the whole, the analysis of finance in Canadian history has been framed within a theoretical model which tended to place heavy emphasis on certain features of this period, and certain key social actors, while ignoring or disregarding other potentially important social dynamics involved in the shaping of Canada's early industrialization. For this reason, a historical discussion of Canada's financial institutions is properly prefaced by a thorough discussion of the themes and issues which dominated the 'new' Canadian political economy tradition as it emerged in the 1960s and 1970s. Thus, this chapter will seek to pursue such a discussion by focusing particular attention on the way that the NCPE debate approached the general evolution of Canadian capitalism and those features which defined its uniqueness. In doing so, explicit attention will be paid to the conceptual tools developed to analyze Canada's early development history, and in particular the role ascribed to financial capital and to the financial system in that development.

The Staples Heritage of Canadian Political Economy

Harold Innis is widely regarded as being the originator of the Canadian staples tradition, and his painstaking studies of Canada's resource industries and their impact on Canada's development remain influential to this day. Of particular interest was his pioneering identification of structural blockages, or 'rigidities' especially associated with staples-based growth. As Drache recalls of the Innis legacy,

Innis was able to show that even though Canada was a privileged social formation and shared common institutions and traditions of the centre, something mediated the transfer of capitalism. For Innis that something was the system of capitalism itself which reproduced these rigidities in the economic process, thus preventing Canada from becoming a self-generating autocentric economy characterized by what he called 'integrated development'.¹⁵

The 'rigidities' Innis identified were specifically linked to economic growth based on the production of resource staples. Excessive reliance on such activities was shown to entail various risks common to all export-dependent strategies, including an acute dependence on foreign prices (demand). Innis also warned of a tendency for staples-based growth to maintain a commercial, as opposed to an industrial, orientation, a fact which could inhibit indigenous industrial development. In this regard, Innis has long been considered a 'pessimist', and many followed in his path.

In the 1960s, Mel Watkins breathed new life into the Innis tradition by developing a more complete staples "theory" of development in his 1963 essay, "A Staple Theory

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¹⁵ Daniel Drache, "Harold Innis and Canadian Capitalist Development," Perspectives on Canadian Economic Development: Class, Staples, Gender and Elites ed. Gordon Laxer (Toronto: Oxford UP, 1991) p. 28

of Economic Growth"¹⁶. Building on the insights of Innis, Watkins set out one of the better explanations for Canada's unique economic development, casting new light both on the weaknesses and strengths of Canada's economy.

Beginning with Innis' work on staples, Watkins constructs a 'linkage' model of staples-derived growth (via the work of Albert Hirschman) which begins with the central feature of Canadian growth, that is, the massive exportation of natural resources. This model can still go a long way in explaining patterns of capital formation in Canada:

The central concept of a staple theory...is the spread effects of the export sector, that is, the impact of export activity on domestic economy and society. To construct a staple theory, then, it is necessary to classify these spread effects and indicate their determinants...If the demand for the export staple increases, the quantity supplied by the new country will increase. This export expansion means a rise in income in the export sector. The spending of this income generates investment opportunities in other sectors, both at home and abroad. By classifying these income flows, we can state the staple theory in the form of a disaggregated multiplier-accelerator mechanism.¹⁷

Though still emphasizing Canada's "comparative advantage" in resource production, this version of the staples theory offers a much more sophisticated explanation for the diverse linkages which not only cemented Canada's emphasis on staples production, but also allowed the benefits of this production to be spread relatively widely. This flexibility ensured that the worst dangers of Innis' rigidities were avoided because a "multiplier" effect operated to disperse the income generated by the export base.

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¹⁶ Reprinted in Gordon Laxer, ed. Perspectives on Canadian Economic Development: Class, Staples, Gender and Elites (Toronto: Oxford UP, 1991)

¹⁷ Watkins, "A Staple Theory...", pp. 82-83

Of particular value in Watkins' model is the centrality given to the linkage effects resulting from the emergence of a relatively high-wage domestic labour market. Whereas, in those resource economies in which the wealth earned through staple exports led to the enrichment of a small elite, the resulting staple "trap" is often associated with only marginal "national" development, Canada avoided this fate because access to the high wage American labour market forced up Canadian wages and maximized the spread effects of Canada's production. In this context, Watkins observed that

The basic determinants of Canadian growth are the volume and character of her staple exports and the ability to borrow, adapt, and marginally supplement foreign technology. These guarantee for Canada a minimum rate of growth that cannot diverge too widely from that achieved elsewhere, particularly in the United States.¹⁸

While "guarantee" may be too strong a word, this observation has proven quite accurate, at least for the medium-term. It allows us to understand how Canada was able to exploit its resource base, as a 'follower' country, while maintaining growth and wage rates comparable to those of its technologically and industrially more sophisticated trading partners, such as the US and Britain. Indeed, Canada's success - despite its limitations - compares well to the experience of other advanced industrial economies in most respects, and particularly with regard to the distribution of wealth and income.

A weakness of Watkins' model was a certain lack of clarity regarding the time-horizons of these staple-derived linkages or the limits to the resulting growth. Insufficient consideration was given to the likelihood that, if such a more diversified industrial economy fails to become competitive eventually, as has happened in Canada,

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¹⁸ Watkins, "A Staple Theory..." p. 96

it will become uniquely vulnerable to the external demand for and the potential exhaustion of the supply of its export staples. Although he does refer to these potential problems, Watkins' original model maintained a fairly optimistic tone, suggesting that, "If the pitfalls are avoided [and] if the staple or staples generate strong linkage effects which are adequately exploited - then eventually the economy will grow and diversify to the point where the appellation 'staple economy' will no longer suffice."¹⁹

Unfortunately, while Canada has avoided some of the pitfalls of the staples trap and has generated significant domestic linkages, it has not led to the ultimate success, that of developing a competitive, dynamic secondary manufacturing sector that Watkins suggested could eventually replace the flagging export staples as the economy's engine of growth:

With the gaining of entrepreneurial confidence and the expanding opportunities of domestic markets, domestic entrepreneurs will persistently usurp markets from foreign suppliers. A well-developed secondary manufacturing sector serving domestic markets and possibly even foreign markets will emerge. Staple exports and imports of manufactured goods may fall as a percent of national income...²⁰

This, as Watkins and his followers have more recently emphasized, did not happen. At least some of Watkins' "pitfalls" were not avoided, so that Canada still bears the "staple economy" label, and maybe deservedly so. Attempts by Watkins and others to explain Canada's "partial" failure found much inspiration in the then-emerging Latin American dependency literature, which addressed similar themes. The resulting merger played a central role in the emergence of the "new" Canadian political economy.

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¹⁹ Watkins, "A Staple Theory..." p. 90

²⁰ Watkins, "A Staple Theory..." p. 90

Dependency and the 'New Canadian Political Economy'

Watkins himself played a central role in linking his early work on the staple theory with the Latin American 'dependency' perspective which had developed a radical critique of the economic relationship between the industrialized, capitalist economies of the North and the developing economies of the South. Although the details of the arguments of this school of thought are summarized well elsewhere,²¹ it is useful to review those elements that became relevant to the Canadian hybrid.

Blossoming in the 1960s, dependency theory sought to explain the situation of 'underdeveloped' countries by arguing that they had, both during and after their colonial experiences, developed social and economic structures which systematically blocked the supposedly "normal" or integrated capitalist accumulation process promised by liberal modernization theory. In a sense, Innis had foreshadowed these arguments when he had already explored the concept of the "arrested" development path. Andre Gunder Frank, perhaps the most prominent early proponent of dependency, provocatively depicts the global relationship as follows:

When we examine this metropolis-satellite structure, we find that each of the satellites, including now-underdeveloped Spain and Portugal, serves as an instrument to suck capital or economic surplus out of its own satellites and to channel part of this surplus to the world metropolis of which all are satellites. Moreover, each national and local metropolis serves to impose and maintain the monopolistic structure and exploitative relationship of this system...as long as it serves the interest of the metropolises which take advantage of this global, national, and local

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²¹ For two wide-ranging overviews, see C.K. Wilber, ed., The Political Economy of Development and Underdevelopment 4th ed. (New York: Random House, 1988), as well as Magnus Blomström and Björn Hettne, eds. Development Theory in Transition (London: Zed Books, 1984), especially chapters two and three.

structure to promote their own development and the enrichment of their ruling classes.²²

This attack on the established liberal tradition of capitalist "modernization" also came into conflict with certain strands of orthodox Marxist economic theory which echoed neoclassical perspectives in describing capitalist accumulation as a global, and historically progressive, process which would develop both the forces of production and modern capitalist social relations. Within the dependency literature, much analytical attention was focused on the relations of exploitation between national economies, using conceptual tools such as unequal exchange²³ to explain the failure of capitalist accumulation to play the same dynamic role in the underdeveloped periphery.

The details of the long and heated debate which followed Frank's initial work fall outside the scope of this paper, but several aspects of dependency's approach were adopted by Canadian writers as a useful basis for understanding the dependent structure of Canada's economy. The resulting new Canadian political economy (NCPE) began with Innis' and Watkins' depiction of Canada's staples-based productive structure as one in which "the engine of growth...had been from the outset staple exports to more advanced industrialized economies"²⁴, and then combined this analysis with dependency's concentration on the inhibiting effects of the penetration of peripheral economies by the capital of the core nations. Together, these arguments gave rise to a

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²² A.G. Frank, "The Development of Underdevelopment", in Wilber, p. 112

²³ Blomström and Hettne, pp. 80-81

²⁴ Innis is paraphrased in M. Watkins, "The Political Economy of Growth," The New Canadian Political Economy (Montreal: McGill-Queen's UP, 1989) p. 17

new explanation for Canada's continentalized and, allegedly, "underdeveloped" industrial structure.

According to this view, it was the massive penetration by foreign capital which had "constructed" Canada's dependent capitalism and caused its trajectory to differ so significantly from that of other industrial economies, especially that of the United States. Indeed, its heavy reliance on foreign direct investment in the manufacturing sector was said to have turned Canada into a crippled dependency, similar in essence, though not in degree, to those of the Third World.

The political edge to this argument was sharpened by the fact that it focused on the villainous role of the United States, whose capital was presented as the overriding cause of the 'imperialist' underdevelopment of Canada. Thus, in attempting to marshal dependency theory in support of an explicitly socialist Canadian politics, James Laxer argued that "the need for Canadian independence to end the exploitation of Canada by the American empire has given birth to new strategies and a new institutional framework for Canadian working class politics."²⁵ The challenge Laxer posed for the Canadian left was to understand the evolution of this dependent status, and to devise ways of overcoming it. Moreover, because 'the Canadian problem' was seen as a result of U.S. imperialism, political opposition could be articulated in terms that paralleled the Third World's resistance against the 'core' states.

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²⁵ J. Laxer, "The Political Economy of Canada" (Canada) Ltd.: The Political Economy of Dependency, ed. R. Laxer (Toronto: McClelland and Stewart, 1973) p. 41

One of the most influential analyses in this vein was R.T. Naylor's 1972 essay, "The Rise and Fall of the Third Commercial Empire of the St. Lawrence"²⁶. Based on a blend of dependency theory and of classical Marxist analysis, it concluded that Canada's economic and industrial development had been stifled by a resource-based merchant-capitalist class that dominated a struggling indigenous industrial bourgeoisie. This analysis presented Macdonald's National Policy as a willing embrace of a U.S.-dominated branch plant industrial structure, facilitated and supported by this 'comprador' Canadian mercantile-financial class. Instead of being regarded as a protectionist effort to strengthen a national industrial base, the National Policy now appeared as a conscious manipulation of the "normal and integrated" accumulation process by an overwhelmingly powerful merchant and financial class that was intent on trade, but not interested in industrial expansion.

The merchant, the banker, the railway and shipping tycoon, and the landholder all benefit from the absolute expansion of economic activity, while in the long run the local industrial entrepreneur loses. The dominance of merchant capital means the draining off of funds into mercantile pursuits and away from industry. Together with the tariff, the result is the stultification of industrial capital.²⁷

Rather than focusing on the conflict between labour and capital or between agriculture and industry, this focuses attention on a conflict within the ranks of the Canadian

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²⁶ Cited above. This essay was followed by the more detailed History of Canadian Business, 1867-1914 2 Vols.

²⁷ R.T. Naylor, "The Rise and Fall..." p. 20

bourgeoisie. Indeed, the working classes and farmers hardly play a role in his narrative.²⁸

Naylor's analysis was the first to concentrate explicitly and primarily on the role of financial capital - as a class fraction - in the Canadian development process. This fraction was said to be central to the power elite of early Canada, alongside which the Canadian state was seen to play a derivative, though important role. State policy was said to be largely under the direction of this hegemonic mercantile-financial class, which naturally used that power to protect and serve its own sectional interests. As a result, this fraction used the state to entrench a "continental" industrial and economic structure, in which domestic Canadian industrialists were effectively overshadowed and displaced by larger, more immediately competitive US based corporations. Canada's hegemonic financial and mercantile classes were therefore depicted as complicit in the subordinate incorporation of Canada into a US-dominated (metropolitan) economy.

The historical explanation offered by Naylor for this development is largely restricted to the assertion that Canada's warped class structure was an unfortunate component of the British colonial legacy. Just as excessive taxation was said to have spawned American revolutionary liberalism, so the mercantile orientation of Britain's colonists is said to have created the imbalance in Canada's political economy which allowed an elite fraction to "grow fat" off its monopoly rents. Moreover, this harvest

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²⁸ Mahon usefully suggests that Poulantzas' work offers insight into the operation of this intra-bourgeois struggle: "The imperialist relations to which monopoly capitalism gives birth create new tensions, for example, between 'comprador' and 'nationalist' elements of the domestic bourgeoisie. In addition, Poulantzas helps to clarify the theoretical status of the statement that the merchant-financiers remained dominant even after the emergence of industrial capital". R. Mahon, The Politics of Industrial Restructuring (Toronto: U of T P, 1984) p. 9

is said to have been reaped at the expense of those social and political interests that might have supported and fostered a more autonomous and ultimately potentially more competitive and successful pattern of development.

While this perspective has the advantage of transcending simple 'comparative advantage' explanations of Canada's development, it suffers from several important weaknesses. Foremost is the restriction of class analysis to a narrow ascription of supreme dominance to one particularly important class fraction. The notion of social struggle, or the sense that economic outcomes are, at least in some sense, the result of open-ended social and political conflicts is largely absent from Naylor's account.

The possibility of assessing the significance of various political struggles of the day is all but eliminated by assuming a structural determination of Canadian underdevelopment, not unlike that suggested by the staples approach that was at the centre of the classical Canadian political economy debate. Perhaps even more serious, however, was the parallel tendency to ascribe one homogeneous orientation to this class fraction and then to seek empirical support for this one proposition. In weighing Naylor's claim that the merchant-financiers had "engineered" the National Policy in order to stimulate the creation of a branch plant economy, Glen Williams points out that

...at no point is evidence produced which would demonstrate the conscious use of the [National Policy] tariff for this end on the part of even a segment of Canada's mercantile-financial capitalists.

In fact, he suggests that

There is substantial evidence to suggest that Canada's merchants and bankers either financed or directly participated in the establishment of many of the new post-1879 industries.²⁹

The implications of this criticism are profound. In the absence of a deeply polarized or fundamentally divided bourgeoisie, Naylor's explanation for Canadian 'underdevelopment' becomes far less persuasive. If behaviour was not inevitably linked to the nature of these competing fractions, then there is a greater need to explore the objective conditions that might have induced financiers, industrialists and others to behave in certain ways.

In this light, the foolishness of Macdonald's National Policy is suddenly less self-evident. Indeed, in stark contrast to Naylor's ridicule of this policy, Williams suggests that

It may be more productive...to view the low priority assigned to industrial development as a quite conventional response to a specific set of global political and economic conditions in which the policy was formulated.³⁰

At the very least, this argument should temper our assessment of Canada's early elites. If their strategies were, in fact, a "quite conventional" response to the economic pressures faced by Canada, then we are returned in many respects to the earlier "staple" argument, which had developed a plausible analysis of the reasons why Canada had produced its particular patterns of growth, and pointed to the inherent dangers of that process. However, perhaps the most distinguishing feature of Canadian industrial growth - the dominance of foreign branch plants within the Canadian economy - was only

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²⁹ G. Williams, "National Policy..." p. 160

³⁰ G. Williams, "The National Policy..." p. 162

partially foreseen in the staples analysis, and this gap led to yet another intense round of debate within the political economy tradition.

Critiques of Dependency and the "New" CPE

In response to Naylor and others approaching Canadian political economy from a dependency perspective, came a host of radical critiques. In fact, many of the best works in the NCPE debate were initially formulated as critiques of the "Naylor thesis" or, as it was later amended, the "Naylor-Clement" thesis³¹. The reaction against a dependency analysis of Canadian economic history was similar in many ways to that which emerged within development theory in the 1970s and early 1980s. Neo-marxist writers like Brenner suggested that the dependency approach, particularly as used by Frank, manifested a 'neo-Smithian' tendency to focus too much on the process of accumulation. However, unlike their neoclassical counterparts, dependency writers' suggested that capitalist imperialism did not lead to modernization and development in the periphery, but was a means of locking it into the structural condition of "underdevelopment". Rather than focusing upon the internal class dynamics which would inevitably emerge in the course of peripheral capitalist accumulation, Brenner complained that dependency merely ascribed an "overdetermining" role to the commercial and trading interests spawned by the trading relationship between metropole and periphery. According to Brenner, the result of such an analysis was the submergence of the 'real'

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³¹ When Wallace Clement published The Canadian Corporate Elite the "thesis" was reworked to include the notion that Canadian merchant capital had been partnered with US industrial capital, stripping Canada of a dynamic and indigenous bourgeoisie.

economic (class) forces which ultimately determine a country's external relationships. Although Brenner may have overstated dependency's alleged tendency to ignore the internal political dynamics of the periphery, the thrust of his criticism was widely accepted.

A similar point also emerges in Skocpol's discussion of Immanuel Wallerstein, the pioneer of world systems theory (an offshoot of dependency), when she suggests that Wallerstein places an excessive emphasis on the same international relationships so heavily emphasized in mainstream scholarship.

He is...explaining the fundamental economic dynamics of the system in terms of exactly the variables usually stressed by liberal economists, while ignoring the basic Marxist insight that the social relations of production and surplus appropriation are the sociological key to the functioning and development of any economic system.³²

The critique, then, began with a rejection of the structuralism implicit in dependency, and with a strong emphasis on Marxist class analysis, which was said to have been neglected and ignored.

