

# Has Free Trade Fulfilled its Promise in Canada? Contesting a “Sacred Tenet” of Globalization Theory

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## ABSTRACT

This paper undertakes a quantitative assessment of the Canadian political economy to see who the main beneficiaries of the free trade era have been by contrasting returns to labor and returns to capital in the pre- and post-free trade eras. Employing concepts and assumptions from the capital as power framework, two pictures are painted: the first picture examines broad changes in the distribution of income and the second picture examines differential business performance. The evidence from this inquiry suggests that although the official purpose of free trade was to boost the earnings of all Canadians, this trade deal actually represented—both in its intentions and consequences—a political-economic transformation written *by* dominant capital, *for* dominant capital.

**Keywords:** trade and investment liberalization; income distribution; capital as power; dominant capital; differential accumulation

## INTRODUCTION

More than 20 years have passed since the Canadian Government took a “leap of faith” and entered into a trade and investment liberalization (TAIL hereafter) regime with the United States.<sup>1</sup> Socially divisive and politically explosive back then, TAIL remains hotly contested today both north and south of the Canada-US border. Evidence for this can be seen in the clandestine fashion in which the Canadian Government is pursuing a bilateral trade agreement with the EU and the criticism it is beginning to draw [Lewenza, 2010]. South of the border, Senator Obama and Senator Clinton ignited a firestorm, however extinguishable, when they claimed they would potentially withdraw the US from NAFTA if the labor and environmental side agreements were not strengthened [Ibbitson 2008]. The opportunism aside, both candidates picked up on the discontent many in the US probably feel with the looming affects of TAIL. What are we to make of this popular discontent with one of the hallmarks of orthodox economic thinking? After all,

arguments in favor of TAIL are as old as the discipline of political economy itself, stretching as far back as the Scottish Enlightenment.<sup>2</sup> As Paul Krugman puts it, free trade is “as close to a sacred tenet as any idea in economics” [1987, p. 131], so why all the fuss?

In his beautiful essay *On Liberty*, John Stuart Mill encouraged us to continuously question the reigning ideas of our time, lest they degenerate into dead dogmas. Mill believed that uncritical submission to inherited empirical opinion is incompatible with freedom and autonomy [(1859) 2002, p. 60]. The startling consensus among mainstream economists on the question of TAIL, both across space and through time, could be greeted as a smashing success by the science of economics into the objective “laws” of capitalism. But then again it could be greeted with suspicion, for it might signal that mainstream economics is a particular way of seeing the world—a two century old habit of thought—that consistently describes and prescribes in a uniform manner. Belief in this “sacred tenet” invites the question: is confidence in the broad-based benefits of TAIL the product of scientific scepticism or of something else?

The task of this paper is to investigate the question of TAIL by looking at its affects on the Canadian political economy. This inquiry will concentrate on the distribution of earnings, contrasting returns to labor (wages) with returns to capital (differential business performance) in the pre-TAIL and TAIL eras. Far from delivering the broad-based prosperity that TAIL enthusiasts promised and that mainstream economic theory predicts, the distribution of earnings in Canada has become decidedly more skewed in the TAIL era. The first section of the paper sets the context by chronicling the long move towards TAIL, including a review of the public promises (read: *predictions*) made by TAIL enthusiasts and an examination of broad changes in the distribution of income. The second section examines shifts in the pattern of capital accumulation and the third section provides a qualitative explanation for the quantitative facts encountered in the first two sections. The argument here is that the capital as power framework

can help us explain both the changes in the distribution of income and in differential business performance because these are two sides of the same power-underpinned process.

### **In search of a methodological clearing**

In his Presidential address to the American Economic Association in 1970, Nobel Laureate Wassily Leontief lamented the state of contemporary economics. The enthusiasm for generating new mathematical and statistical techniques had come to overshadow the more substantive goal of the discipline, namely strengthening the empirical validity of its assumptions and testing their usefulness for generating conclusions. His call was to renew the discipline by deepening its empirical foundations through “systematic large-scale factual analysis” [1971, p.5]. Did the economics profession heed Leontief’s call? Not by the early 1980’s, it hadn’t. In a letter published in the journal, *Science* Leontief presented evidence which indicated that throughout the 1970’s approximately 1% of the articles appearing in the *American Economic Review* contained empirical analysis based on data generated by the author, an abysmally low proportion for a discipline that aspires to scientific status [1982, p. 104].<sup>3</sup>