A very similar exchange occurred in the Canadian debate when Panitch suggested that the dependency categories erected a false dichotomy between some ideal type of autonomous development and dependent underdevelopment, and that the tendency of the NCPE literature to portray the Canadian class structure as static and one-dimensional, had blinded it to the central insight of class analysis.

It is true that the most celebrated studies in the new political economy of the 1970s (those of Naylor and Clement) have been distinguished by their explicit connection between class and dependency. But the definition of

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³² T. Skocpol, "Wallerstein's World Capitalist System: A Theoretical and Historical Critique," *American Journal of Sociology* 82:5 (March 1977) p. 5

class that has been operative here has been one which puts emphasis on the characteristics of the various fractions of the capitalist class to the virtual exclusion of a conception of class as a contradictory social relation between workers and capitalists.³³

The real point is not merely that the Naylor-Clement studies were incomplete in not having given subordinate classes adequate consideration, but that the flaws in this approach led to a failure to understand the objective constraints impinging on Canadian economic development. For Panitch, closer attention to the class dynamics of the period would have led to a sounder understanding of the objective reasons for Canada's competitive weaknesses and its ultimate dependency. As he has observed in later work:

By looking at interclass relations, especially by examining the extent of class struggle between workers and capitalists in industry, we may discern discrete limits to the accumulation potential of Canada's indigenous manufacturers, apart from those allegedly imposed by the values and machinations of the bankers (many of whom invested in industrial production where it was profitable to do so and thus became industrial capitalists themselves).³⁴

In what is perhaps the high point of the last two decades of Canadian political economy analysis, Panitch argues that such an examination reveals that the struggles of Canadian workers and farmers helped to impose just such limits on Canada's "accumulation potential", and on the state's room for manoeuvre. Utterly unable to force a more repressive low-wage model onto Canadian workers, the state played a mediating role and accepted or fashioned a series of temporary compromises.

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³³ Leo Panitch, "Dependency and Class in Canadian Political Economy," Perspective on Canadian Economic Development: Class, Staples, Gender and Elites Ed. Robert Laxer, (Toronto: Oxford UP, 1991) p. 269. Emphasis added.

³⁴ Leo Panitch, "Elites, Classes and Power in Canada," Canadian Politics in the 1980s ed. Michael S. Whittington and Glen Williams (Toronto: Methuen, 1981) p. 178

The limits which workers (and farmers) posed to the rates of exploitation were constantly tested in struggles by both sides, but given a balance of power in which the subordinate classes were implicated as well as the capitalists, it was scarcely surprising that the Canadian state fostered protectionism, the development of the wheat staple in the West and direct foreign investment, in order to promote capital accumulation and to mediate between the class forces in Canada.³⁵

Once the analytic focus is concentrated more squarely on the country's multi-class dynamic, other features of Canadian history - such as the high-wage domestic labour market - take on much greater significance as a part of the framework for Canadian capitalism.³⁶ Such an approach also allows many of the insights of Watkins' and Innis' staples theory to be incorporated into the contemporary analysis. Thus, the reason why many of the 'forward' and 'final demand' linkages that were so strongly highlighted by Watkins were able to emerge lay in the very nature of Canada's class configuration and the ability of workers to demand wages broadly commensurate with those in the US since they could, and to some degree did, freely take their labour there. As Panitch has shown, this also meant that Canada's comparative advantage in the staples industries had to be exploited to a maximum since it made Canada's fledgling domestic industry more vulnerable to competition from larger and more advanced American corporations. The result:

While Canada got industrial production - beyond that which it already had from the 1850s on - it did not get it under the control of indigenous Canadian capital; it got its own industry but not, to the same extent, its

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³⁵ Panitch, "Dependency and Class..." p. 283

³⁶ For a full consideration of the significance of Canada's high-wage domestic market see Glen Williams essay, "Canada - The Case of the Wealthiest Colony," This Magazine (Feb.-March 1976)

own industrial capitalists; it industrialized, but dependently and incompletely.³⁷

The strength of staples theory and of the more class-based analysis is that they both depend fundamentally on the study of history to generate their insights. Moreover, as Watkins most recent work demonstrates, they can be complementary if categories and concepts are used openly and fluidly enough to recognize that the outcomes of social struggles are never predetermined, given the complexity of the world, the nature of human agency and unpredictable path of technological innovation.

The work of Panitch did not nullify the political concern with Canadian dependency, its origins or its contemporary implications. Rather, this work has given rise to an analytic and political project whose task it is to formulate alternative policies to guide Canada's industrial and economic restructuring in ways that would take account of the changing nature of its (increasingly troubled) "class compromise". Mahon has followed a similar approach, pointing out that major threats to the equilibrium of the existing hegemonic bloc (such as that posed by Canada's widespread deindustrialization in the 1980s) constitute obstacles but they also present opportunities for reconstituting that bloc, since the economic interests of both dominant and subordinate classes are ultimately at stake. Thus, if the state were to "permit" deindustrialization,

...the political interests of the staples fraction might be placed in jeopardy. Those in charge of branch plants or Canadian capitalists dependent on them (e.g., Canadian auto parts firms), indigenous industrial capitalists, and workers whose jobs and wage levels depend on the maintenance of a viable manufacturing base would no longer find it

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³⁷ Mel Watkins, "The Political Economy of Growth", p. 21

possible to satisfy their material interests within such a development process.³⁸

Far from being trapped in 'pessimistic structuralism', such an approach explicitly affirms the open-ended nature of social struggles, and argues that threats to class compromises may be "conducive to the emergence of forces posing a potential challenge to the hegemony exercised by the staples fraction."³⁹

Of course, in the decade since Mahon's study was published, there have been few grounds for optimism in this regard. What might then have seemed like conditions conducive to the emergence of a technologically-driven "nascent nationalist bourgeoisie",⁴⁰ prepared to take on a bold new role in leading the accumulation process, appear to have proven largely ephemeral in the free trade era of the 1990s.

Reformulating the "New" Canadian Political Economy

Far from having ended the debate over dependency, many recent contributors to Canadian political economy continue to frame their arguments in relation to various elements of the dependency approach. Others have defined themselves in opposition to it, aggressively contradicting the applicability of the concept to Canada. Thus, Carroll has suggested that Canada represents a fully integrated 'advanced imperialist' power, whose status and achievement are drastically underestimated by the formulations based on the dependency perspective.

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³⁸ Mahon, p. 18

³⁹ Mahon, p. 18

⁴⁰ Mahon, p. 18

To the extent that political independence is real, private foreign investment must normally be regarded not as a cause of dependence but rather as a means of fortification and diversification of the economies of the host countries. It thereby reduces "dependence" in the long run.⁴¹

However, if this is case, one might expect that Canada, with one of the highest per capita foreign direct investment (FDI) rates in history, would have one of the most "fortified" and "diversified" economies in the world.

But this is clearly not the case. It seems that Carroll is echoing Bill Warren's critique of the Latin American dependency approach,⁴² which leaves the real crux of the problem embedded in the ambiguity of such terms as "political independence" or "sovereignty". Neither adequately defines 'real' political independence, or explores the circumstances under which the foreign control of assets might limit or constrain that independence. Rather, Carroll remains satisfied that

Direct and portfolio investment both bring a local accumulation of capital and return flow of wealth to the capital-exporting country. Although direct investment implies a form of multinational control and a flow of repatriated profit, if the investment is to be maintained, a share of the profit must be kept in the country.⁴³

This simply fails to recognize the many potential differences between domestic and foreign investment in other respects. Thus, the development of "national" stocks of physical and social infrastructure, or of research and development capabilities, have

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⁴¹ W. Carroll, "Dependency, Imperialism and the Capitalist Class in Canada," The Structure of the Canadian Capitalist Class Ed. Robert Brym (Toronto: Garamond P, 1985) p. 37

⁴² See Bill Warren, "Imperialism and Capitalist Industrialization," New Left Review 81 (1973) and Imperialism: Pioneer of Capitalism (London: New Left Books, 1980). This work attempted to show that the theoretical foundation of dependency was mistaken, and its empirical basis was also quickly eroding. Warren's claim was that as capitalist production relations were becoming globalized, the "peripheral" social formations were "normally" progressing beyond their dependent structures.

⁴³ Carroll, p. 37

generally been associated with long term domestic investment. But Carroll fails to investigate the relationship between Canada's weak R & D record (among the lowest in the OECD economies) and its heavy reliance on foreign investment. Only by ignoring these complex and critical questions is he able to reach such optimistic conclusions regarding Canada's long term prospects.⁴⁴

The empirical data Carroll offers in support of his case shows the rate of domestic ownership of key industries rising, along with the rate of Canadian foreign direct investment in the U.S. However, these recent trends do not, in and of themselves, establish the independence or "maturing" of Canadian capitalism, as Carroll implies. Indeed, when combined with rapid de-industrialization, they may simply reflect divestment by foreigners, and increasing capital flight from domestic investors.

In fact, given the recent 'hollowing-out' of Canada's manufacturing, it appears more likely that Canada's long-standing technological and industrial weaknesses (which had long been offset by successful resource exploitation) are now becoming a chronic problem, leaving Canada - in relation to its major trading partners - more dependent than ever. In painfully sharp contrast to Carroll's optimism, David Wolfe describes the restructuring of recent years (including the FTA) with an ominous warning:

More people are working in lower-paying, poor-quality, service-sector jobs or working part-time, because of their inability to find full-time jobs. If left unchallenged, the new global trade imperative will result in a continuing downward spiral of incomes and living standards for the

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⁴⁴ Warren's "optimism" for the developing world was similarly misplaced. While he may have been able to suggest that "underdeveloped countries are steadily improving their bargaining positions and their ability to control foreign firms operating in their territories" (in "Imperialism and Capitalist..." p. 20) in the early 1970s, this position has become increasingly untenable, particularly in light of the massive debt which still burdens so many developing countries.

majority of workers, while capital becomes more detached from any commitment to its domestic economic base.⁴⁵

These were the main themes that dominated the NCPE debates during the 1970s and early 1980s. In many ways, the field is still apparently in transition, seeking to redefine itself once again. Since the global crisis of the 1970s, changes in the 'real world' of global political economy are offering a host of new issues, experiences and spaces to investigate. But there is a continuing echo of earlier voices in the CPE debate (Innis, Watkins, etc.). Rather than "class" or "dependency" being eclipsed entirely, their theoretical-conceptual content is gradually being filled in and developed. The widely-discussed globalization of inter-capitalist relations, and the apparently matching decline of the role played by national states in explicitly coordinating accumulation processes, has actually led to a re-affirmation of the NCPE's concern with dependency, class, and state. At the same time, there are ongoing efforts to reconstruct these concepts in new and more broadly inclusive ways.

In reaction to the perceived rigidity of "structuralist" social theory, many have appealed for a political economy that would theorize human agency with a more complex consciousness, and place more emphasis on non-class identities. As Rianne Mahon has recently suggested, such a recast CPE should appreciate that

Class still matters but other social forces, whose aims are "historically progressive" but whose social base, demands and terrains of struggle are not reducible to class, also require recognition. Here the concept of

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⁴⁵ David Wolfe, "Trade and Technology..." p. 111

identity, produced by feminists and students of the new social movements, has real insight to offer.⁴⁶

Such an appreciation of the increased theoretical significance of identity is being combined with an increasing focus on the rapid shifts occurring in production structures, both domestically and internationally.

Another aspect of the new approach suggested by Mahon involves a deeper appreciation of the ways in which "space" constrains, and partly determines, the course of economic processes. In some respects, this recalls the work of writers like Williams who had earlier suggested the possibility that an excessive emphasis on the tensions between "nations" may prevent us from conceptualizing a social formation like Canada's in terms that see it as fully integrated into a larger regional or metropolitan economy.

He points out that

When investment, production, and trade are considered, the Canadian economy may now be usefully conceptualized as a geographically large zone within the US economy. While itself regionally divided, this zone has until now maintained the capacity to reproduce its own unique social and political formations rooted in various popular and elite conceptions of a distinct Canadian nationality and culture.⁴⁷

Williams sees this as a kind of 'fourth alternative' in situating Canada within the international economy. Rather than seeing Canada as either a dependent and peripheral social formation, an 'advanced imperialist' power, or an ambiguous combination of the two, Williams' admits more complexity by transcending the narrow focus on competing

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⁴⁶ R. Mahon, R. "The 'New' Canadian Political Economy Revisited: Production, Space, Identity," Production, Space, Identity: Canadian Political Economy Faces the Twenty-first Century, ed. R. Mahon, J. Jenson, & M. Bienefeld (p. 10) *****

⁴⁷ G. Williams, "Canada in the International Political Economy," The New Canadian Political Economy Eds. Wallace Clement and Glen Williams (Montreal: McGill-Queen's UP, 1988) p. 132

national capitals. Although his 'region within the centre' framework may risk understating the role played by the nation state in creating and reproducing that integrated continental economy, its strength lies in the recognition that the distinctiveness of Canada - both as a political-economic and a cultural entity - has been increasingly eroded in the course of Canadian development.

Williams' position has the further advantage of being able to incorporate many of the insights of both the dependency and the class analysis traditions of the NCPE, without insisting on either their exclusivity or on any particular concept's predominance. Such theoretical flexibility would enhance political economy's ability to incorporate a wider range of social and cultural forces (civil society) into its analysis of the content and dynamics of Canadian development.

More concretely, as we take these new issues into account, the emergence of a strong political economy tradition in Canada can only really be understood in relation to the ongoing changes and crises facing the Canadian economy and its many governments today. Political economy has always been more than an academic discussion, and it now faces the challenge of defining economic policy options in an environment where the "hegemonic" balances of the past are in flux, and where a new hegemonic bloc, with no national attachment at all, may be emerging. While this process continues to be debated, it is increasingly clear that the market regulation of recent years has made the composition of a coherent "compromise" over industrial strategy both more difficult - and more necessary - than ever before. It is in considering the essential need for Canadians to reassert control over the investment function, that we now turn to a more detailed

discussion, and a historical assessment of the financial sector through which this control is exercised.

A "Political Economy" Approach to Canada's Financial History

This chapter has reviewed the main ways in which Canadian political economy has sought to interpret the history and development of Canadian capitalism. We have especially emphasized those formulations (Panitch, Mahon) that sought to overcome the rigidity and "structural determinism" associated with the Canadian-dependency hybrid. Certainly, a significant distance has been travelled, from Watkins' early appropriation of Innis' staples theory, through the latter's experimentation with dependency, to current attempts at a broader synthesis. Unfortunately, the general debate over how to characterize Canada's dependency has frequently left the concern with specific sectors and institutions relatively neglected.⁴⁸

As we argued in the last chapter, one relatively neglected sector is Canada's financial system. To date, the financial sector's main appearance in CPE scholarship came via Naylor's analysis and, as we have attempted to show, this analysis led to a certain simplification of this sector's role and of financial capital's interests and political engagements. In what follows we shall attempt to take advantage of the theoretical advances made in the CPE debate as a whole to reassess the role of the financial system in Canada's development.

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⁴⁸ We should mention that Mahon's study of textiles is a significant exception.

Such a project is not without difficulty. The concept of financial capital draws our attention to a blur of statistical details - interest rates, inflation, the money supply, rates of investment and return - which distract from the class position of its owners and managers and their relationships with other social interests, involved in the "real" economy. Moreover, given the shifting dynamics of Canada's "hegemonic bloc", it is not easy to define the role of the financial sector in leading, following, or profiting from economic processes, especially since political movements, particularly those representing or based on the "subordinate" classes, have often articulated their demands without explicit regard for the workings of the financial system.

On the other hand, there have been moments when financial and monetary concerns were at the forefront of popular political movements. Perhaps the classic Canadian example of this was the CCF's Regina Manifesto of 1933, which, as its second policy proposal, urged:

Socialization of all financial machinery--banking currency, credit, and insurance, to make possible the effective control of currency, credit and prices, and the supplying of new productive equipment for socially desirable purposes..."⁴⁹

Indeed, the financial system has played a role in certain popular movements: witness the successful assault by popular (agrarian) groups on the US's commercial banking system in the 1830s, which permanently transformed that country's financial system.

But such frontal assaults are rare. More common, and less visible, are the gradual shifts in the constitution of a hegemonic bloc, when significant institutional

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⁴⁹ See Leo Zakuta, A Protest Movement Becalmed: A Study of Change in the CCF (Toronto: U of Toronto P, 1964)

changes are brought about with the consent of the key hegemonic classes. Thus, even if Naylor captured part of the Canadian reality in describing a dominant but "comprador" financial elite, we need to ask to what extent that elite was internally divided, and how agrarian, proletarian, or industrial political interests helped to shape (or accede to) the resulting structure, and how their general interests were accommodated or articulated within it.

One methodological difficulty in proceeding is that much of the previous work in this area has tended to focus strictly upon the allocative function of Canada's financial institutions, attempting to determine the extent to which this function has been performed with "efficiency". A political economy approach will require us to draw upon a much broader and more qualitative set of historical resources.

Conclusion

We conclude with a restatement of our primary research question: to what extent did the Canadian financial system actively deny support to an emerging industrial class? While the question itself arises out of the discussion of merchant capital by the Canadian dependency writers, a more recent contributor has come to a similar conclusion by using elements of the (class-based) approach discussed above. Thus, in his discussion of Canada's branch plant industrialization, Gordon Laxer contrasts the financial systems of Europe which were able to directly promote domestic industrial growth, with Canada's

allegedly 'risk-averse' system. Moreover, he centres his argument within a class-based framework, and argues that it was the impotence of Canada's agricultural classes that determined this outcome:

Unlike the European investment banks, Canadian banks did not make substantial long-term investment in domestic industry, nor did they participate in manufacturers' managerial decisions. It was not that Canadian banks were bereft of domestic capital; in fact, they were so powerful that they expanded abroad on a major scale in the 1900-1913 period, at precisely the time when American branch plants first established their hold on Canada. Canadian industry did receive the necessary capital, but much of it was not from domestic sources. And because farmers were defeated in their attempts to bring about credit reform, the lending orientation of the banks did not move towards a policy of financing domestic industry. Canada's failure to adopt either the American or the German banking system was not related to peculiar tendencies of Canadian farmers, but simply to their political weakness.⁵⁰

While this improves upon Naylor's earlier formulation, Laxer has raised several questions which we will consider in what follows. If it can be shown that Canadian commercial banks failed to support domestic industry, then what role did they play in the early industrialization process? If it was the political weakness of Canada's farmers that determined the conservative and comprador character of Canadian banking, what was the cause of this weakness? And what of the weakness, or strength, of labour in this process? How did the Canadian state relate to the banks in this regard? And finally, on the comparative question, we might ask what configuration of political forces allowed certain European economies to establish developmentally-minded industrial banks that operated with a more national and long-term focus.

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⁵⁰ G. Laxer, *Open For Business: Foreign Ownership in Canada* (Toronto: Oxford UP, 1989) p. 254

In developing his argument, Laxer uses Gerachenkron's 'late-follower' model of economic development to compare Canada's experience to that of several European countries.⁵¹ In doing so, he shows that many countries with broadly similar resource bases were able to sustain relatively more autonomous industrialization processes (Sweden, Germany, and perhaps Russia), while Canada's industrial development remained relatively 'truncated' and dependent. Laxer argues that these different experiences were largely determined by the varying capacities of their financial systems to focus accumulated savings on investments in technologically-oriented industrial opportunities.

According to Laxer, the adoption of a British-style ('conservative') banking system was highly inappropriate for Canada's resource-based economy. Moreover, whereas the United States had rejected a similar commercial banking system in the 1830s, Canada lacked similar social or political forces capable of launching such a challenge on its conservative banks.⁵² As we have argued in response to Naylor, this kind of theorization is unsatisfactory. Although it attempts to avoid the mistakes of the simpler 'class domination' model of Naylor, it allows the problem to return by the back door, so to speak. By suggesting that the dominant class is usually able to exert its self-interested control, Laxer ends up like Naylor, asserting the dominance of merchant-

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⁵¹ A. Gerachenkron, *Economic Backwardness...*

⁵² Laxer shows that, in a similar period of American economic development, the monopoly position of the commercial banks was overcome through the mobilization of credit-poor farmers: "In the early nineteenth century private commercial banks did not lend readily to farmers, who needed capital to mechanize agriculture. The result was that the agrarian-based movement that swept Andrew Jackson to office also destroyed the Bank of the United States and the whole commercial banking system." See "Class, Nationality and the Roots of the Branch Plant Economy," *Perspectives on Canadian Economic Development* Ed. Robert Laxer (Toronto: Oxford UP, 1991) p. 251

finance, but explaining it by means of the alleged weakness of one of the subordinate classes.

As we have seen, hegemonic 'equilibrium' is achieved through open-ended social and political struggles. But it is material interests which remain the catalyst, even as those interests are changed and filtered through different perspectives and circumstances. Thus, to understand the peculiar character of Canada's financial system, we might do better to begin with a more materially (and historically) grounded sense of the development options actually available at this time. The assumption that a more promising development trajectory had been "hijacked" by an excessively self-interested financial class fraction may risk positioning the theoretical analysis 'before the history', so to speak.

In re-orienting ourselves, we face the very difficult historical question: were there other viable development options? And might they have offered a more egalitarian and industrially successful path? While these counterfactual questions will ultimately remain unanswered, some answers are implicit in some of the more sophisticated CPE analyses earlier discussed. Thus, Panitch's suggestion that it was labour's strength, largely due to its ability to exit the labour market, that limited the competitiveness of Canadian industry, does pose a formidable obstacle to many glibly assumed alternatives. Similarly, Williams' work, though still critical of the misguided choices of earlier elites, questions whether a much more thoroughgoing industrialization was a realistic possibility in nineteenth-century Canada:

The establishment of Canada's modern industrial structure was almost completely dependent on US manufacturing for reproduction (through

patents, licenses, and machinery) of its means of production and consequently was never in a position to become a competitive force within the world capitalist economy.⁵³

The contrast between these positions and Laxer's is remarkable, but we are still left with the difficulty of adequately accounting for Canada's relative competitive weakness. This question is addressed quite generally by nearly all contributors to the NCPE, but perhaps most insightfully by Panitch.

Ultimately, we might ask whether the 'main question' of Canadian political economy must remain framed in this "negative" way. Should political economy not also account for Canada's relative long-term prosperity, particularly considering the initial weaknesses that are so often heralded? In fact, as we will attempt to demonstrate in the following chapters, it is again through the lens of the 'hegemonic bloc', that we can find clues to developmental success, as the achievement of workable class compromises have not only meant that economic conflict has been mediated, but also that the stability required for successful accumulation has been achieved for significant periods of time. As history records, such stability can, given the other requisite conditions (available factors and resources) yield substantial periods of material prosperity as well as a reasonable diffusion of welfare and relative political and social stability.

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⁵³ G. Williams, "The National Policy..." p. 173

CHAPTER III

Financing Development:

Banking, Industrial Growth, and the Canadian State, 1821-1914

Introduction

The discussion of the last chapter sought to review, in broad outline, several of the primary themes and disputes that catalyzed the "new" Canadian political economy in the 1960s and 1970s. As shown, it was the interpretation of Naylor that sparked a good deal of this discussion, and in particular his primary emphasis on the financial elite, as the critical impediment to the development of a Canadian industrial capitalist class. Although several writers have taken issue with Naylor's position, no one has developed a comprehensive "political economy" analysis of Canada's financial system in order to explain more fully why the financial institutions played the role that they did in financing Canada's industrial growth. Considering the central role played by the financial systems of most other "advanced" countries in their growth and development, this gap in the Canadian debate needs to be filled.

This is not an easy task, however, since the empirical records are sparse and uneven. That is partly the reason why Naylor offered so little empirical data to justify his dramatic characterization of early Canadian political economy. Indeed, much of the

real statistical detail of Canada's early banking and financial history will never be available, since it was often not recorded in the first place. Even such statistical measures as national income and gross national product did not begin to be systematically tabulated until 1926.³⁶ In the financial sector, the accounts of chartered banks were only required to submit data reflecting the relationship of their note-structure to their capitalization at a highly aggregated level. Hence, there are no disaggregated records of bank assets, for the entire period from 1820 to 1926. All we know is what proportion of assets were held in the form of securities, notes, and loans, and this only for the chartered banks. This means that a detailed assessment of the activities of the banks, and of the financial system more generally, must be primarily qualitative, and its conclusions must remain tentative. Within these methodological constraints, the following history will seek to demonstrate that the available evidence lends little support to a critically important element of the "Naylor thesis" - namely, the notion that the Canadian state and Canadian development were dominated by an anti-national financial elite.

The argument does not deny that an important fraction of the Canadian bourgeoisie was financially-based, or that great fortunes were made in the banking industry. Moreover, it does not deny that the mercantile orientation of the Canadian business class did lead them to concentrate on the relatively safe investments available in the production and trade of Canada's main staples in a relatively unsophisticated form. However, this does not allow the story of early Canadian growth to be simply portrayed

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³⁶ Kenneth Buckley has produced "estimates" of GNP and gross capital formation back to 1900, but no earlier. Capital Formation in Canada, 1896-1930 (1955; Toronto: McClelland and Stewart, 1974)

as being dominated by a homogeneous hegemonic elite. Things were not so simple, as the following discussion will seek to show.

Although Naylor's focus on the financial system yields important insights, his analysis underestimates both the autonomy and the significance of the Canadian state in leading, financing and politically legitimating what was an enormously expensive and long term national development project. The state was, in fact, the key actor in the allocation of those financial resources that would become vitally important constituent elements of Canada's industrialization, so that, in this sense, Canada actually pursued a "state-led" (as opposed to a company-led) development path. It is important to realize that the "politics" of industrial development in Canada cannot simply be reduced to, or equated with, the economic interests of one "industrial" class fraction. Rather, both industrial development, and the development process more generally, as led by the state, resulted from the interplay of many conflicting social struggles involving both leading and subordinate classes concentrated in different sectors. The overall strategy, centred around staples and the creation of a national transportation infrastructure, demanded a high degree of social cohesion that could only be achieved through the constant re-creation of "hegemonic coalitions" based on various fractions of the primary social classes. The state cannot, therefore, merely be identified with one hegemonic mercantile-financial class - though it was undoubtedly significantly constrained by this fraction's significant material power. Rather, the state was faced with the task of establishing and maintaining conditions under which some of the material interests of a number of different classes could be realized, and this would mean following a course

of action that would, on occasion, conflict with the apparent demand/preferences of the leading class fraction. The following history will aim to shed light on this process as it was reflected in the evolution of Canada's financial system. In doing so, it will offer a different nuance to the story of Canadian development and to the role that finance played in this process.

Linking Finance to Development

Canada's financial history appears paradoxical from a "late development" perspective. As a follower country, Canada faced the task of modernizing its economy and industrializing without the capital or the artisanal base to compete with those who had already industrialized, and without the luxury of building a slow and gradual development process because of that competitive threat. In many late developing countries where economic and political elites found themselves obliged to 'push' national industrialization programs in the face of such intense competition, the financial system - with varying degrees of state involvement - was used extensively in support of this objective. In his discussion of early German industrial growth, Gerschenkron points out that the rapid industrial expansion that such a program required did not have to be financed purely from 'accumulated wealth' (i.e. savings) being redirected into industrial pursuits.

The focal role of capital provision in a country like Germany must be assigned not to any original capital accumulation but to the role of credit-creation policies on the part of the banking system. It is true that the banks also collected and passed on to entrepreneurs both current savings

and some previously created assets that could be converted into claims on current output, but this is much less significant.⁵⁷

The key is the existence of an institutional structure which is able to provide private industrial enterprises with sufficient finance on terms that encourage long term investment. In countries such as Germany, where major fortunes had not been amassed through a gradual industrial expansion, this institutional role required large investment banks to use credit creation as a spur to growth.

In other countries, such as Russia and Japan, this function was fulfilled by the state itself, with the functional assistance of differing financial institutions. Canadian development conforms to these models rather more closely than the British or American "leading" models, but with one major difference. Rather than taking on the task of stimulating an industrialization process based on a "national" industrial bourgeoisie, the Canadian state drew a large amount of its "development capital" from foreign markets. While the banking system played a role in facilitating the mobilization and transfer of this capital, the process was begun and led by a young Canadian state that was severely constrained by its close proximity to the highly competitive and powerful US economy. Generally speaking, by capitalizing on the dynamism of the American economy, the "soft capitalism" of the consequent Canadian staples model achieved relative long-term success, but paid a price by continuing to suffer from the underlying structural weaknesses of a relatively dependent economy whose industrialization process was dominated by foreign capital.

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⁵⁷ A. Gerschenkron, *Economic Backwardness...*, p. 45

Early Canadian Banking History - 1763-1841

We begin with the system's very early origins. Although several comprehensive institutional and monetary histories of Canada have been compiled,⁵⁸ most emphasize the personal, 'romantic' elements of their stories, while shedding little light on the social or political reasons why the system took the form that it did. Rather than summarizing this voluminous literature, the following discussion will focus on the identification of some unique features that distinguished Canada's early banking system, and on the political and economic forces that gave rise to them.

The beginnings of colonial finance and currency in what is now Canada emerged in the late 18th and early 19th centuries. When the fur and lumber trades first drew French, and later British, traders into the interior of British North America, the lack of effective monetary and financial institutions soon became a recognized problem. With its cumbersome barter exchange system, and a chaotic metallic currency regime, the pioneer economy was soon in dire need of a reliable medium of exchange. The simultaneous circulation of playing card money, Army bills, merchants' 'bons' (I.O.U.s), and various other experimental currencies, soon demonstrated the value of a standardized monetary system to 'lubricate' internal trade both within and between the maritime colonies and the two Canadas (Upper and Lower). Owing to significant differences in local governance and economic priorities, each of these three regions had spawned

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⁵⁸ These include V. Ross, A History of the Canadian Bank of Commerce, vols. I-III (Toronto: Oxford UP, 1920); The Centenary of the Bank of Montreal, 1817-1917 (Montreal: Bank of Montreal, 1917); R.M. Breckenridge, The History of Banking in Canada (Washington: National Monetary Commission, 1910); R.C. McIvor, Canadian Monetary, Banking and Fiscal Development (Toronto: MacMillan, 1958); and R.M. Breckenridge, The Canadian Banking System, 1817 - 1890 (Toronto:n.p., 1894)

separate and sometimes competing monetary systems.⁵⁹ The rigidity of the awkward bartering system, the instability of uncontrolled paper currencies and the rapid growth of trade in what was then British North America, soon led to appeals for standardized banking.

Eventually, some of the largest Montreal merchants began to meet this need by extending their early experimentation with quasi-banking services to the legal chartering of banks.⁶⁰ The first fully chartered banks were established in roughly the same four year period, with banks first appearing in Upper Canada and the maritimes. The first true chartered bank was the Bank of New Brunswick, receiving its charter in 1820, followed by the Chartered Bank of Upper Canada (1821). In Lower Canada banking developed immediately thereafter, with the Bank of Montreal (1822), the Bank of Quebec (1822) and the Bank of Upper Canada (1822), among others. The economic environment in which these early banks emerged was remarkably different from that of the later Confederation era. As one bank history points out,

[Canada's] whole population was less than 400,000, and that of Montreal, already the chief trading centre, less than 20,000...

...Domestic trade was carried on principally by barter and exchange. Shopkeepers who bought from the merchants were compelled to give long

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⁵⁹ McIvor describes the differences in the valuation of, among others, silver coins: "East of Quebec, and introduced by Massachusetts merchants arriving in Nova Scotia, there prevailed the 5s. rating known as "Halifax" currency. In Quebec and to the west, and introduced by New York merchants arriving in Montreal, the 8s. rating known as York currency became standard." Canadian Banking... p. 13ff

⁶⁰ The following early history is derived primarily from the following works: Adam Shortt, "The Early History of Canadian Banking," Money and Banking in Canada ed. E.P. Neufeld (Toronto: McClelland and Stewart, 1964); R.C. McIvor, Canadian...; H.H. Binhammer, Money, Banking & the Canadian Financial System (Toronto: Methuen, 1982); and W.T. Easterbrook, W.T., North American Patterns of Growth and Development: The Continental Context (Toronto: U of T P, 1990)

credit to the settlers, who almost invariably made payment in farm products, which were shipped to Montreal in settlement of their accounts.⁶¹

These conditions prevailed throughout much of North America. Indeed, it is interesting to note that the Montreal merchants had chartered their first banks not long after the establishment of the First Bank of the United States, developed under the guidance of Alexander Hamilton. Observers have also noted strong parallels between the Bank of Montreal's "Articles of Association" and the First Bank's constitution.⁶² However, although the development of Canada's banking system began at about the same time and on the same trajectory as that of the United States, divergent political conditions soon led to significant differences, shifting the U.S. pattern firmly towards the decentralized "free" banking system that, in many respects, remains dominant today. Ironically, Hamilton's vision of a highly capitalized and centralized commercial banking system actually did emerge successfully in the Canadian colonies, where it spawned much less political opposition.

Several aspects of this birth of the Canadian banking system are of note. First of all, it is widely acknowledged that Canada's trade and commerce was strictly controlled by merchant-capitalists who often held local monopolies in both the goods they traded and in the issuance of the notes of exchange that functioned as the initial medium of exchange. Predictably, the formation of the first banks was therefore primarily a

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⁶¹ *The Centenary...*, p. 6

⁶² McIvor, for example, points out that "there is no doubt that the Articles were taken directly from the constitution of the First Bank of the United States, a document devised by Alexander Hamilton, the first secretary of the Treasury of the new Republic." p. 26. Going even further, Shortt, refers to Hamilton as "the Father of the Canadian banking system", p. 79ff.

mercantile enterprise, reflecting the central economic role of the merchant class in both Canadian colonies.

In the case of the Lower Canada banks, all directors were leading merchants of the colony, and a large proportion of the early advances were to these merchants. This association of ownership with the British commercial element, and the identification of many partners with the Legislative Council of the province, contributed to a growing tendency to increased popular criticism of the banks' operations as time went on.⁶³

Because of the close political alliances of those associated with these banks, the Chartered Bank of Upper Canada and the Bank of Montreal in Lower Canada were able to exert an effective restricting influence on the number of banks their respective legislatures chartered. The same was true in Nova Scotia where the Halifax Banking Company (organized in 1825), although a private bank, was able to maintain its monopoly position until the formation of the Bank of Nova Scotia in 1832.⁶⁴

The result was a banking system which followed the Scottish tradition of 'branch banking', conducted by a small number of large and highly-capitalized banks, providing discount services to merchants and farmers through the issue of bank notes. While several small banks were formed in this early period, they remained small and primarily dependent on the urban centres in which they were formed.

From Unification (1841) to Confederation (1867)

The decision to unify the provinces of Canada marks the first explicit attempt to co-ordinate a national developmental effort. Unification in 1841 was a direct result of the colonial administration's decision to extend several major transportation projects that had already resulted in the accumulation of large public debts. The cost of these canal

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⁶³ McIvor, p. 30

⁶⁴ Binhammer, p. 60

and transportation projects was tremendous, particularly in per capita terms. Unification allowed debts to be consolidated and therefore offered foreign (largely U.K.) investment capital a more attractive home. Clement interprets this development as representing the victory of urban elites over agricultural interests:

As a strategy to have the populace finance canal construction, the union further reinforced the unity of merchant and political interests against each province's agricultural hinterlands.⁶⁵

While these developments probably do reflect the dominant power of an urban merchant class, such an interpretation may underestimate the extent to which Canadian farming also depended upon the development of an inexpensive transport and delivery system that would allow them to reach export markets efficiently.

While the expense of these public infrastructure projects may have increased the degree of interdependence among classes with otherwise different political interests, this shift was neither universal, uniform or permanent. A major challenge to the existing situation came in 1842 from within the fledgling legislative-political elite (we can call it the "state"), which sought to increase the central power of the colonial government. To this end, Lord Sydenham, first governor of the united province of Canada, proposed the establishment of a public or 'central' bank for the united province - the 'Bank of the Province of Canada'. The main reason behind this proposal was the redirection of the revenues generated by the note issue function into the public purse, where it could support those broader "national" objectives.