It seems that mainstream economics is in a curious position then, methodologically speaking. “Analytical rigor” is often associated with juggling algebraic symbols while “legitimacy” is conferred on work that deals in highly formalized models and technical puzzles, often totally devoid of empirical content. Without having to dive head-first into the murky waters of methodology we might do well to heed Leontief’s simple advice and get back to basics. Whatever else an academic discipline can and should do with itself it must provide a satisfactory account of the facts and should be judged on its ability to do so. For Thomas Kuhn, the “scientist must...be concerned to understand the world and to extend the precision and scope with which it has been ordered” [1962, p. 42]. Our task as social scientists is not only to provide an explanation of the facts, but to discover new facts and actively create them through the generation of new

concepts and categories, facts which in turn order our world. Karl Popper [1963] reminds us that, stretching back to the pre-Socratics much inquiry in science and philosophy centered on explaining the visible with reference to the invisible. And it is here—with the use of power as an organizing principle rather than marginal utility—that mainstream economists are likely going to feel uneasy. But we would be unwise to reject a framework just because it does not synchronize with our subjective experience and personal political attitude. We ought to judge the validity of a concept on the basis of its usefulness; that which the concept enables us to do or demonstrate. In appraising the validity of concepts and the assumptions which underpin them we should ask if they “pay their way,” empirically speaking.

### **CONTEXTUALIZING TRADE AND INVESTMENT LIBERALIZATION**

Far from having active supporters throughout its history, TAIL has tended to find an unreceptive audience among ruling elites in Canada. Part of the reasons for anti-TAIL sentiment can be found in Canada’s political culture. Unlike the US which is thoroughly liberal-whig or bourgeois in values, Canada has traces of toryism and socialism in its official politics. Both ideologies are opposed in one way or another to liberalism and have the potential to be protectionist and nationalist in orientation.<sup>4</sup> Shifting from political culture to historical events, a variety of economic, political, and military forces—not least among them the end of the American Civil War—culminated by the mid 1860s so that “reciprocity” between Canada and the US ended. This development propelled the Canadian statesman, John A. Macdonald to propose that the maritime colonies unite with Canada East and Canada West in a confederation that might ensure the preservation of their independence. In 1866 Macdonald’s political platform called for the extension of Canada’s boundaries horizontally along the American border, a linking of the territory by rail, and the establishment of tariff barriers to protect the domestic market for

Canadian industry. Canada was spawned, then, from anti-TAIL impulses and successive Canadian governments have had to work at safeguarding Canadian independence, something they considered threatened by TAIL [Beatty 2002]. Aversion to TAIL among ruling elites persisted through much of the 20<sup>th</sup> century. This began to change in the 1970's when Liberal Governments undertook overtly nationalist policies, including rejecting TAIL with the US. This prompted dominant capital in Canada to re-evaluate its way of doing politics. Up until then dominant capital had lobbied political parties, helped them financially and supported them behind the scenes. In 1976 the Business Council on National Issues was formed (since re-branded as the Canadian Council of Chief Executives), made up of the CEO's of the largest corporations operating in Canada. Taking their cue from Business Roundtable in the US, the explicit objective of the organization is to have dominant capital participate directly in the policy-making process.

In the late 1970's and early 1980's the CCCE led an "attitude adjustment" within the business community which had, up until then, showed little appetite for a TAIL deal with the US. But by the early 1980's, thanks in part to the attitude adjustment there was a near consensus on the issue of TAIL [McBride 2001, p. 70]. Indeed, even before a free trade deal became part of the Mulroney Conservatives' policy platform, the CCCE, headed by CEO Tom D'Aquino, led a delegation to Washington to try to promote the idea to the Business Roundtable and Reagan Administration. In 1983 the CCCE began promoting the idea to the Canadian public. Despite this, Brian Mulroney campaigned against TAIL during his 1983 Tory leadership race, but after winning the 1984 election the Tory cabinet was invited by the CCCE to an extensive briefing at a secluded retreat in Quebec. The following year at the so-called Shamrock Summit in Quebec City Mulroney and Reagan formally announced the launching of free trade negotiations. That same year Mulroney's conversion from anti- to pro-TAIL was vindicated by the Macdonald's Commissions findings (see note #1), which made TAIL with the U.S. the centerpiece of its three-

volume report on Canada's economic future [Clarke 2007]. Despite opposing a TAIL deal with the US in the 1988 election and calling for the renegotiation of NAFTA in 1993, when the Liberals came to power later in 1993 they sensed the change in the political climate. Jean Chrétien, the Liberal Prime Minister would famously remark: "Protection is not left wing or right wing; it is simply passé. Liberalization is not a right-wing or left-wing issue; it is simply a fact of life" [Quoted in Alexandroff 1993, p. 56], and with this the conversion of Canada's ruling elites from anti-TAIL to pro-TAIL had been completed.