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⁶⁵ Clement, *The Canadian Corporate Elite* p. 55

The vigorous debate generated by this proposal exposes some important differences among Canada's seemingly unified elite. Although the proposed public bank was not intended to compete for discounting services, or for deposits with the chartered banks, they worked hard to defeat the proposal in order to protect the revenues they received from the note issue function. Thus, even though the proposal had the support of the governor of the province and of certain key members of the financial community, including Francis Hincks (a former Finance Minister) and George Moffatt (a founder of the Bank of Montreal) the proposal was ultimately defeated.

The episode reveals both the government's desire and need to increase central revenues (in order to pay existing debts and to finance infrastructural investments) and the considerable political influence of the banking community, which, on this occasion, was able to override an initiative emanating from the highest levels of the political leadership. However, the fact that the proposal was taken so seriously also shows that Canada's embryonic state was capable of acting quite independently in its search for mechanisms to finance the canal, road (and later the railway) infrastructure. Moreover, the proposal also stimulated "popular opposition because it was feared that such a central bank would concentrate excessive power in the hands of an unelected political executive."⁶

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⁶ G. Laxer points out that bank opponents included all of those who "opposed any scheme strengthening the revenues of the unelected executive" (G. Laxer, Open for Business p. 171). It is interesting to note that the Scottish banking system - one that Canada's has been widely compared to - shifted to a public monopoly on note issue in 1845, not long after Sydenham's proposal was defeated in the province of Canada. See Breckenridge, R.M. The Canadian... pp. 14-15

The consequences of the defeat of the Sydenham bank are unclear. The government still faced the financial crisis that had gripped the province(s) from early in their existence, and since domestic finance appeared now to be unattainable, it turned increasingly to the international financial markets - a solution that would become a perennial option, as well as a rising source of concern.

Some analysts have argued that the main weakness of Sydenham's proposed bank was its failure to allow for an organic 'elasticity' in the note issue, so that banking capital and credit would become too closely linked to the size of the government debt, and not linked to private entrepreneurs' fluctuating need for capital.⁶⁷ This debate was to remain of central concern throughout the next decades, and is worth some scrutiny. Established banking practices suggested that the elasticity provided by flexible - and seasonal - loan issues would be diminished by the granting of a monopoly to public security-backed notes, and that this would leave borrowers short in the largely seasonal peak periods of activity. The opposing argument focused on the problems of the business cycle, suggesting that the existence of notes backed by government securities would counteract the tendency of the money supply to contract ominously when the volume of commercial loans fell (during depressions). This would reduce economic fluctuations by providing a far more stable money supply during those periods when it was most urgently needed. While the financial interests won the early rounds of this power struggle, in time, the note issue was to become a government monopoly.

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⁶⁷ See H T. Davoud, "Lord Sydenham's Proposal for a Provincial Bank of Issue," Money and Banking pp. 104-105

Given the common perception that the financial interests and the political leadership in Canada were virtual identities, it is worth considering briefly why the government was able to encroach gradually upon the note-issuing powers of the chartered banks. Had the bank presidents' alone determined policy, there would never have been such a shift, and the government treasury might have faced even narrower constraints. The fact that, in the long run, the government was able to win this battle, not only suggests the importance of the issue to the government, but also reveals the degree of its autonomy from the dictates of the financial community. Moreover, it underlines the fact that the costs of national development were being assumed by an active state, which faced a perpetual financial crisis as a result.

One might wonder what the establishment of a Sydenham-type central bank would have meant for the activities of the existing chartered banks. It is possible that a government intent upon economic expansion might have used it to encourage competition and to force the banks to evolve along lines more similar to those of the American "free" banks. Certainly the need for easier credit was widely perceived. In fact, in 1850, after yet another serious economic crisis (1847-1850), a Free Banking Act permitted the establishment of smaller banks, with a capital base of just \$100,000. The Act was clearly intended to shift the established model towards the small bank-based model in existence across the border in New York. Binhammer emphasizes the significance of the smaller capital requirement:

This was a small amount by chartered bank standards; the intent was to encourage the formation of unit banks similar to those in the United States and to avoid application to the legislature for a charter. Bank notes were to be printed by the government and could be obtained by the banks from

the Inspector General of the province upon depositing with him public securities of an equivalent amount.⁶⁸

It is possible that, on this occasion, the general opposition of the chartered banks to the Free Banking Act was overcome only because they foresaw that the poor design of the legislation would guarantee its ineffectiveness. Indeed, for Canadian farmers and others fighting for easier access to capital, these new Canadian free banks did not turn out to be a solution, because they were at a severe competitive disadvantage from the outset.

Laxer points out that

Finance Minister Hincks forced the free banks to tie up their capital in low-yield government securities, a requirement not made of chartered commercial banks. As a result free banks could not compete with the chartered banks.⁶⁹

On the other hand, the government's evident intention of stimulating new financial services and its capacity to overrule the chartered banks on this point, again reflect a degree of creativity and independence on the part of the state that Laxer may have downplayed. In the event, only five small banks were formed under the Act's auspices, and the only two that succeeded soon obtained charters and reverted to the set pattern. The Act was eventually repealed in 1880.

The shifting balance of forces between the financial sector and other interests was further reflected in a second attempt to extend government control over the issue of bank notes which proved more successful than the earlier Sydenham proposal. Thus, in 1866, on the eve of Confederation, a Provincial Note Act was proposed by finance minister

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⁶⁸ Binhammer, p. 63

⁶⁹ G. Laxer, p. 171

Galt. This Act was passed amidst controversy following two major bank failures - that of the Bank of Upper Canada and the Commercial Bank - and the damaging impact of an economic downturn. It authorized a provincial note issue of \$8 million and provided generous incentives to all chartered banks to retire their own notes and convert them into provincial notes.⁷⁰ When the chartered banks refused to accept the proposal, the government persuaded its own bank - the Bank of Montreal - to retire its private notes unilaterally and to float only government-backed notes. As the largest and most stable bank, the Bank of Montreal thereby acquired a vested interest in increasing the circulation of government notes, since it now stood to benefit from this change. With this partial victory, the government began the long process through which the banks were eventually induced to accept the shift from the original specie-based notes to government paper.

By the time of the American civil war (1860 to 1865), the contrast between the system evolving in Canada and that which had been established in the United States was quite sharp. The American banking system of radically decentralized 'free banking' had emerged as a result of the political assault on the established commercial banking system by the populist frontier democracy associated with the presidency of Andrew Jackson. The consequent establishment of innumerable local independent banks contributed to the opening and development of the western American frontier. Laxer views these events

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⁷⁰ "The banks were offered a subsidy of 5 percent per annum on the value of notes retired until the end of their charters, and a commission of 1/4 to 1 percent for handling and servicing provincial notes." J. W. O'Brien and G. Lerner, Canadian Money and Banking (Toronto: McGraw-Hill, 1969) p. 29

as a direct reflection of the superior political power and organization of America's farming classes.

Starting with a more conservative system than England's, [the US] destroyed its central bank and the near-monopoly of large commercial banks in the 1830s. Unrestricted banking allowed the number of state banks to mushroom to 1,562 by 1860. For a time the new American system favoured debtors over creditors, and capital flowed more freely into farming and industry. In these years the United States became an industrial country.⁷¹

It is the contrast between this development of "free" banking in the US with the continued dominance of large branch banks which leads Laxer (and Naylor) to conclude that it was the Canadian banking system's continued preference for short-term (liquid) assets that failed Canadian development.

There are several reasons why this conclusion ought to be softened. While the institutional structure of this early financial system did not, by itself, generate the long-term finance that industrial enterprises of the period required, it should be remembered that by mid-century there were few sophisticated industrial enterprises even attempted in Canada while American industry had begun its "take off", fuelled by a large and rapidly growing internal market. Although there was a period when "frontier" banking clearly favoured borrowers, it is important to remember that American industrial expansion was largely self-financed through the investment of "retained" earnings. While the American free banks may have helped to create a "borrowers" market for a short time in the mid-19th century, it is also true that these small banks frequently failed during economic

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⁷¹ G. Laxer, Open For Business p. 174

downturns. Thus, although "easy" credit can promote growth, there is also a pressing need to minimize the social and economic costs of excessive instability.

Moreover, Laxer's claim that the Canadian banks' preference for liquidity and caution can be explained by their oligopolistic position in the market must be qualified. Although an oligopolistic branch banking system can encourage such "excessive" liquidity preference, there is no necessary causal link between the two. In fact, Gerschenkron argues that a centralized system is essential to deal with the risks of "late development". It is thus important to consider the possibility that the evolution of the relatively conservative orientation of Canada's financial system may largely reflect the pattern of Canada's economic opportunities which made it difficult (or impossible) to add the risks of investing in long term industrialization in the face of fierce US competition, to those of investing in the inherently risky staples on which the economy was built and in an infrastructure whose per capita costs were enormously high given Canada's geographic and demographic configuration.

Turning to the available evidence, Table I (below) shows the financial position of the chartered banks in 1850 and 1856. One of the most striking features of this data is a high loan to capital ratio. As Shortt notes, with only

One-tenth of the bank capital being invested in government securities and available only in the event of bankruptcy, and only part of the small amount of coin and bullion on hand being unlimited legal tender, it is obvious that the remainder of the capital and the notes and deposits were loaned to the public to the extent of eight-ninths in 1850 and twelve-thirteenths in 1856.⁷²

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⁷² Adam Shortt, "Currency and Banking, 1840-1867," Money and Banking in Canada ed. E.P. Neufeld, (1964; Toronto: McClelland & Stewart, 1967) p. 140

Table I - Chartered Bank Financial Data, 1850 and 1856

	1850	1856
Capital Paid In	\$2,775,880	\$4,804,768
Coin and Bullion	384,111	886,410
Notes in Circulation	1,309,932	4,199,211
Deposits	1,524,267	2,803,238
Loans	4,374,898	9,611,315

Source: Adam Shortt, "Currency and Banking, 1840-1867"

This high loan ratio suggests a willingness on the part of the banks to take considerable risks, and appears incompatible with the claim that they had an unduly strong preference for liquidity. Moreover, the banks had some reason to be cautious in their lending since the cyclical rhythm of the early Canadian economy brought frequent sudden downturns that always severely strained the banks' position. Thus, although there were few major banking failures in the pre-Confederation period, the two of note both resulted from long-term (and high-risk) loans to the railroads. The Bank of Upper Canada, at the time the government's banker, lost a great deal in the downturn of 1857-58, but with government assistance was able to hide its weaknesses for over six years until its real financial position became public, at which time the government lost over \$1 million upon the bank's failure.⁷³ The Commercial Bank, another of the older established banks, also suffered heavy losses in the early 1860s, and was eventually forced to accept a merger with a larger competitor. The fact that such losses occurred and that the banking system was frequently under severe pressure from the fluctuating pioneer economy suggests the

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⁷³ See Shortt "Currency and Banking..." p. 147

need to qualify Naylor's depiction of an oligopolistically-protected bank system which enjoyed the "luxury" of a conservative lending pattern.

The claim that the Canadian banks conducted a part of their banking abroad has some basis in fact, although part of the reason for Canada's heavy reliance on foreign capital has been shown to have resulted from the high cost of its infrastructural needs. However, this does not explain the pattern of lending entirely. In 1865, William McMaster, a director of the Bank of Montreal, publicly criticized the bank's business with "Montreal importers and to foreign exchange transactions in New York". Speaking of his subsequent decision to leave the bank and to establish a competing institution, McMaster dramatically declared that "all we seek is the good of the country. We believe that all the floating capital which some banks get hold of is loaned out of the country. Our policy is to benefit our respective localities by employing our own, and the floating capital coming under our control, in the support of the trade and industry of the place."⁷⁴

McMaster did acknowledge that the business in which the banks were involved in the New York markets was profitable. However, as shown in the following chapter, the banks' submissions to the government (after 1900⁷⁵) show that the volume of long term foreign loans to total assets peaked at 5.9% in 1902, but averaged approximately 3% before the first world war. Even short term ("call") loans accounted for an average

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⁷⁴ Qtd. in Melvor, p. 72

⁷⁵ It was in 1900 that the banks were required to report the volume of their assets being lent abroad. The following statistics are from C.A. Curtis, "Statistics of Banking," Statistical Contributions to Canadian Economic History Vol. I (Toronto: MacMillan, 1931)

of around 7% of assets in the same period, while "total loans in Canada" ranged between 50 and 65% in the same period. Since this "foreign" business had been growing, it is highly doubtful that these proportions were any higher previous to this. As all of the major banks pursued such business, it is similarly unlikely that there were any meaningful divisions between a "national" and "continental" camp in the banking industry, and McMaster's comments undoubtedly reflect no small element of posturing.

Finally, despite the seriousness of the crisis that led to the aforementioned bank failures, the period from 1850 to Confederation was a period of strong economic growth. An export boom that was fuelled by both the (Canada-U.S.) Reciprocity Treaty of 1854 and by the American Civil War meant that, despite a brief depression (1857-1858) following a speculative real estate boom, the Canadian economy experienced its first major expansion. This, together, with the increasing strength of the US economy, led much of the Canadian business class to conclude that "the future of Canadian commerce [lay]...in her ability to tap into the United States industrial boom"⁷⁶ and the large and growing markets that it was creating.

The economic growth that accompanied this rapid expansion of Canadian exports was more than matched by an expansion of domestic credit and banking facilities, that included the opening of more and more chartered banks. By the time of Confederation, there were thirty-five banks with charters, operating in each province. In addition, most of the existing larger banks had sought and received approval to increase their

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⁷⁶ Clement, Canadian Corporate Elite p. 59

capitalization over this period, so that banking in Canada experienced substantial growth even though some of the new banks would later prove to be of questionable character.

Table II - Number of Chartered Banks Operating in Canada, 1830-1867

Year	Number of Banks (as of Jan. 1st)
1830	6
1835	14
1840	16
1845	16
1850	15
1855	23
1860	31
1865	34
*1867	35

Source: Neufeld, The Financial System of Canada

It is difficult to determine the extent to which this growth in the financial system reflects the system's "efficiency" in mobilizing savings for investment (i.e. intermediation) and to provide finance for development. There is no established method of measuring such efficiency, nor would there be enough empirical data to do so. However, it is clear that commercial credit expanded broadly in proportion with the expansion of the economy, and especially of Canada's staple industries. In this respect, Canadian development was not unusual since industry and finance have tended to "flourish - and decline - together"⁷⁷ in the course of industrialization. Moreover, the

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⁷⁷ Rondo Cameron et al, Banking in Early Industrialization (Toronto: Oxford UP, 1967) p. 313

financial system's ability to expand so readily to accommodate new opportunities demonstrates the key role it played in the development process through the promotion of credit and the monetization of commerce. We might tentatively infer from this that the banking system's "conservatism", and its reluctance to get heavily involved in the high risk finance of an indigenous industrialization process may have largely been a result of limits imposed by the country's relative industrial weakness, as well as the need to finance the relatively risky primary sectors and the even riskier, long term infrastructure projects on which the creation - and the survival - of the country depended.

Confederation to World War I

The central significance of Confederation, and one of its primary justifications, lay in the unification of jurisdiction over all fiscal, monetary, and banking matters in the new country. Naylor's interpretation of the BNA Act emphasizes its centralizing elements:

The Act was essentially a document in public finance, reserving for the federal government every power critical to controlling the pattern of economic development. All taxes other than direct (which then implied land taxes), regulation of trade and commerce, banking, credit, currency, bankruptcy, canals, telegraphs, navigation, and all residual powers went to the federal government. Provincial revenue requirements were expected to be met by a paltry subsidy.⁷⁸

However, this characterization may overstate the 'centralizing' character of the BNA Act, given the relatively decentralized nature of the resulting federation. Moreover, it also risks understating the economic and political constraints that were imposed on Canadian

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⁷⁸ Naylor, "The Third Commercial..." p. 14

policy makers by the high volume of cheap goods flooding in from the United States, the attractiveness of the high wage US labour market to Canadian workers, and a certain residual sentiment among some Canadians that American annexation was either desirable or inevitable. In taking on the powers it did via the BNA Act, the state was, in effect, preparing for an open-ended battle for its very survival.

With respect to the financial system, the BNA Act provided for an extension of the existing bank charters, until new banking legislation could be enacted. This occurred with the passage of the Bank Act of 1871, which enshrined many existing banking practices into law, including the restriction of bank notes to denominations of \$4 and higher; the requirement that at least one-third of reserves were to be held in Dominion notes; the requirement that monthly statements be presented to the government; and the prohibition on loans against real estate. With the passage of this Act, banking became more nationally uniform, and government's power was more firmly entrenched in the chartering and regulation of banks.

However, the route to this eventual outcome was not smooth or direct. Not satisfied with the new federal government's financial powers, the first federal Minister of Finance, Sir John Rose, had acted immediately after Confederation to alter Canada's banking legislation "along the lines of the National Bank Act in the United States."⁷⁹ As the Bank of Montreal's issuance of government notes only accounted for about 19% of the money supply, the government was still hoping to take over the banks' power to issue notes. The proposal to create a new "public bank" which would take over the note

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⁷⁹ McIvor, p. 64

issue was, once again, defeated, and the Minister's prompt resignation "forestalled any further efforts in this direction,"⁸⁰ until the formation of the Bank of Canada decades later.

On the other hand, the profitable note issue was, in fact, gradually taken over by the government. The 1871 Bank Act revisions did make Dominion notes mandatory in all of the banks' reserves, a move which further increased their volume. By 1877, Dominion notes accounted for over 36% of the notes in circulation, and this figure gradually increased in the years following. By 1907, the government notes amounted to 45% of the total, and in 1914 they became the majority of the notes in circulation.⁸¹ Hence, while the proposal for a public bank was again denied, the new currency system represented a not insignificant victory for the government, and paved the way for the eventual establishment of the Bank of Canada.

Nonetheless, the first post-Confederation government remained deeply indebted while still facing a pressing need for a bigger and cheaper transportation infrastructure. Although it is unclear to what extent the banks could have raised the credit required without triggering inflationary pressures, the government's reliance on foreign (portfolio) capital was increased by this outcome. The first six years following Confederation were highly prosperous, partly due to the high volume of imported capital. Moreover, as the economy grew, the banking industry - still quite stable relative to the American unit banks - expanded equally rapidly. Between 1867 and 1874, the number of active banks

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⁸⁰ McIvor, p. 64

⁸¹ Computed from C.A. Curtis, "Statistics of Banking"

grew from 35 to 51, their capitalization doubled and their combined real assets quadrupled.⁶² However, although this expansion meant more readily available credit for development, the quality of the loans and, in turn, the solvency of the banks, declined.

In the domestic market for capital, a part of this expansion in financial intermediation was seen in the growth of Government savings banks, which were geared specifically toward attracting the savings of the "poor". As ex-Finance Minister Rose said in the first session of parliament,

If there was anything which the Government ought to encourage, if it could, it was the habits of economy and thrift on the part of the population; and if there was any securities which ought to be put beyond the reach of possible contingencies, it was the savings of the poor. We found that where the Government had taken Savings Banks under their protection, the number of depositors and amounts per head in proportion to population were very much increased.⁶³

It is revealing to find that when the government attempted to entice more of these personal savings into the financial system (through marginally higher interest rates in the Savings Banks), the chartered banks were urgently opposed to this competition for the public's savings. In raising their objections through their primary communications organ, the Monetary Times, they later complained that the government

...pays more for these deposits than the rate paid for the last loan [from the banking system] - four per cent. against about 3% - which cannot be good economy on the part of the government. It is paying an unnecessary price for what it borrows through the savings banks...The savings of the people which they

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⁶² E.P. Neufeld, The Financial System of Canada (Toronto: MacMillan, 1970) p. 97

⁶³ Debates House of Commons. First Session. Dec. 7th, 1867. pp. 213-214

collect are either spent unproductively or locked up in public works; in one case they contribute but remotely to reproduction, in the other not at all.⁸⁴

Though certainly presenting the banks with unwelcome competition for under-utilized (but increasingly important) public savings, the government demonstrated a willingness to tap new sources of capital, and mobilize these resources for the "public works" which the bankers argued were only "remotely" contributing to the country's economic expansion. In this regard, the federal government played a positive role in the creation of new mechanisms through which the costly transportation projects (and the associated government debts) could be financed.

When the depression of 1873-1879 enforced a renewed contraction of bank credit, the severity of the downturn again appeared to be made worse by the fact that the banks became increasingly cautious. One historian supports these claims by noting that "from the 1873-5 period to the 1896-1900 period, loans as a proportion of total assets declined by 12.1 percentage points, which was largely accounted for by the 8.5 percentage point increase in security holdings and 5.6 percentage point increase in cash items and call loans."⁸⁵ In fact, in response to this depression, the banking system eventually reduced its capital, used up its reserves, and amalgamated its business, further concentrating the industry into fewer hands as many of the less solvent banks failed. Indeed, "between

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⁸⁴ Monetary Times, Trade Review and Insurance Chronicle Vol. XVIII, No. 30 (Toronto, 1885) p. 857

⁸⁵ Neufeld, Financial p. 113

1880 and 1910, it is estimated that approximately thirty per cent of Canada's banks failed."⁶⁶

This rapid succession of boom and bust, and especially the serious depression from 1876 to 1879, increased the political unity among many of those who felt their effects most harshly. Indeed, the 'Dominion Grange', a farmers movement, began to mobilize popular demands around financial and other reforms in the 1870s.

The Grange wanted an end to the monopoly aspects of capitalism itself. It opposed the exactions of the middlemen, who stood between agrarian producers and urban consumers. Lack of access to farm credit was another major concern, leading the Grange to advocate government ownership of all banks as a way of breaking the monopoly of the commercial banks. It urged public ownership of railways, telephones, and telegraphs for similar reasons.⁶⁷

Considering that European socialism was just then emerging as a significant political and ideological force, this program appears - even today - quite radical. However, the Grange, like other agrarian movements, remained small and 'petit-bourgeois' in character, mobilizing owner-operator farmers to challenge the political dominance of the urban commercial elites in the political arena. Neither it, nor its more successful followers, the "Patrons of Industry" of the 1890s, were ultimately able to force the political establishment to accept their agenda.⁶⁸

It was against this background that Sir John A. Macdonald announced the National Policy of 1879. It called for tariff protection for Canadian industry and the

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⁶⁶ Neufeld, Financial p. 76

⁶⁷ G. Laxer, Open For Business p. 136

⁶⁸ Laxer also argues that the failure of these early agrarian movements can be largely attributed to their tendency to divide along ethnic-regional lines between French and English.

development of a continental railway (the CPR), and constituted the new Dominion government's first major 'interventionist' policy package. Because it appeared to be the first post-Confederation attempt at a national industrial policy, it has been a lightning rod for critical comment by Canadian political economists - though with some conflicting results. While at first glance a tariff-based import-substitution (ISI) policy might appear to be an effort to induce the establishment of a stronger national industrial base, many writers have concluded that the opposite was true. Namely, that the National Policy symbolized the conscious formation of a long-term alliance between Canadian merchant capital and U.S. (branch plant) industrial capital.

The critical assessment of the National Policy (found in much of the NCPE literature) suggests that the need for world-competitive industrial capital was met through a cooperative relationship with large American firms. It suggests that the National Policy implied Canada's acceptance of a technologically and industrially backward - but socially and economically advanced - growth process. As Canada had little sophisticated secondary manufacturing industry to protect, the National Policy represented a de facto invitation to large U.S. industrial corporations to establish manufacturing branch plants within Canada. The result was an industrialization process dominated by American industrial capital, rather than a stimulus to the growth of a Canadian manufacturing sector. Of even greater significance was thought to be the fact that this investment capital came in the form of direct equity investment, which vested managerial control and technological sovereignty very strongly (though not exclusively) in the hands of the non-Canadian owners of the resulting subsidiaries. As part of the continuum of capitalist

accumulation in Canada, the National Policy has often been viewed as a natural next step in staples exploitation:

In effect, the National Policy... confirmed and extended the structure laid down in the days of the fur and timber trades. Canada was to remain a staple-producing economy firmly fixed in the structure of the initial phase."

But it is the form of that policy which is the subject of so much controversy. There can be little doubt that the strategy did intend to make use of US industrial competitiveness by encouraging the relocation of US firms within the borders of the Canadian economy. The risks involved in the only alternative - an open economic competition between indigenous and independent capitals - was clearly deemed to be too high for Canada's relatively small and uncompetitive manufacturing class.

But it is when we combine the economic constraints with the lack of political support for such an "independent" alternative that we gain greater insight into the limits facing Canadian policy makers and the forces shaping that policy. Given relatively open access to the American labour market, with its high mobility and relatively high wages, the "hard" option was almost certainly unavailable to Canada. As Panitch has argued, any effort to increase the exploitation of "absolute surplus value" (by depressing wages) from the production process would have met both political resistance and labour flight. However, the relatively high-wage structure associated with the "soft" option in Canada had the marked advantage of providing a domestic market that attracted foreign (US) capital, thereby providing the nexus around which a dynamic multiplier-accelerator could operate. While workers in Canada were as yet still unorganized, as compared with the

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" Easterbrook, p. 197

unionized workforce of later years, the "market exit" option gave labour a not-insignificant role in the formation of a "hegemonic compromise" over the National Policy. In this regard, it is revealing that the Macdonald government initiated Canada's first substantive labour legislation, in the form of the Trade Union Act, alongside the National Policy tariffs. As Craven and Traves note:

Once Macdonald had realized the political significance of the growing manufacturing system of the country, he became aware that "he must also devote himself to labour." While protection of home industry was to be the main incentive attracting industrial interests, workers and employers, to the Tory ranks, the appeal had somehow to be made credible to workers, winning them away from the Reform traditions of the opposition party. Macdonald had to portray himself as the workingman's friend in some sphere distinct from the tariff policy itself.⁹⁰

Even if such portrayals were little more than "posturing," the content of such legislation as the Trade Union Act (which legalized unions in Canada) and the direct appeal for the support of workers underlines no small element of the need for, and realization of, a bloc of support for the new policies of the federal government. Certainly such alliance-building efforts are difficult to reconcile with a conception of a development premised on the supreme dominance of only one class fraction. Indeed, Mahon argues that the National Policy

...promoted a pattern of growth that allowed workers, independent commodity producers (e.g., farmers), and industrial capitalists to draw certain material benefits. Workers gained jobs and relatively high wages; farmers and fishermen benefited from policies designed to secure a larger export market for their

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⁹⁰ Paul Craven and Tom Traves, "The Class Politics of the National Policy, 1872-1933" Journal of Canadian Studies 14:3 (1979) p. 17. This passage is partly a paraphrase of an argument earlier developed by Creighton.

commodities; industrial capitalists benefited from the expansion of a (relatively) protected home market.⁹¹

This "hegemonic" compromise did not, however, guarantee instant success. In fact, throughout the 1880s the high growth expected from the National Policy was slow in coming. World market prices remained low (through to 1896), and the 'opening up' of the Canadian west was significantly slower than had been hoped. However, once world commodity prices rose after 1896, Canadian wheat producers did soon achieve high rates of growth and significant prosperity. When the volume of the wheat export increased, the rail network extended by the National Policy was there to provide cheaper transportation to the foreign market, making the Canadian product that much more competitive.

In the years before this rapid expansion occurred, several key legislative changes affected the banking industry. Most significant, for present purposes, were the changes introduced by the 1890 Bank Act, which included an increase in the minimum paid-up capital required to begin banking operations, from \$100,000 to \$250,000, because it had been the smaller, more locally-focused banks that had proven most vulnerable during depressions. The Act triggered many mergers and thus served to increase the economies of scale achievable through the further concentration of the industry.

A second key change was also designed to increase institutional stability. This involved the establishment of an insurance scheme in the form of a 'Bank Circulation Redemption Fund', through which bank contributions were to be used to redeem the

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⁹¹ Mahon, p. 14

notes of failed banks. The Canadian Bankers' Association (CBA) was formed shortly after these Bank Act revisions, partly in order to administer this Fund. Henceforth, the CBA provided the banks with a single public voice through which to express their collective interests and concerns.

The 1896 recovery began a long and significant economic expansion that was to last for twenty-five years. Connected directly to the rise in world wheat prices, Canadian growth was fuelled both by its export success and by massive new imports of both British and American capital. Indeed, it was primarily in the years 1896-1913 that Canada's branch plant industrial structure took shape.

There is evidence that this long economic boom was accompanied by a further reorganization and concentration of the banking industry. Between 1900 and 1913 the number of bank branches grew from 708 to almost three thousand, while unadjusted bank assets tripled from approximately \$500 million to \$1.55 billion.⁹² However, over the same period, there were also seventeen bank mergers and seven failures, so that the number of banks in operation was reduced to 24. Moreover, thanks to cooperative efforts to assume responsibility for the liabilities of failed banks, the Canadian banking system avoided the disastrous domino effects triggered by similar failures in the United States.

Throughout this period, a large proportion of the loan capital entering Canada was employed to fuel the expansion of western wheat production. As this enhanced the

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⁹² See McIvor, pp. 82-83, or Curtis, statistical appendix. The inflation-adjusted 1913 figure would be approximately \$1.2 billion. For price indexes, see O.J. Firestone, "Canada's Economic Development, 1867-1952," Paper presented to the Third Conference of the International Association for Research in Income and Wealth, Sept. 1953.

demand for 'seasonal' credit, the asset structure of the banks came into conflict with the legal limits imposed on their ability to issue notes. Still lacking a central mechanism for creating additional credit (like a central bank), the government was forced, in 1907, to make ad hoc amendments to the Bank Act, allowing excess note issues during the harvest months, subject to a small tax penalty. These 'excess' issues soon became a semi-permanent feature of the system. Eventually, the penalty tax was removed and by 1913, the Bank Act was revised to make them fully legal. The successful management of these strains and stresses contributed to the Canadian banking system's international reputation for stability, and increased Canada's appeal as a site for long-term investment.

Investors in Great Britain and other countries were very favourably impressed by the strength and stability shown by the Canadian banks in the [1907-8] crisis. Within a short time British capital was being invested in Canadian enterprises in unprecedented volume. On a smaller scale American and continental European funds were also attracted.⁹³

The banks thus not only played a role in facilitating the inflow of foreign capital (by accepting deposits and floating Dominion bond issues), they also served as a symbol of Canada's relative financial and economic stability.

Unquestionably, 1896 to 1914 was one of the most rapid expansionary phases that the Canadian economy has ever witnessed. As such, it was also the period when Canada's industrial structure took shape. While still facing intense competition from the U.S., the Canadian economy was driven by a booming wheat economy centred in Winnipeg. But within this context, foreign investment (both equity and debt) began to finance the country's first really significant industrial expansion, largely centred on Ontario. As the American frontier began to decline as an alternative settlement option, net immigration into Canada from the U.S. suddenly contributed to an increase in overall

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⁹³ A.B. Jamieson, Chartered Banking in Canada (Toronto: Ryerson P., 1957) pp. 39-40

immigration and became a further source of new capital. Very high rates of growth resulted, and this fuelled a significant diversification of production into a rapidly expanding (and largely foreign-owned) manufacturing sector. Table III (following page) shows the rapid growth of manufacturing output over this period.

We have suggested in the foregoing that the National Policy represented a strategy which carried some risks, but much less than a full-blown national and independent industrialization would have entailed. The vigour of this pre-war boom may be taken to signify the medium-term success of that strategy, as both the net and the gross real values of manufacturing output doubled between 1900 and 1910. On the strength of this boom, and the growth in wheat production that accompanied it, Canada's dependent industrialization was truly launched. What role did Canada's financial system play in this process in general? And did it impose a deleterious constraint on it, and through it on Canadian history? It is to this more general question that we now turn.

Table III - Manufacturing Statistics, 1890 - 1910
(1935-39=100 for constant dollars)

Year	Net Value of Products (\$ million)	Gross Value of Products (\$ million)
1880	358.6	855.5
1890	648.2	1,390.2
1900	681.0	1,527.3
1910	1,425.5	2,944.4
*1917	1,690.3	3,721.4

Source: Canadian Secondary Manufacturing Industry, Royal Commission on Canada's Economic Prospects, 1957

"Pushing" Industrialization: State-led Development

This chapter set out to review several key turning points in the emergence of Canada's early financial system, and to examine the extent to which that system can be presented as "the" problem of Canadian development; or more specifically, the extent to which its operation, political orientation, or its oligopolistic structure inhibited the emergence of an indigenous and independent national industrial base. Although the available data do not allow us to draw a conclusive judgement, they do suggest that the arguments of Naylor and Laxer, which aim such scathing critiques at the operation of the banks, may be overdrawn. At best, their role must be considered as no more than one dimension of the economic and social processes that produced Canada's branch plant industrialization.

While some critics have argued that Naylor had underestimated the initial strength of Canadian industry, the truth is that many of Canada's early industrialists proved unable to sustain their enterprises in the face of branch plant competition. Whereas in the U.S. industrial growth had begun earlier and had developed more rapidly, Canada was faced with the need to "catch up" on the basis of relative economic and technological weakness. To do so, it would have to achieve an even faster pace of industrialization to succeed and to become and remain competitive. However, as Panitch (and Williams) have pointed out, the relatively repressive low-wage growth model on which such an effort would have had to be built was not really available in Canada, if only because its labour market was so open and fluid and because its resource base, dependent as it was on the foreign demand for staples, generated an economic base on which a "soft" option

could succeed. Given these social, political and economic constraints, it could be argued that the necessary or "hegemonic" compromise discussed in the last chapter could only have been achieved on the basis of a dependent development path that embraced and encouraged the expansion of US industrial capital (and UK portfolio investment) into Canada, in order to build a high wage economy on the resource rents available in this case. That was why Canadian capitalism - with all of its structural faults - industrialized in the way that it did; and that is also why its financial system took the shape, and played the role that it did.

In this context, we may recall the "linkage" model elaborated by Mel Watkins. While most of the staples writers were careful to warn of the inherent risks of staple-based industrial growth, Watkins also indicated how a dynamic multiplier could emerge from such an economic base in a protected market. We find precisely such multiplier effects generated by the 1900-1913 boom, fuelled by large capital imports. In this period,

The high rate of construction activity financed from foreign borrowings created a large demand for domestic commodities and labour. Industries formerly dependent on the export outlet found profitable markets at home. Workers in depressed areas and occupations readily obtained employment elsewhere....⁹⁴

A final crucial point must be added here. While the tariff, as has been discussed, played a central role in the National Policy, we must not forget the second pillar of the Macdonald strategy: a national transportation infrastructure capable of cheaply moving the staples across - and out of - the country. This was constructed at enormous cost to

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⁹⁴ Canada. Royal Commission on Dominion-Provincial Relations. Canada: 1867-1939 Book I (Ottawa: 1939) p. 76

the government, as Laxer shows. But it also provided the necessary framework, and basis for the linkages on which Canada's eventual - and dramatic - agricultural and industrial expansion would be based.⁹⁵ In this regard, the dependent strategy for rapid accumulation and national development that was pursued by the Canadian state achieved no mean measure of success by historical standards.

The picture of early Canada which emerges from this discussion is therefore not that of a promising industrial infant, stifled by a dominant and perverse financial elite, but that of an economy led by a developmental state willing and able to pursue an integrated development strategy that was conditioned by the need to maintain a relatively high wage economy and by the presence of extensive natural resources. As was true of many of the late-developers, it was the Canadian state that absorbed the risks of developing the infrastructure necessary for such a strategy; risks that Canada's financial, mercantile, and industrial capitals were unable to take. For its first century, this strategy achieved many of its explicit objectives.

Of course, this should not be interpreted to mean that pursuing a dependent industrial structure is always desirable or unproblematic. Rather, the argument suggests that the analysis of Canada's growth must be firmly rooted in the material constraints and the political realities of the time. In Canada's case, the strategy that served it reasonably well for so long has now, unfortunately, met new constraints that may alter the balance of our judgement. Now, as the country's resource base loses its capacity to provide a solid foundation to its economy, the fact that indigenous Canadian industry was "sacrificed" to foreign ownership in earlier years, now becomes of central importance.

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⁹⁵ G. Laxer has emphasized the exorbitant costs of the Canadian railroads, although he concludes by this that they were, in the long run, a disaster. See Open For Business chapter 5.

This general conclusion can be linked to the concept of the "hegemonic bloc", discussed in the previous chapter. Zysman concludes his excellent discussion of finance and industrial adjustment with the suggestion that economic constraints are interwoven with institutional and political (social class) factors, and can only be overcome when these forces are in some sense coordinated.⁹⁶ Hence, he argues that understanding the complex themes of industrial and economic growth demand an analytic synthesis that views them in their dynamic interconnectedness. Such analyses are not simple and not easily quantified. But they may be necessary, as Zysman suggests, if we are to gain a better understanding of the shifting nature of economic power, state policy and class relations.