### **The promises and predictions of trade and investment liberalization**

TAIL was sold to the Canadian public on two interrelated grounds: necessity and prosperity.<sup>5</sup> Canadians were told that technological advances meant that production and markets were globalizing, and should Canada not secure stable, predictable access to the US market it would be relegated to the periphery of the global political economy [Trefler 1999]. Fear was not enough to induce Canadians, however. TAIL also had to hold out the promise of enhanced prosperity. The rationale, rooted in neoclassical theory, was easy enough for the public to understand. Tariff reductions would force Canadian firms to become continentally competitive on threat of extinction, and in so doing, lead to gains from increased specialization and economies of scale as manufacturing production shifted from short, diversified product runs for national markets to longer runs of more specialized products for continental markets. There would be a difficult period of adjustment in which uncompetitive firms would be eliminated, but freeing capital from narrow national constraints would enable it to flow to where it could be most profitably employed and this would bring net benefits to Canadians in the form of better jobs. The promises/predictions of TAIL were issued from a variety of sources. The Economic Council of Canada predicted a 1.8 percent boost in employment [Robinson 2007, p. 261]. The Canadian Department of Finance predicted a boost to long-term economic performance, including a long-

term increase to real GDP of 3 percent. The productivity gap between Canadian and US manufacturing was supposed to close along with a boost to long-term productivity growth. And on the question of distribution the explicit assumption was that gains from TAIL would be widely shared with workers in the form of higher wages [Jackson 2007, p. 212].

How are we to assess the validity of neoclassical predictions and the public (policy) promises that are derived from them? The success or failure of TAIL, however qualified, has continuing political relevance, for the Canadian Government is pursuing an ambitious TAIL agreement with the EU and is marketing this deal to the Canadian public on the apparent success of NAFTA [McParland 2008]. But was NAFTA a success? If yes, by what criteria? Who was it successful for? If one takes prediction as a legitimate criterion for distinguishing successful from unsuccessful theories then we must contrast the predictions and public promises with the facts. If a theory is going to provide us with a reliable guide to action then it should be judged on whether it “holds up.” Let’s be good empiricists, then, and see if it holds up. Table 1 contrasts a few basic performative measures for Canada and the OECD. Canada is contrasted with the OECD average so as to pick up on global trends and their affects on Canada. What these broad facts tell us about Canada is that inflation-adjusted (“real”) GDP growth did not pick up after the institution of a TAIL regime, quite the opposite actually, nor was labor productivity boosted. The story with wages is even worse. The 1980’s was a tough decade for organized labor, but inflation-adjusted wages have hardly budged in the TAIL era (and continue to trail labor productivity). The trends in the Canadian political economy mirror those in the OECD to some extent, but that aside, the promises and predictions of TAIL were not supposed to be dependent upon global economic performance. These facts alone are insufficient for generating conclusions to be sure, but at the very least they tell us that we ought to be sceptical about the public promises of TAIL and perhaps a bit suspicious of the theories that informed those promises.

**Table 1**  
**Basic Performative Indicators: Canada | OECD**  
 (Decade Average Growth Rate)

Measure	1960's	1970's	1980's	1990's	2000's
'Real' GDP	5.1   5.5	4.1   3.7	3.0   3.0	2.4   2.5	2.1   2.2
Labor Productivity	3.8   ...	2.5   2.4	1.3   1.5	1.6   1.1	1.1   1.4
'Real' Wages	2.35   ...	2.78   2.53	-0.02   0.38	0.63   0.52	0.05   0.24

SOURCE: Statistics Canada through Global Insight and World Bank through World Development Indicators for GDP; Cansim and Global Insight for Labor Productivity; IMF and OECD through Global Insight for Wages.