In closing, when we weigh the combined pressures of Canada's class structure, resource base, and its international economic location, the behaviour of Canada's "hegemonic" fractions of capital, and of its state leadership become more understandable, and probably more defensible. Indeed, given the true social and economic realities of the time, and the relative success of the Canadian development model in historical terms, a more positive on-balance assessment seems more reasonable. Even Glen Williams, who does not hesitate to question the policy choices of Canadian governments through time, acknowledges that:

The key to Canada's post-Confederation development strategy was the ambitious, even visionary expansion and intensification of the staples economy by opening up the West with railway construction. In this respect, our political and economic elites achieved no mean measure of success, thereby establishing both their entrepreneurial spirit and skills.⁹⁷

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⁹⁶ John Zysman, Government, Markets, Growth: Financial Systems and the Politics of Industrial Change (Ithaca: Cornell UP, 1983) pp. 285-320

⁹⁷ Williams, "National..." p. 176

CHAPTER IV

Finance and Rapid Industrialization in the World War One Era

Introduction

The previous chapter reviewed the early evolution of Canada's financial system. The conclusion of this brief history suggested that the established notion of an unusually timid and anti-national financial bourgeoisie is not entirely supported by the available evidence. While there was clearly an emphasis on the (highly profitable) exploitation of Canada's abundant staple resources, it is not at all clear that this "mercantile" tendency resulted in what Naylor characterizes as the active stultification of Canadian industry. On the contrary, the evidence shows Canada's early financial institutions responding to the available economic opportunities which were, not surprisingly, concentrated in activities linked to Canada's abundant staples, as well as the publicly financed establishment of an enormous transportation and institutional infrastructure to allow these opportunities to be realized. Moreover, while Canada's financial sector was definitely highly concentrated from the outset, there appears to have been substantial competition for business amongst all of the banks, and a willingness to lend that often exceeded prudent levels leading many banks to either liquidate or merge.

This chapter continues our historical survey, but focuses on a much shorter period in which the financial system was faced with the enormous challenge of financing the

massive expenditures linked to World War I. Because the scale and the costs of this war were so massive and unexpected, a review of the financial sector's and the government's response to this challenge should offer important insight into the character of Canada's financial system. Moreover, since the central push for industrial investment had occurred in the decade and a half leading up to the war, the period as a whole will allow us to examine the claim that the banks behaved irresponsibly by neglecting investment in national economic development in general and Canadian manufacturing in particular.

The New Canadian Economy, 1914 - 'Stunted and Blocked'?

As shown in the last chapter, the Canadian economy experienced an unparalleled boom in the years leading up to 1913, and the banks had enjoyed parallel growth. At the same time, a strong merger movement in commerce had been extended to the banks, leaving control of banking capital in even fewer hands by the time this was borne out. While increasing concentration of either industrial or financial capital is always a matter of concern, there can be a "silver lining" in that the process can also create the scale required for industrialization to "spurt" ahead. That is why analyses of corporate (or capital) concentration are most useful when combined with a more general assessment of the links between changing corporate structures and the overall performance of the economy in which they operate. To contextualize our discussion of the operations of the Canadian financial system during World War I, this section will therefore first briefly summarize the overall trajectory of the Canadian economy up to 1914, paying particular attention to the formation of industrial (manufacturing) capital.

Undoubtedly, as indicated by Canada's substantial contribution of quite sophisticated machinery to Britain's war effort, the country's industrialization was well on its way by 1914. From its beginnings in lumbering, milling, and the production of agricultural implements and fairly simple manufactures, Canadian industry had, by 1914, developed the capacity to produce a more sophisticated array of industrial products, while substantially increasing its aggregate productive capacity. Contrary to the 'stunted' and 'blocked' picture presented by several writers in both the old and new CPE traditions, Drummond describes a rapidly growing and vibrant Canada, which had overcome many difficult geographic barriers.

For the years before World War One the numbers tell a story of impressive and, apparently, accelerating growth. In forty years the number of industrial workers rose by 174 per cent, the physical volume of output more than quintupled.⁹⁵

In contrast to the notion that capital scarcity had significantly inhibited the expansion of Canadian industry, he notes that on the eve of the war, Canada had significant "unused capacity" in steel and steel-based industries.

The investment wave of the Great Boom (1896-1913) having passed over the province's economy, many of these industries [iron, steel, nickel, other manufactures] had more capacity than they would have known what to do with, in the absence of wartime demand for boilers and engines, railway equipment, electrical apparatus, explosives, and the like.⁹⁶

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⁹⁵ I. Drummond, Progress Without Planning: The Economic History of Ontario Between Confederation and the Second World War Ontario Historical Studies Series (Toronto: U of Toronto P, 1987) p. 106

⁹⁶ Drummond, p. 150 Drummond's suggests that the strength of Canada's early industrialization was much higher than is generally appreciated.

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PM-1 3½"x4" PHOTOGRAPHIC MICROCOPY TARGET
NBS 1010a ANSI/ISO #2 EQUIVALENT

PRECISION^{SM} RESOLUTION TARGETS

While some of this investment was channelled through the banks, the bulk of it was derived from massive importation of foreign capital, increasingly in the form of U.S. direct investment. For many analysts, this was the key turning point in the formation of a fundamentally dependent industrial structure in Canada.

Several observers have suggested that Canada's technological dependence and export weakness denied a more thoroughgoing and "independent" industrialization, as was occurring in more 'world-competitive' economies such as Japan, Germany, and Sweden. Williams has presented detailed evidence that Canadian manufacturers demonstrated little interest in exploring or penetrating foreign markets. They thus lost the benefits that would have resulted from larger production runs, and this created a self-imposed market horizon, effectively limiting their market potential within Canada's national borders.

In proceeding in this manner, Canadian political and economic elites demonstrated little awareness of the long-term implications of their choice of investment priorities. In opting for limited, but above all rapid and cheap, industrialization they believed they were contributing to the creation of a more integrated and balanced national economy.⁹⁷

Williams provides important evidence to the effect that the manufacturing which did take place in Canada tended to be of simple, unsophisticated commodities, with little value added in secondary processing.

Such arguments have been central to the "pessimistic" view that Canada's stunted and biased industrial structure has emerged at the expense of a more balanced or integrated pattern of economic development. However, it is somewhat ironic that, while

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⁹⁷ Williams, Not For Export p. 32

the roots and significance of Canada's 'branch plant' industrialization have been well-researched and understood, the same cannot be said for the implicit judgement that a number of feasible alternative development paths were available to Canada at certain times. In fact, these judgments may have been somewhat optimistic. Once the rate of U.S. foreign direct investment (FDI) increased, and subsidiary companies began to dominate the Canadian industrial sector, our judgement of the success or the relative merits of this chosen path must be sensitive to the acknowledged limitations imposed by the Canadian situation. In other words, while it can be agreed that the ISI/branch plant model made Canada heavily dependent on foreign capital and technology, and continued its dependence on world market commodity prices (and foreign demand), this fact in and of itself cannot be considered 'proof' that the model failed. Moreover, if another measure of success is used, such as the pace or extent of industrialization, or the level of real wages, Canada's position might appear somewhat different. Indeed, in these respects, Canada's performance compares well with many of those "fully" industrialized countries for many years.

We can gain some idea of the capacity of this "dependent" economy's ability to respond to sudden challenges by briefly examining the effects of the pre-war boom. In this period, there was a tremendous increase in the demand for Canadian products, both for staple agricultural products and foodstuffs and manufactured items for warfare. How did the Canadian economy respond to this surging demand? The following discussion will examine the performance of Canada's manufacturing sector during the war, and this

will be followed by a more detailed examination of the financial system's role in financing the war.

We begin by looking at the rapid growth in Canada's manufacturing sector during this period. The explosive growth in foreign demand which accompanied the war offers us a revealing opportunity to observe the system's ability to respond. The immediate results of the boom are reflected in Table IV (below). Along with the manufacturing growth shown in Table II of the previous chapter, the output increases appear to be most impressive.

Table IV - Proportions of Raw Materials to Partly and Fully Manufactured Goods Exported From Canada, 1914-1929 (per cent)

Fiscal Year	Raw Materials	Partly Manufactured	Fully Manufactured
1914	63.2	10.1	26.7
1920	35.7	15.1	49.2
1924	43.4	16.8	39.8
1929	48.5	14.3	37.2

Source: Dominion Bureau of Statistics, The Manufacturing Industries of Canada, 1932

However, while Williams recognizes that, "on the surface, it appeared that our industrialists took advantage of the unusual circumstances of these years to improve dramatically their standing in world markets,"⁹⁸ he goes on to suggest that the large statistical increase in the volume of exports and in the relative proportion of finished

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⁹⁸ Williams, Not for Export p. 62

manufactures, is accounted for primarily by war munitions, a 'state-induced and state-regulated' business which provided little or no push into new or more sophisticated product markets, and did not alter "the extensive pattern of minimum capital investment and extensive technological dependence".⁹ Indeed, it is clear that much of this "boost" to production depended on the exogenous actions of the federal government (in procuring contracts and participating in the war).

Even though there is some truth in these criticisms, it is also true that there were no guarantees that Canada's 'dependent and technologically unsophisticated' manufacturing sector would be able to respond to this new demand with such vigour. It is not insignificant that Canada had developed the technological and the aggregate (plant and skill) capacity to allow it to expand the production of war materials very rapidly and, without this, it could not have made its "heroic" contribution to Britain's war effort. It might, therefore, deepen our understanding of the Canadian model's strengths and weaknesses if we examine how Canada was able to respond to this sudden leap in foreign demand, particularly as the same international crisis that increased the demand for its products also extinguished its primary source of investment capital (UK portfolio investment).

The answers to this question are to be found not so much in political and administrative policy decisions made after 1914, as in the already-established industrial structure, as well as in the unique contribution of the banking system (as shown below). As suggested by Drummond, the investment boom of the pre-war period had already

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⁹ Williams, Not For Export p. 65

created a substantial manufacturing base, capable of producing a high volume of goods. When war demand came (with propitious timing), the established capacity that Canada had developed was strongly called upon, and Canada was prepared to respond during a time when a strong political commitment was generated within government and among average Canadians. In this sense, the 'hegemonic bloc' which was formed out of the post-Confederation National Policy struggle was maintained strongly as the main social forces united - as they did in Europe - around a common cause.

The productive infrastructure of the economy was well prepared. The data in Table IV indicate that between 1914 and 1920, the proportion of Canada's exports that took the form of fully manufactured goods increased sharply, from 26.7 per cent to 49.2 per cent; and the share of partly manufactured goods increased from 10.1 to 15.1 per cent. These increases undoubtedly reflect the growth in the 'war industries', but when these proportions did slip back in the 1920s, it is significant that the proportion of fully manufactured exports remained significantly above pre-war levels.

Although such aggregate data do not tell us much about the development of technological capacities, or about successes in conquering new export markets, they do reveal the Canadian economy's increasing capacity to produce and export non-staple products, under the right conditions. On the other hand, the fact that the proportion of fully processed manufactured exports did decline in the post-war years, provides support for Williams argument that Canada's manufacturers had developed only a limited capacity to operate as "world market" exporters. The question is: was this capacity "too limited"?

The fact is that the increased production and export of manufactured goods from Canada indicate that despite its relatively dependent industrialization pattern, Canada's industrial expansion drew on its high wage domestic market and its unique position in the North Atlantic "triangle", to overcome the danger of "mere" staples exploitation. In Canada's case, this "weak" industrialization proved compatible with rapid growth, high wages and social and political stability. Although a full comparative analysis lies beyond the scope of this paper, it is worth pointing out that, among countries exhibiting an "autocentric" development pattern, one of the keys to extensive and successful industrialization was a highly productive agricultural sector that could be dynamically linked to industrial modernization. In these terms, Canada appears to compare rather favourably with its rivals in the international hierarchy of the period.

In per capita output of manufactures the United States took first, Canada third, Australia fourth, and New Zealand sixth place in 1913. The combination of high agricultural productivity and advanced industrialization consequently translated itself into a high-ranking position with regard to per capita income: the United States had the lead, followed by Canada (second place), New Zealand (third place) and Australia (sixth place).¹⁰⁰

A comparison of real wages would yield similar results. Such data, for all its ambiguity, suggest that Canada's manufacturing sector was not insignificant, except when compared with that of the United States. Further, this suggests that the long-established suspicion that Canada's financial elites were 'stifling', devaluing or neglecting industrial development might best be re-framed as an issue of time-horizons, rather than an absolute 'block' on, or hostility to, industrialization per se. In other words, although the

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¹⁰⁰ D. Senghaas, *The European Experience*, (Dover: Berg Publishers, 1985) p. 48

nature of Canada's industrialization has exhibited important structural weaknesses - particularly over the long term - as reflected in its high levels of foreign debt, foreign ownership and its lack of indigenous technological capacity, these problems must not be allowed to obscure the fact that Canada did launch an impressive and relatively successful process of industrialization and development. Indeed, given Canada's comparative position in the international economy, its geopolitical position, its proximity to the US labour market, its social and political configuration and its initial technological weakness, the pattern of industrialization may even have been "appropriate".

While the remarkable economic growth and the industrial expansion of the pre-war period had certainly fuelled the development of Canada's banking sector, these developments also posed new problems since such high levels of investment required large and rapid increases in financial capital. In a world of specie-backed money, this posed formidable challenges. But the war-crisis of 1914 followed a period of unusually rapid growth of Canada's financial assets.

The period 1870-1910 was one in which financial intermediary assets grew at an historically high rate, with the constant dollar per capita asset figure rising at 4.4% per annum, as compared with the long-term average of 3.4%...It was also a period in which financial intermediary assets grew much more quickly than did gross national product.¹⁰¹

This expansion in the assets of financial intermediaries (primarily the banks) reflects a virtual explosion in portfolio foreign investment flows into the Canadian economy. Based on the prospects for rapid growth in the prairie wheat economy, and historically low interest rates in international (London) capital markets, Canada attracted an

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¹⁰¹ Neufeld, *The Financial System*... p. 69

overwhelming volume of long-term capital during this period. According to Mackintosh:

So high a rate of investment was made possible by a huge import of capital from abroad. In 1901, British and foreign investments in Canada were estimated to be \$1,232 million; in 1921, the estimated amount was \$4,906 million. During the pre-war period, it was this import of capital which made great prosperity possible and the expansion of the economy was dependent upon it.¹⁰²

Indeed, this flow of long-term capital actually outweighed gross export revenues in the years 1910-1913. And it was this capital, channelled partly through the banking system, that financed the massive investment of the pre-war period.

Certainly the mere fact of such rapid growth and investment does not vindicate the role played by the financial system, nor does it prove that Canadian industry and Canadian industrialists were gaining as a result of this investment. But, on the other hand, evidence of a systematic "failure" of finance must be derived from a detailed assessment of the financial system's performance in intermediation (i.e. channelling savings to investors), or in an entrepreneurial role (choosing the "best" borrowers).¹⁰³ In other words, do we find evidence that there were a) untapped sources of investment capital; b) significant investments made in either speculative or uncompetitive enterprises; c) creditworthy and viable borrowers who were overlooked or systematically ignored; or d) viable borrowers in need of new kinds of financial instruments or institutions. Of

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¹⁰² W.A. Mackintosh, The Economic Background of Dominion-Provincial Relations Report of the Royal Commission on Dominion-Provincial Relations, Appendix III (Ottawa: King's Printer, 1939) p. 41

¹⁰³ There is a long standing debate over the possibility of this latter role. See Colin Mayer, "The Assessment: Financial Systems and Corporate Investment," Oxford Review of Economic Policy 3:4 (1987) pp. ii

course, piecing together the evidence regarding any one of these "failures" must rely primarily on qualitative judgments since none of these variables can be definitively measured in quantitative statistical terms.

In the judgments of Naylor and many other contributors to the CPE debate, the banks played a detrimental and negative role, denying "national" industry the capital it needed - and could have used - to develop. In documenting Canada's combination of "advanced capitalist" growth with a dependent, branch-plant industrial structure, Laxer accepts this view, arguing that "Canadian banks failed to effectively fund industrial development, leaving a void for foreign capital and foreign management to fill."¹⁰⁴ However, even if they do not reduce the banks simply to "neutral" providers of credit, neither Laxer nor Naylor systematically explore the question of whether the political or economic conditions in Canada would have made industrialization based on a domestic industrial capital a real possibility. More importantly, it is extremely unlikely that such a "national" alternative could have been pursued on the basis of the relatively high real wages and social conditions (compared to those in other countries at the time) that were found in Canada throughout this period.

Financing Canada's War Effort

One means of assessing the character of the financial system is to examine its operations during a time of significant economic stress such as that on the eve of World War I when both the banks and the federal government found themselves in a very

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¹⁰⁴ G. Laxer, Open for Business p. 173

difficult situation. Several important aspects of this situation were noted in the previous chapter, including the fact that the banking system met its "credit limit" in 1907-08, and required ad hoc adjustments.

The key to these changes was the introduction of the Central Gold Reserves, which allowed the note issue to be expanded beyond the limits set out in the 1908 legislation.

The banks were authorized to issue notes beyond these limits provided any such excess was covered dollar for dollar by gold or Dominion notes deposited in the Central Gold Reserves, which were to be managed by four trustees, three appointed by the Bankers' Association and one by the government.¹⁰⁵

The threat of impending war exerted further pressure to facilitate the expansion of credit. This intensified when the war began in August 1914, and fears of financial collapse and runs on the banks sent the bankers to Ottawa for 'emergency consultation' with the government. At this point, Canada entered a new world, as the Canadian dollar was taken off the gold standard to which it had faithfully adhered for sixty years.¹⁰⁶ An executive Order-in-Council was passed which

suspended the redemption of Dominion notes in gold, allowed the banks to pay off liabilities to the public with bank notes, permitted the banks to use the excess circulation privilege the year round instead of for the usual six months, and, finally, empowered the Dominion Government to make advances of Dominion notes to the banks upon the pledge of satisfactory securities.¹⁰⁷

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¹⁰⁵ McIvor, p. 84

¹⁰⁶ Jamieson, pp. 46-47

¹⁰⁷ C.A. Curtis, "The Canadian Banks and War Finance," Money and Banking Ed. E.P. Neufeld, p. 207

The "Finance Act" of 1914 formally legalized the provisions of this Order-in-Council.¹⁰⁸

Having brought the liquidity crisis under temporary control by means of this potentially inflationary expansion of the money supply, the government began a period of close cooperation with the chartered banks. It remains to be seen, however, what new roles the banks would come to play in this new and rapidly changing economy. Certainly the sheer scale of the increase in their activity is notable in and of itself.

The table below (Table V) shows the dramatic increase in the gross value of both bank loans and bank assets. It also shows the overall ratio of bank loans to bank assets to have gradually decreased between 1890 and 1920, from 76 to 47 per cent. This decline may indicate either an increasing preference for liquidity, or an increase in the flow of Canadian loan capital abroad. However, the latter is clearly not the case in this period, as the volume of bank loans to "elsewhere than in Canada" never rose higher than 6% in the period up to 1920 (see Figure 1, two pages forward).¹⁰⁹ Rather, a gradual increase in liquidity preference is evident from the increased 'reserves' held in the form of Dominion securities, cash on hand, as well as easily liquidated 'call' loans.¹¹⁰

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¹⁰⁸ This Act was made permanent in 1923, and brought the long process of transferring control over note issue to the federal government to a last plateau, which was followed by the establishment of the Bank of Canada in 1935.

¹⁰⁹ These statistics computed from C.A. Curtis "Statistics of Banking"

¹¹⁰ E.P. Neufeld has indicated that this move reflected the long-term trend: "There seems to be little doubt that the banks moved permanently into more liquid assets from the First World War onward." *The Financial System...* p. 119 We note that this trend actually began at the turn of the century, perhaps earlier.

Table V - Chartered Bank Loan Assets, 1890-1920 (Current \$)

Year	Total Loans in Canada	Total Assets	Per Cent
1890	\$195,008	\$254,629	76.6
1900	316,921	440,348	65.6
1905	481,262	757,989	59.3
1910	699,978	1,230,825	54.0
1915	890,852	1,574,211	53.1
1920	1,563,952	3,091,675	46.8

Source: C.A. Curtis, "Statistical Contributions to Canadian Economic History"

This shift toward an asset-structure which emphasized liquidity might suggest that the banks were operating with increasing caution, possibly depriving worthy borrowers of needed investment funds. But this need not be the case and seems difficult to reconcile with the rapid economic growth achieved at this time. Certainly it was not the case that the banks channelled "most of Canada's savings" out of the country, as one banker had earlier charged (previous chapter). Moreover, it is worth noting that many of the securities being purchased by the newly cautious banks were both government and corporate (esp. railway) bonds, used to finance vital infrastructure projects that created the conditions for private investment. Moreover, had one of the major projects (i.e. a railway) failed, the consequences for the economy, for public finance, and for the banking system could have been disastrous. In this sense, one could say that the banking system did play a central role - at one level of remove - in financing the development process, especially those projects that were sanctioned and guaranteed by public, as opposed to private, interests.

FIGURE 1

A similar point might be raised with respect to bank finance for "risky" manufacturing enterprises. There have been more positive accounts of the Canadian banks' behaviour, which views them as accepting a "normal" share of risk. For example, in reviewing the history of banking in Ontario, Drummond suggests that

For all their reassuring talk, Ontario bankers were not averse to risk. The Home Bank plunged heavily into the financing of British Columbia timber limits; the Bank of Commerce involved itself so heavily with the Canadian Northern that if the Dominion had not first guaranteed and then acquired the railway and its obligations, the bank would have been in serious difficulty.¹¹¹

¹¹¹ Drummond, p. 315

It is noteworthy that the risks taken by the banks in this passage were in staples and transportation - and not in the intrinsically even riskier manufacturing sector. However, Drummond also shows that several Canadian banks were, in fact intimately connected to various manufacturing interests. Thus, the Western Bank, for example, was "floated by several local families who were active not only in commerce but in manufacturing;"¹¹² and Chester Massey, the agricultural machinery manufacturer, was part of the group that established the Metropolitan Bank. Moreover, Drummond adds that "through the financing of the bond houses' inventories the chartered banks were involved in flotations and new issues [of corporate bonds] at one remove."¹¹³

Of course, such anecdotal evidence does not allow one to conclude that the banks supported industry as much as other sectors. However, it does suggest that certain banks were willing to get involved in industrial finance in cases where the benefits appeared promising. Nonetheless, there is no doubt that the financial system lacked institutional mechanisms like the German investment banks which not only supported industrial enterprises, but actually became directly involved as managers and industrial entrepreneurs.

The Success of the War Bond Campaign

The needs of the first world war spawned several other significant changes in the financial system. Foremost among these was the discovery - or more accurately, the

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¹¹² Drummond, p. 314

¹¹³ Drummond, p. 321

creation - of a new domestic source of savings, brought into existence by the federal government's war bond campaign.

Once the immediate liquidity crisis had been successfully averted, serious problems in public finance remained, including rising current account deficits, declining capital inflows, and revenue losses from declining import duties which were still the government's primary revenue source.¹¹⁴ The government initially sought to finance the resulting deficits by borrowing and credit creation, but this unwitting use of a Keynesian stimulus based on borrowing and the issue of "fiduciary" notes, unleashed a "multiple credit expansion" that was funnelled through the banking system. As this process expanded the flows of currency and exchange, it both fuelled domestic demand and stimulated greater production, but it also led to higher prices, especially for raw materials. Partly because of such problems, these early experiments in fiscal policy persuaded the government to try issuing war bonds to finance the explosion of expenditure associated with the war effort. The sale of war bonds reduced the risk of inflation because they were offset by the expenditure reductions accepted by the bond purchasers.

The Dominion government began with an initial objective of raising \$50 million in its first "large-scale" domestic borrowing effort, and was no doubt favourably impressed by the \$100 million it actually realized. After this surprising initial success, the government proceeded to finance nearly all of its war expenses through domestic borrowing in this form, a dramatic change for a country that had been so dependent on

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¹¹⁴ Melvor lists the increases in Dominion Government deficits from \$151 million in 1915 to \$533 million in 1920 (current dollars). p. 105

foreign capital. By the end of the war, the government had floated six major war bond issues, the largest netting \$690 million in 1919. Remarkably, in the period from 1915-1920, over 90% of the \$2.2 billion borrowed by the public sector was raised in the domestic market.¹¹⁵ Jamieson is effusive in recognizing this achievement.

It is almost beyond belief that within such a short space of time Canada had been transformed from a country doing most of its financing abroad to one raising huge domestic loans to finance the cost of taking part in a great war and supply funds to other countries to buy goods in Canada.¹¹⁶

This raises the question: how was a young pioneer economy, commonly regarded as seriously hampered by 'capital shortages', able to generate such volumes of funds domestically? There are several answers. The first is the inflationary expansion that followed the credit induced boom of the 1914-1915 period. Not only did this trigger inflation, it also left many Canadian firms and institutions with "excess liquidity". Thus with high industrial and agricultural output, and an inflationary rise in both prices and incomes, investment capital became abundant. While things would 'cool off' considerably soon after the war when the economy slipped into recession for several years, this liquidity cushion proved very useful going into the war.

Perhaps the biggest reason for this development was the intensity of patriotic support for the war, which allowed a tremendous jump in domestic savings rates to be achieved. Buckley shows that 'net savings as a percentage of GNP' averaged about 7 percent from 1900 to 1915, but jumped to 17.1 per cent for the 1916-1920 period, only

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¹¹⁵ The statistics in the foregoing are derived from McIvor, Chapter 6 - "The Financial Aspect of World War I and its Aftermath", pp. 101-126

¹¹⁶ Jamieson, p. 49

to return to around 7 per cent thereafter.¹¹⁷ Combined with the rapid overall rise in GNP, this massively increased the available volume of investible financial capital.

However, the sharp increase in savings rates also reflects several key changes in the operation of the chartered banks during the course of the war. The banks both played a central role in the war bond campaign, and sharply increased their lending to the government, making extensive use of the new rediscounting facility created by the Central Gold Reserve. Jamieson summarizes the contributions of the banks, as encouraged by the government's moral suasion, as an important part of the overall war effort:

In the intervals between war loans the banks advanced large amounts to the Canadian Government, usually by purchasing treasury bills. They also made temporary advances of large amounts to the British Government and to the Imperial Munitions Board. They encouraged people to purchase war savings certificates and war savings stamps, which were placed on sale at all branches of the banks. Branch managers were asked to do their utmost to encourage customers to respond to the government's urgent requests for greater production....For a great number of patriotic organizations branches of the banks facilitated the collection and transfer of subscriptions and the disbursement of funds, free of charge.¹¹⁸

Thus, there were several different ways in which the banks supported the Government's efforts to meet its substantial financial requirements, and we may infer that their relatively centralized structure proved useful for this purpose. In utilizing the extensive

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¹¹⁷ K. Buckley, Capital Formation... p. 99

¹¹⁸ Jamieson, p. 50 This text also underlines a primary advantage of the branch banking system for this particular purpose: "In rural communities where farmers paid for their bonds out of savings accounts which had been built up gradually over a long period, totals were often substantially reduced and slow in recovering. This was offset in industrial communities where part of the proceeds of the loan was used to pay for munitions and other supplies, and was deposited in the banks by various beneficiaries. With branches well distributed, therefore, a bank was not likely to suffer more than a temporary reduction in total deposits [due to such increased savings]." p. 49

branch networks of the banks, the government came to rely increasingly on the very broad war bond market which had been partly created by the them. For the sixth (and last) war bond issue, there were over one million subscribers, drawn from a population base of less than 9 million. It is quite clear that without the extensive branch network of the chartered banks, Canada's financial situation - as well as the country's overall role in the war - would have been quite different.

Conclusion

Throughout this account, we have referred back to the CPE debates outlined in chapter one, and especially that cluster of arguments (centred around Naylor) which sought to 'explain' Canada's inability to diversify its economy more completely or create stronger and more independent technological capacities. The past two chapters have challenged that strand of this argument which holds that Canadian financiers bore a large share of blame for this failure because they had "stifled industry" and effectively undermined any possibility of a more independent national industrialization process. While it is unquestionably the case that the Canadian chartered banks played a more passive role in industrial development than was the case in certain European economies (esp. Germany), it does not follow that the financial system was itself the critical obstacle to a fuller industrialization. The difference, it would seem, is of some importance if political economy is to sharpen its analysis of the opportunities both created or denied by social structures (a dominant "financial" fraction, a militant working class,

conservative state institutions) and the dictates of "real" economic costs and opportunity costs, as reflected in a given economy's supposed "comparative advantage".

Thus, although advanced from the political left, the Naylor-Laxer argument may in fact share Rostow's neoliberal presumption that capitalist development is both linear and cumulative, and that aberrations from the original models (the U.K., the U.S.) demand explanation.¹¹⁹ When such a theoretical framework serves as the foundation for political-economic criticism, it is all too easy to claim that certain social actors "failed" to perform their "normal" role - meaning the role expected on the basis of the successful and normative model. Speaking of this problem in the context of the development debate, Senghaas points out that

For a long time there has been a tendency in the development debate to take the development of the highly industrialized societies for granted, and to regard underdevelopment as the problem - that is, as the phenomenon that demands explanation. In view of the development history of the past 250 to 500 years, however, it would seem more sensible to regard peripheralization as the norm and successful development as the exception.¹²⁰

By inverting the broad theoretical perspective on the development process, Senghaas highlights what has been a central methodological problem within this strand of Canadian political economy. From this alternative perspective, our terms of inquiry might have been cast differently. Rather than setting out to search for a "cause" for "failure", or underdevelopment, the question to be answered might have been: what went right?

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¹¹⁹ W. Rostow, The Stages of Economic Growth (Cambridge: Cambridge UP, 1960)

¹²⁰ Senghaas, p. 16

Certainly, when the question is reversed in this manner, the behaviour of the Canadian financial system, and in particular of its banks, appears less exceptional.

Taken as a whole, the debate over the role of the banks reveals a rather weak theorization of the role that a financial system plays in relation to corporate investment in a market economy - though this weakness is not peculiar to Canadian political economy. On one hand, there is a standard interpretation of financial intermediaries performing their functions as virtual "automatons", without leaving a strong imprint on the character or volume of corporate finance.¹²¹ According to Mayer, this has long been the most widely accepted view among economists, and is embodied in the "Modigliani and Miller proposition", which sees the financial system as

The lubricant that oils the wheels of the productive sector of the economy. If the investment activities of firms necessitate new forms of finance, the financial system responds by creating new instruments and institutions. That is an inevitable consequence of the competitive process within the financial sector of the economy and the responsiveness of finance to the needs of industry can only be inhibited by regulatory requirements...¹²²

On the other hand, analyses such as Naylor's and Laxer's assign overwhelming determining influence to the Canadian financial system. A more balanced view would presumably locate the truth somewhere between these extremes. The importance of the financial sector would then be found to vary quite widely across different economies, depending upon factor endowments, technology, the balance of class forces, and the role and activity of the state.

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¹²¹ Rondo Cameron and Hugh T. Patrick reject such a simple analogy in their "Introduction" to *Banking in the Early Stages of Industrialization* p. 7

¹²² C. Mayer, "The Assessment..." p. ii

The last two chapters have attempted to highlight the particular significance of this last variable - Canada's active state apparatus - in directing Canada's industrialization and development. In this sense, the role of the financial system in shaping and financing Canada's dependent industrialization remains unclear. However, it is not likely to have been the decisive or determining factor. At most, it represented merely one of several constraints. Much more systematic microeconomic evidence would need to be collected from the history of specific Canadian manufacturing firms, in order to establish the claim that they faced systematic discrimination from Canada's financial institutions.

CHAPTER V

Conclusion - The 'Brave New World' of Globalized Finance

By following the money flows in the market economy and in the institutions that structure that flow we can learn a great deal about the uses to which the society's resources are put, the people who make the allocative decisions, and the process through which control is obtained and exerted.¹²³

Introduction

The previous two chapters sought to examine some important aspects of Canada's 'money flows' and the institutions which structured them during a crucial phase of its early industrial growth. They are also presented as an argument for the need for new research and new theoretical investigation of the history and current structure of Canada's financial system from a political economy framework. As we argued in our first chapter, Canadian political economy has focused a good deal of its attention on alleged and real weaknesses in Canada's manufacturing sector and the related lack of economic and political sovereignty. That this should be of such concern for political economists is certainly understandable, and the accumulated Canadian political economy (CPE) tradition has led to a much clearer understanding of the peculiar character of Canada's

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¹²³ John Zysman, Governments, Markets, and Growth... p. 8

industrialization. However, in dealing with the financial sector, some political economists have been led to rather extreme, and ultimately unpersuasive conclusions. If political economy is to generate meaningful insight into particular historical periods, it must be able to distinguish between the painful but unavoidable social costs of large-scale economic changes and those social costs which are clearly unnecessary, and only borne as a result of the ideological myopia, managerial incompetence, or naked greed of those imposing them. This chapter begins with a general assessment of the story told in the preceding chapters, within the context of the wider theoretical framework of the current Canadian political economy debate. This effort will then be followed by a brief consideration of the tumultuous changes in national and global financial systems that have occurred in the past ten years.

Banking and Industrial Finance: Theoretical Questions Remaining

In order to draw our comments into summary form, it is worth recalling again Naylor's depiction of the early Canadian situation:

[In Canada,] federal control over banking and currency ...prevented the pursuit of cheap money policies (which favour the debtor by reducing the burden of debt by inflation at the expense of the creditor.) The debtors were farmers; the creditors, financiers and railway magnates. The conservatism of the banking structure and its government-protected concentration helped after, as well as before Confederation, to perpetuate a staple-extracting economy.¹²⁴

One merit of Naylor's analysis is his clear identification of various social classes as political and economic players, struggling over the formulation of both public and private

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¹²⁴ Naylor, "The Rise and Fall..." p. 16

sector policies and decisions (and the exercise of power). But throughout his discussion, Naylor implicitly assumes, not just that there might have been other possible development paths, but that there was a blatantly obvious one, which would have led to full fledged industrialization if only Canada had developed a "liberal" financial system like that of the United States. On this basis, he concludes that the central problem of Canadian economic development was the unfortunate existence of a 'hegemonic' Canadian financial elite which intentionally and forcefully undermined this superior alternative.¹²⁵

As we have attempted to show, the difficulties in this argument lead us back to one of the original questions of Innisian political economy: Why did Canada not emerge as a leading world-competitive economy in the first place? And what unique conditions confronted Canada's business elites and policy makers? Naylor's assertions that Canada's focus on the exploitation of unsophisticated staples was facilitated - and even partly designed - by its "conservative" bankers and financiers may only serve to underscore the reality that this strategy was readily available, and that under Canadian conditions it allowed a relatively wide spread prosperity for most of the population. Meanwhile, his critical conclusion may underestimate the obstacles that would have faced any attempt at a more comprehensive industrialization process.

So why did the CPE debate become so fixated on the Naylor position in the 1970s? Certainly it was widely recognized that the banking industry represented one of

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¹²⁵ Williams expresses the same point this way: "[Naylor's work] even implied that the dominance by an industrial capitalist fraction in Canada would have led to the formation of a radically different national economic strategy similar to that pursued in the United States where industrial capitalism has been victorious - economic independence as the result of rapid industrial expansion fuelled by high levels of protectionism and immigration." See "The National..." p. 159

the strongest pillars of Canadian capitalism and that it is one of the industries that extended its operations to the "international" market at an early date. For this reason, the banking industry has come under close scrutiny. But why was this scrutiny so often begun with the assumption that there had been a 'villain' in Canada's economic history? Glen Williams has suggested that Naylor and other political economists (who had taken up variations of the dependency approach) ended up with a confused sense of the decision making processes involved in Canada's early policy debates, leading them to adopt psychological and cultural explanations for Canada's supposed economic weaknesses:

Armed with retrospective disagreement with the low priority assigned by the National Policy to industrial development, [these political economists] have assigned a number of 'fatal flaws' to the pre-World War One bourgeoisie to reveal their burden of guilt in the tragedy - lack of entrepreneurship, anti-nationalism, intra-class rivalry, and so forth. While it may be hazardous to lump all these approaches together, what they commonly share is a presumption of abnormal or even pathological behaviour on the part of the state and economic elites.¹²⁶

The assumption of such pathologies in Canada's decision makers unfairly and inaccurately simplifies the complicated tasks of political economy, which must include the determination of how various patterns of social behaviour do follow certain logics, even when in the long term they might appear 'irrational'.