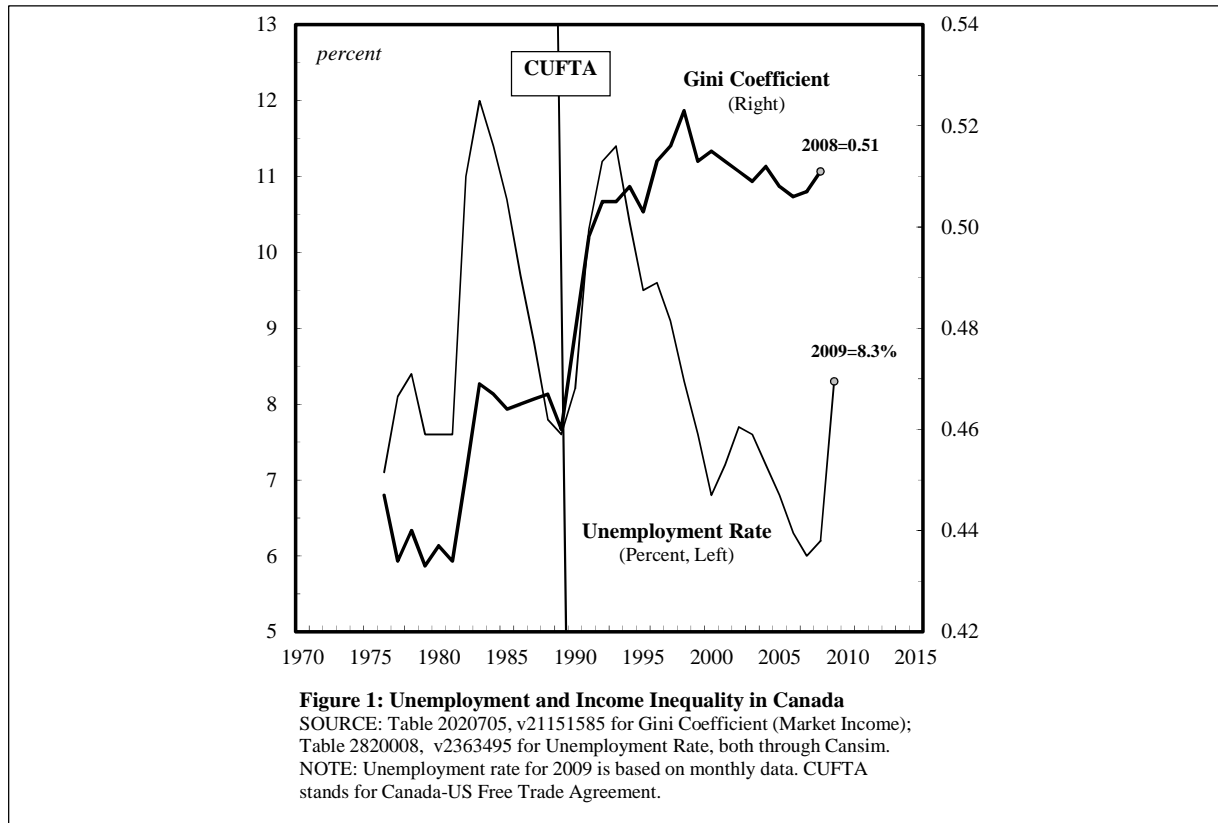
NOTE: Inflation-adjusted hourly earnings for the G7 are compared with Canadian ('real') wages because data are unavailable for the OECD as a whole.

Let us now begin with a broad measure of distribution: the gini coefficient.<sup>6</sup> Figure 1 contrasts the gini coefficient with the unemployment rate since the mid-1970's. This figure shows us two things. First, sharp rises in the gini coefficient (increasing income inequality) correspond with sharp increases in unemployment. Second, the positive correlation between the gini and unemployment only holds when unemployment rises. When unemployment falls sharply the gini remains stubbornly steady. We can infer from this simple chart that unemployment via crisis corresponds to redistribution. In 1989, just as the Canada-US Free Trade Agreement (CUFTA) was coming into effect we witnessed a sharp increase in unemployment and a corresponding spike in the gini coefficient. Might the move towards a TAIL regime have something to do with redistribution in the form of job destruction? Let's ask a mainstream economist:

The amount of job destruction in the years following the FTA was historically high and the unemployment rate rose for three successive years...To what extent this high rate of job destruction was solely caused by the FTA is unclear and controversial. *But it is unquestionable that the FTA made a large contribution* [Parkin and Bade 1997, p. 923, emphasis added].

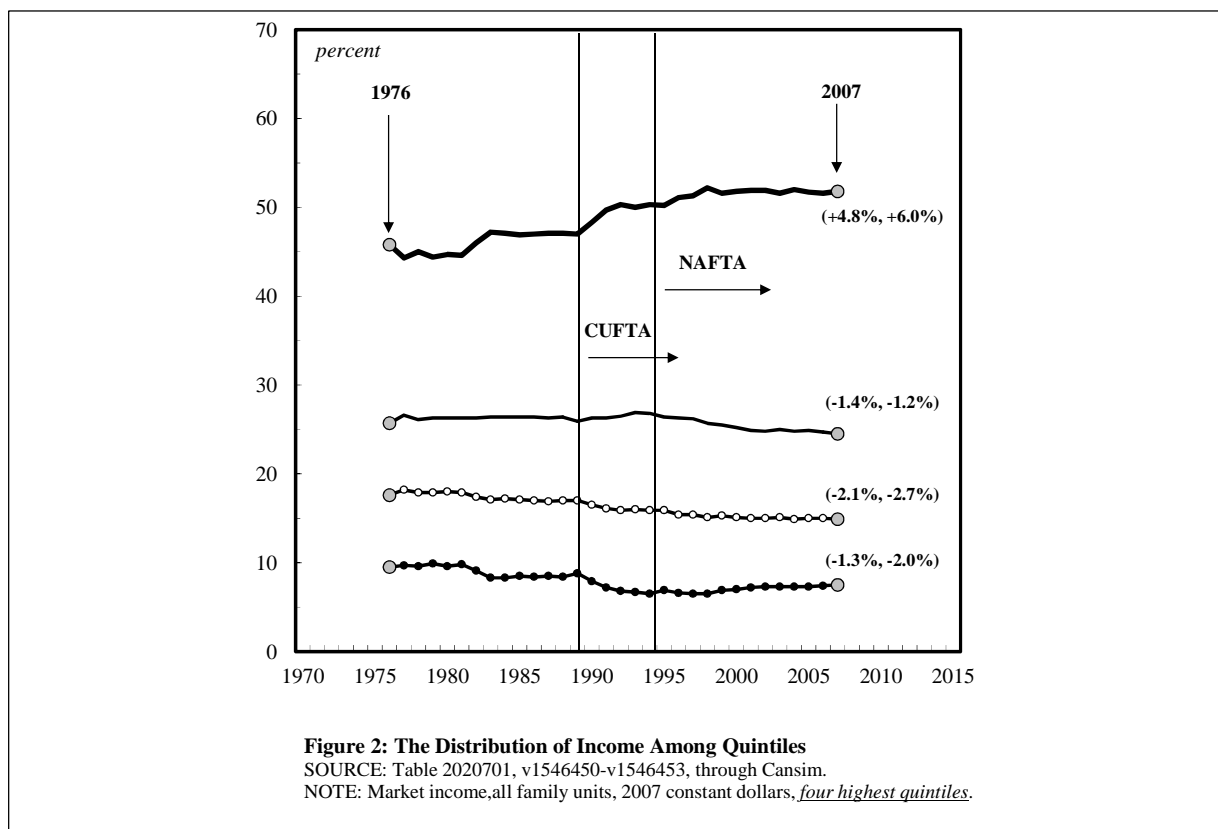
Income inequality would rise for nearly 10 consecutive years following the implementation of CUFTA and though the unemployment rate fell back to pre-CUFTA levels by 2000(!) the gini coefficient did not fall proportionately along with it. Crisis and unemployment led to a stable redistribution of earnings. And while the data for the gini coefficient ends in 2008, if

the pattern of the preceding 30 years holds we can expect the latest spike in unemployment attributed to the global financial crisis to correspond to even higher levels of inequality, and so, redistribution.