Our first general theoretical conclusion, therefore, is that the assumption that industry and finance necessarily share a mutual enmity must be explored more deeply, in light of particular circumstance. Indeed it was Marx himself who first pointed out the potential for powerful tensions to arise between industrial and financial fractions of

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¹²⁶ Williams, "National Policy..." p. 162

capital. He described the "constant guerilla warfare"¹²⁷ between these sections of the bourgeoisie, based on the competitive quarrel over the distribution of surpluses between industry (as pure profit) and the financial system (as interest). However, to extrapolate from this point to the conclusion that these battles must lead to the "victory" of one side is to misrepresent what Marx also showed to be fundamentally necessary for the accumulation process itself to proceed: i.e. some form of balance among the contending social forces. As Harvey paraphrases,

An imbalance in the power relation between industry and finance will force departure from equilibrium and so threaten accumulation. From this it follows that the survival of capitalism depends upon the achievement of some kind of proper balance of power between industrial and financial interests.¹²⁸

However, as Harvey also points out, to be successful this balance must also extend to the overall social relations (relations of production) in the economy, which can be worked out either through brute repression or through some sharing of the material rewards of growth. Thus, in Depression-era America,

Roosevelt's New Deal fits exactly into such an interpretation. The net effect must be to bring productive forces and social relations back to some equilibrium position from whence the accumulation process can be renewed.¹²⁹

This is the sense in which the "hegemonic bloc" formed in post-Confederation Canada served to achieve a vital social and political balance. As we have emphasized, following Panitch and Williams, the Canadian labour market was such that workers and farmers were centrally involved in the formation and maintenance of a hegemonic balance of

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¹²⁷ Paraphrased in David Harvey, *Limits to Capital* (Chicago: U of Chicago P, 1982) p. 299

¹²⁸ Harvey, p. 299

¹²⁹ Harvey, p. 327

class forces. This balance was achieved and maintained on the basis of a relatively high wage structure which, as we have argued, had a number of key consequences. First, it kept needed skilled and unskilled labour in Canada, providing the basis for growth. Second, it allowed the formation of a significant domestic market which attracted US producers (blocked by the tariff) and spread the benefits of growth relatively widely. And third, as Panitch argued most forcefully, it meant that industrial production in Canada had to expand "on the basis of relative surplus value, the application of extensive fixed capital to the production process to expand labour productivity, and not on the basis of cheap labour",¹³⁰ which had the further consequence of limiting the "power of the Canadian bourgeoisie as a whole and constrained the policy choices of the state."¹³¹ The result was a hegemonic bloc - reflected in the operations of the state - through which Canadian capitalism evolved within the ambit of relatively more competitive American industrial capital.

The second theoretical conclusion drawn here extends from this first point: given the need to accommodate such a "balance" of class forces, the role played by the Canadian state in this early period appears far more central - and far more "developmental" - than several of the NCPE accounts appear to suggest. Thus, the political struggles reviewed in chapter three around such key powers as the right to issue bank notes and to create credit are seen to represent far more than the technical management of the monetary and financial systems. They indicate the working out of

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¹³⁰ Panitch, "Dependency and Class..." p. 281

¹³¹ Panitch, "Dependency and Class..." p. 280

a discrete accumulation process which entailed coordination of different sectors and class interests within several key constraints. In these contests the financial institutions were generally directly in conflict with the state, and although they were powerful, they did not exert absolute dominance or instrumental control of the state, or of its leadership. In fact, the Canadian state's eventual success in taking over the powers of note-issue probably reflects its relative autonomy vis-a-vis one of Canada's most powerful economic class fractions. And this autonomy appears to have been exercised for very intelligible reasons in support of longer term economic development in the context of a precarious and constrained economic situation. The dissonance of the history we have reviewed and the theoretically-derived interpretation of Naylor reinforces the importance of generating theoretical observations on the basis of history, as opposed to interpreting the available evidence through a particular theoretical lens.

A third and final theoretical point can be raised. In examining the early development experience of Canada, or of any other "late-follower", it should be remembered that the growth processes of each country vary not only across space but also over time. If, for example, a "hegemonic balance" can be achieved for some time in order to successfully pursue an industrialization process, it is certain that this balance will face disruptions and challenges over time, potentially causing acute crises, as demand, supply, and factor availability are all changed by the growth processes themselves. Indeed, in the Marxist conception, such crises are inherent to the capitalist development process, and demand more and more radical mechanisms to mediate them. Hilferding, for example, suggested that the rise of "finance capital" - a fusion of

industrial and financial interests - represented a higher, and perhaps final, stage of the development process, wherein the stability of capitalism could only be maintained through the absolute concentration of economic interests into one class.¹³²

Hilferding was led to this conclusion on the basis of an examination of the unique dynamics of the German economy of the turn of the century, and his generalizations based on this model were clearly overdrawn. Neither Canada nor a great number of other follower economies shared the basic features of Germany's economy when they embarked on industrialization. Nonetheless, this was one of the earliest depictions of the "monopoly" stage of late capitalism, and in it Hilferding presented a sophisticated linkage between the growth and power of financial capital and the growing crises facing the German economy.

For the Canadian debate, there is some resonance of Hilferding's 'monopoly capital' thesis in Naylor's critique of the banks. Thus, the thrust of the latter's critique was that the Canadian bankers enjoyed a virtual 'monopoly' over the Canadian market. The difference, according to Naylor, was that rather than arising out of a fusion between finance and a vibrant industrial capital, here a financial monopoly opted to suppress the emergence of a national industrial class. Moreover, Naylor suggests that the banks would have supported industry more effectively had a more autonomous state created a competitive financial market (and in this regard there appears to be a significant strand of classical liberalism in Naylor's position). In fact, the extent of competition in Canada's financial sector is difficult to assess. The available evidence suggests that

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¹³² R. Hilferding, Finance Capital (1910)

Canada's banks did compete for business and for loans. This was especially true in the initial stages and remained true to a significant degree after the sector had become increasingly concentrated in the 1890s and 1920s. Indeed, the reduction in the number of active banks from a high of 41 (in 1885) to roughly 10 (in the 1920s) occurred through merger movements that were at least partly triggered by intense intra-industry competition (as was happening in the US in the same period).

Thus, the questions to ask regarding the financial system in Canada change to: What possibilities were open to the banks? What kinds of development could have been financed successfully under Canadian conditions? Certainly (and understandably) the Canadian banks were more 'conservative' than the American free banks, but many of these caved in disastrously with each period of downturn, creating many problems, and misallocating resources in the process. It is true that the Canadian banks were interested in relatively safe investments such as those available in the markets for government bonds and in the established staples industries. But such choices are unremarkable in an economy focusing on the development of a costly infrastructure to consolidate and extends its staples based economy. As Williams has stated with regard to the state's choice of an ISI-type industrial model,

In the light of the near-monopoly of effort in the direction of resource exporting, the choice of a less thoroughgoing industrialization strategy, with a greater similarity to the ISI of the periphery than to the world competitive model of the centre nations, is hardly surprising.¹³³

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¹³³ Williams, *Not for Export*, p. 32 Emphasis added.

This applies equally to the decision-making and the resource allocation of Canada's financial elites. Given the country's long-established exploitation of its abundant and easily-acquired staples commodities, and given the relative wealth and stability that the Canadian economy was increasingly offering, a more radically 'national' industrial strategy would probably have been socially costly, politically impossible and perhaps even economically inadvisable in the short to medium term. As Bienefeld has suggested, the supposedly 'conservative' choices of Canadian lenders to avoid the riskier and longer-term investment required by more sophisticated and capital-intensive industry should also be considered unsurprising, given the environment of the period.

In the short term a more comprehensive industrialization policy would have entailed significant risks and costs and these would have been difficult to accept when Canada's early survival as a nation depended on its ability to contain the steady outflow of labour to the high wage US. So long as the 'soft option' of dependent industrialization could meet that objective, there was unlikely to be strong support for a more comprehensive industrial policy from capital, from labour, or from the farming or resource sectors.¹³⁴

As this 'soft option' did achieve many of its objectives - the formation of a relatively stable, high-wage economy and the maintenance of some measure of political independence - we begin to see that the real explanation to the puzzle of Canada's peculiar 'dependence' may lie in the nature of the class forces and in the structure of economic opportunities confronting this young, staples-based nation.

Moreover, the hegemonic balance which was achieved through this early period was to last for some time, as the Canadian economy achieved growth rates and levels of

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¹³⁴ Bienefeld, M. "Financial Deregulation..." p. 33

social welfare which were comparable to many other "follower" economies, and even impressive in their own right. But, as we have seen recently, the unevenness, and the technological and industrial dependence of Canadian capitalism were destined to reach, along with many other "advanced" economies, a renewed situation of crisis, in which many of the weaknesses and difficulties in the original model would be realized in such a way that the accumulation process would itself face a serious threat. As we suggested in our first chapter, such a crisis has arisen in recent years, and the questions surrounding the role of financial capital, industrial policy, and technological/industrial dependence have become more pressing than ever before. It is to this period that we now turn.

The Rise of Global Finance - The Demise of National Sovereignty?

If we apply our concluding remarks to a brief consideration of current political economy questions, we find an intriguing echo of some familiar questions in the issues raised by the new regulatory regimes evolving in the Western capitalist economies today. As corporate capital has globalized, powerful global financial markets have emerged, and these have proven to be forces of both integration and disintegration. In the process, economies have become both more interpenetrated and "dependent", and more desperate to create larger units of economic order (such as the European Community). As Canada's particular vulnerability is exposed by these developments, one can begin to see that CPE's long standing concern with Canada's lack of a strong, nationally based industrial and technological capacity may have been both justified and precient. As the

deindustrialization of Canada proceeds, many of the more pessimistic assessments of Canada's past development patterns are proving to be prophetic. This does not mean that they were always right. It means that their concerns were justified, and that, now as before, we must assess the political possibilities and economic costs of pursuing alternative patterns of development.

The current crisis has again led to very different positions as to how Canada should, or could, respond and adjust. While thousands of businesses were bankrupted through the recessions of the early eighties and the early nineties, what remains of Canada's national and transnational capital has come to enjoy an expanding range of choice, while a relatively immobile labour force suffers from the competitive pressures emanating from a global economy characterized by large labour surpluses.

The extent of the crisis is registered in the dramatic transformation of the financial system, both in Canada and globally. What had been an international financial system constituted by discrete (and quite individualized) national economies, is evolving into a qualitatively new global system which operates increasingly outside of traditional national boundaries or controls. Unsurprisingly, the questions which have concerned political economists most recently include: what is driving these processes? And what are their social effects likely to be for a country such as Canada?

First and foremost, political economists have once again been concerned with the effects this will have on political sovereignty. Thus, Bienefeld argues that, in its dilution of national control over capital markets, the federal government has pursued policies

which may very well exacerbate the pressures exerted by an increasingly unstable global economy:

The attempt to regain a meaningful degree of sovereign control of Canada's financial system faces formidable opposition from an international financial system that is now dangerously unstable and that has grown enormously powerful as a result of deregulation, the FTA [Free Trade Agreement] and Canada's heavy past reliance on external long-term capital.¹³⁵

The political consequences of this deregulation have a ratcheting effect on state policy. When this is combined with the recent assault on the public sector's direct involvement in the economy, there is less and less room for governments to manoeuvre, even to assist enterprises or sectors considered strategically important. Though her consideration of these issues is intended to describe the 'developing' world, Maxfield's assessment of the political effects of a more globalized financial system echoes Canada's situation well.

The international integration of financial markets has altered the context of national industrialization all over the world. Capital is more mobile than ever before. For national capitalists, short-term investments in domestic markets or foreign investments often provide higher, lower-risk returns than investments in long-term industrial expansion. Yet inducing nationals to invest in long-term industrial projects at home is among the most urgent tasks facing national governments. The rise of international markets...curtails state capacity for this task...¹³⁶

While some might assume that such an enormous change in the public-private relationship would have been preceded by significant planning, or by careful study, such is not the case. Little detailed consideration has been given to how the instability which may follow such deregulation will affect either political or corporate decision making,

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¹³⁵ M. Bienefeld, "Financial Deregulation..." p. 53

¹³⁶ S. Maxfield, Governing Capital: International Finance and Mexican Politics (Ithaca: Cornell U P, 1990) p. 2

especially in so far as various changes occur simultaneously. Mayer points out a stunning lack of theoretical work conducted to prepare Britain for its sudden financial deregulation:

There was virtually no discussion at the time of the "Big Bang" about its effects on corporate sector financing and there are few economic theories that could have been called upon to guide the policy-maker, had he been so inclined.¹³⁷

Such an absence of wide discussion is startling, considering the instability and risks inherent in such a massive shift away from nationally-regulated financial capital to the highly liquid and increasingly mobile forms of financial capital. The liquidity and rapid turnover of financial instruments allowed for higher rates of return with less risk to the nimble and fleet of foot, especially if the more general risks could be 'socialized', as occurred in the U.S. savings and loan debacle of the late eighties. As Friedmann recently put it,

With the combined crises of the early 1970s, accumulation shifted from industrial capital to mineral rents, and via petrodollars, to banking capital. Abandonment of Bretton Woods in the face of Eurodollar markets, and later multiple currency money markets in many financial centres, set banking loose.¹³⁸

This deregulation, together with changes in trade volumes and technology, triggered an explosive growth of international capital flows in the 1970s (at the time flowing primarily to the developing countries) and this intensified further in the eighties (though to different destinations). For the most recent period, one economist has outlined a stunning scenario of spiralling international lending:

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¹³⁷ Mayer, "The Assessment..." p. i

¹³⁸ Friedmann, H. "New Wines, New Bottles: Regulating Capital on a World Scale," in Studies in Political Economy 36 (1991) p. 35

In 1980 the stock of "international" bank lending (ie, cross-border lending plus domestic lending denominated in foreign currency) was \$324 billion [U.S.]. By 1991 - despite the third-world debt saga, which throttled new lending in the mid-1980s, and despite last year's further squeeze as banks struggled to meet new capital requirements - it had risen to \$7.5 trillion. To put these figures in perspective, the combined GDP of the 24 OECD industrial countries in 1980 was \$7.6 trillion; in 1991 it was \$17.1 trillion. So during the past decade the stock of international bank lending has risen from 4% of the OECD's GDP to 44%.¹³⁹

It is being increasingly recognized, even within the mainstream, that we are witnessing a qualitative structural shift in global economic relations, and that one of its effects is a powerful constraint on the effectiveness and latitude of 'national' economic policies and strategies. While some observers hail this change as a boon, in so far as it "liberates" markets from disruptive state regulation, others remain unconvinced that "free and global capitalism" has much to offer the vast majority of the globe's inhabitants. In this setting, issues which had previously been considered the technical concern of pure economists are receiving more attention from political scientists, sociologists, and others concerned with the maintenance of political sovereignty, and, hence substantive democracy. Perhaps more than any other of the industrialized countries, Canada has a great deal at stake in these changes in global economic realities, and we anticipate that the attention they receive will quite rightly continue.

Conclusion

The main purpose of this paper has been to qualify R.T. Naylor's scathing critique of Canada's early financial capitalists and state elites. It was overstated and

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¹³⁹ Crook, C. "Fear of Finance," The Economist September 19th, 1992

partly mistaken to blame them so singularly for failing to pursue a national industrialization strategy in Canada. His argument does not adequately explain the emergence of a relatively stable and prosperous economy, paying some of the highest industrial wage rates in the world and doing so for more than a hundred years. It is further in danger of overlooking the fact that policy makers in Canada faced not only the "generic" constraints confronted by all so-called "late-follower" economies (i.e. technological weakness, weak firms and institutions), but other constraints and opportunities that would have made such a strategy politically impossible, socially undesirable and economically costly - at least for many years. Once this is understood, the formation of a relatively conservative banking system can be understood as having more to do with the nature of the non-financial business opportunities (in the staples trades) than with the misguided predispositions and the moral-political fibre of the country's bankers.

This argument should not be interpreted to mean that the bankers and the merchant capitalists of the time were above reproach. In fact, the histories recount many examples of questionable banking practices, of corruption, and of normal 'business' ethics that place profits above the public interest. Moreover, given the fact that past strategies and the past behaviour of the banks has served Canada fairly well by comparative historical standards, this does not mean that there were no weaknesses or that it will continue to be so in the future. Indeed, as we have shown, the Canadian economy and Canadian society now confront problems that may require significant changes in its financial system and in its broader economic policy, if the interests of

Canadians are to continue to be served reasonably well. This does not mean that such changes will necessarily occur. But it may provide a basis for the political support without which they will remain impossible.

In the face of these recent changes - and particularly their recent scale - political economists must interrogate these dynamics more directly and more deeply. The fact that financial questions have previously been of interest primarily to neoclassical economists has meant that we inherit many gaps in our understanding, both empirical and theoretical, and filling them will demand comparative research into the operation of other financial systems. We need to begin that project by addressing questions such as the following: How can financial systems that have little experience with long-term, industrial lending be adapted to contemporary conditions? Is coordination of this kind of lending by national governments feasible? And, perhaps most difficult, how can governments re-introduce control over financial flows so that they can be channelled to uses that serve the interests of a democratically determined and nationally coherent development strategy?

Reclaiming a national, or even a regional development project from the global stage of foreign and transnational capital may depend on building a popular base for enacting costly, and (in the short term) disruptive economic policies. This is never easy, especially in hard times. Indeed, the generation of such support is only likely if it is widely believed that a significant section of the population has something important to gain through a re-engineered policy mix, or, alternatively, has something significant to lose by a failure to act. The fact that certain policies were not adapted in the past had

to do with the nature of the political forces that constituted the hegemonic bloc on which Canada was built over a hundred years. And, as we have argued, these political forces reflected, to a large degree, the nature of the economic opportunities that faced the government, the people and the financial system of the day.

The nature of those opportunities is now changing, and in turn, the established balance of political and economic forces is being threatened in qualitatively new ways. While, in the immediate term, these changes are inflicting high social costs, we must always appreciate that new balances and compromises - the formation of a new hegemonic "bloc" - are possible; for Canada, they may be vital. The current crisis clearly holds substantial new challenges, and its impact is being hotly contested. It is also becoming increasingly obvious that a qualitatively different set of policies will be required in order to face these new challenges. Political economy has a central role to play in allowing people to understand more clearly the implications of various policy choices. Nowhere is this more clearly the case than in relation to policies regarding the financial sector.

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