If the TAIL era has corresponded with greater income inequality we should look a bit more closely at the distribution of earnings. Figure 2 portrays inflation-adjusted income shares for the four highest quintiles.<sup>7</sup> At the right-hand side of each series are two numbers in brackets. The first number indicates the percent change since the onset of the TAIL era and the second indicates the percent change since the beginning of the series in 1976. So for instance, the highest income quintile has seen a 6 percent increase in its share of national income since 1976 with the bulk of it—4.8 percent—coming in the TAIL era. The middle three quintiles, which by any standard will constitute the working poor and a part of the middle class, have seen distributional losses since the onset of TAIL. The timing of the distributional changes is highly significant. The

distributional gains for the highest quintile and the distributional losses for the middle three quintiles come with the inception of the CUFTA and NAFTA. The instituting of a TAIL regime corresponds with distributional gains for the affluent and distributional losses for everyone else. The top 20 percent of income earners is quite a large group, however, and we need to focus a bit more closely on this group to see how the distribution of earnings has changed for high income earners.



Detailed information on high income earners in Canada is, unfortunately, hard to come by. However, we can draw a number of inferences from the facts presented in Table 2. This table gives us a snapshot of average inflation-adjusted earnings at three points in time for the highest income echelons in Canada. The figures for 1992 can serve as a proxy for pre-TAIL era earnings and 2004 as TAIL era earnings.<sup>8</sup> While Figure 2 show us that distributional gains accrued to the highest income quintile only, we have good reason to suspect that gains within the highest

quintile are highly skewed towards the upper end. When we break the high income group down into smaller units the resulting granularity reveals steeply progressive gains. So while the TAIL era has been an unqualified success for the top 10 percent of families in Canada, racking up gains of 34 percent, their performance looks paltry compared to the astounding gains made by the top 0.1 percent and 0.01 percent of income earners, with gains of 108 percent and 142 percent respectively.

**Table 2**  
**Free Trade Era Gains for High Income Earners**  
(Inflation-Adjusted Average Income, 000's \$CAD)

<b>Income Group</b>	<b>1982</b>	<b>1992</b>	<b>2004</b>	<b>Gain: 1992 → 2004</b>
Top 10%	\$153	\$160	\$215	34%
Top 5%	\$197	\$206	\$296	44%
Top 1%	\$380	\$404	\$684	69%
Top 0.1%	\$1,143	\$1,196	\$2,493	108%
Top 0.01%	\$3,658	\$3,490	\$8,443	142%

NOTE: Family income, 2004 constant dollars.

SOURCE: Adapted from Murphy, Roberts and Wolfson. 2007. "High Income Canadians," *Perspectives on Labour and Income*, Statistics Canada, p.7, Table 4.

To recap, these broad facts tell us a few things. First, the distribution of income in Canada has become markedly more unequal over the last generation. Second, the only group to make notable distributional gains are the top 10 percent of income earners. Third, the gains within the top 10 percent of income earners are skewed towards the upper end. And finally, the timing of the distributional changes corresponds with the implementation of a TAIL regime. These dramatic facts require an explanation. Tempting as it might be, we cannot claim that the top 10 percent of income earners are performing so well simply because they are “working more.” A recent study [Yalnizyan 2007] shows that the bottom 90 percent of Canadian households are working more weeks per year and more hours per week today than one generation ago and yet are seeing a smaller distributional share of national income. The only group to make substantial

distributional gains—the top 10 percent—is the only group to be working *less* today than one generation ago. We must look elsewhere for our explanation, but where?

### **Explaining (away) distributional outcomes**

In plain language the standard explanation for these dramatic distributional changes is to point to technology and globalization. These forces, it is said, have altered the demand for certain types of labor. As a result, “flexible skills” are in high demand in the knowledge economy and get rewarded at a higher rate than other skills. People with low education or with low skill levels are having their wages bid down by the developing world, hence the increase in income inequality [Jaumotte et. al. 2008]. The ideological significance of this line of reasoning is so obvious that it barely requires mention: by rooting distribution in the blind, impersonal forces of technology and trade the more substantive questions about how our very-human-created institutions shape distributional outcomes are neatly side stepped (see note 6), especially questions about power. The standard explanation is dependent upon intellectual support structures stretching back to the nineteenth century, so before supplying a tentative explanation using the capital as power framework let’s briefly review and interrogate these supporting structures to see if they can withstand scrutiny.

A recent study [Piketty and Saez 2003] of income inequality in the US found that top income and wage shares have taken the form of a U-shape over the 20<sup>th</sup> century, so it seems the trends in Canada are mirrored elsewhere in the industrial world. The trend towards greater income inequality is significant, the authors contend, because it suggests that Simon Kuznets’ [1955] influential hypothesis can no longer account for the facts. Mainstream economics has generated a number of theories to explain the distribution of income across society, including reference to individual choice, chance and human capital, to name a few [Friedman 1953; Becker and Chiswick 1966; Becker 1992]. But explaining the distribution of earnings with reference to

the choices people make or their “human capital” would be meaningless without a series of foundational ideas from the nineteenth century, namely the ideas of the marginal revolution as articulated by Walras, Menger, J.B. Clark and others. It was Menger specifically who, by having the principle of marginal utility cover all areas of the economy made questions of production essentially inseparable from questions of income formation and distribution. Clark would later systematize this line of reasoning with his concept of the production function, but by having the marginal principle cover the whole range of economic phenomena distribution ceased to be an isolatable question [Schumpeter 1954, p. 913].

If explaining the aggregate distribution of income with theories about choice or human capital is entirely dependent upon the production function then this one concept is carrying quite a heavy load. But can it withstand the weight? The production function claims to demonstrate the technical relations between the factors of production and the output of the production process. The prices of the factors of production and the rate at which they are rewarded are determined by their technical productive power. The productive power of labor, in turn, is attributable to the original and acquired human capital of the worker. But the Cambridge Controversy demonstrated the impossibility of explaining wages and profits, that is, the distribution of income across society, by drawing a connection between the *physical quantities* of labor and capital used in production and the *physical quantities* of marginal products attributable to these factors. This means that mainstream economics is without an adequate theory of the distribution of income [Hunt 2002]. But if the production function is theoretically impossible and empirically empty, so is the whole enterprise of delineating a person’s income based on human capital, endowments, choices, and so on. There may be an observed correlation between high education and high earnings, but rather than attributing the latter to the marginal productivity of the former it might simply be explained with reference to “credentialism” or some other social practice.

Some might be tempted to argue that the marginal productivity theory of distribution is a highly abstract theory from a century ago and has little contemporary relevance. But this cannot be true for two broad reasons. First, economics textbooks continue to use the concept of the production function when discussing aggregate distribution [Parkin and Bade 1997, Ch. 30] even after the concept has been shown to be highly dubious, if not flatly refuted. The second reason is exemplified in recent headlines. Coming under fire for Goldman Sachs' compensation policies in the wake of an investment bank-induced crisis, Lloyd Blankfein could do no better than justify the exorbitant compensation packages with reference to employee productivity [Farrell 2009]. The reporter forgot to ask how the productivity of Goldman employees could be measured, and this is no small omission since Blankfein's response is entirely dependent on this ability. Specifically, how can we isolate the output attributable to each employee and *with what units* can we measure individual productivity, because without knowing the technical productivity of each employee we could never know if it is above, below or equal to their pecuniary earnings. If pressed with this question we might expect Blankfein to have answered by saying he knows of no other way to calculate an employees' productivity aside from looking at what s/he *actually earns*. And herein lies the basic problem. His explanation, which is rooted in mainstream theory, is to explain earnings by pointing to earnings and *assume* that actual pecuniary earnings are an accurate reflection of the underlying productivity. But elementary logic requires that that which is to be explained cannot figure in the explanation itself otherwise we run in circles and invalidate our argument. So how are we to explain the distribution of earnings?

## **DISTRIBUTION AND REDISTRIBUTION**

The capital as power framework approaches capital as the central institution of the political economy and its accumulation as the central process [this brief synopsis of the capital as power

framework, along with some empirical measures, are inspired by Nitzan and Bichler 2009]. Unlike mainstream or Marxist political economy, capital is not viewed as an economic category anchored in material reality. Nor does it even center on production *per se*, though production plays a large role in capital accumulation. Instead, capital is thought of as commodified power. The reasoning behind “power” is as follows. The institution of capital, and by extension, capitalism, centers on private ownership. The word “private” comes from the Latin *privare* which means “to deprive” and *privatus* which means “restricted.” Contrary to popular understanding, private ownership is *not* an institution which enables those who own, but one which disables those who don’t own. And in the final analysis institutionalized exclusion is a matter of organized power. This means that the architecture of prices and the magnitude of capital are not reflections of underlying utility or productivity, but are a symbolic quantification of the power of absentee owners (“investors”) to shape the process of social reproduction as a whole. This makes capital a broad power institution and not just a narrow form of “economic” power.

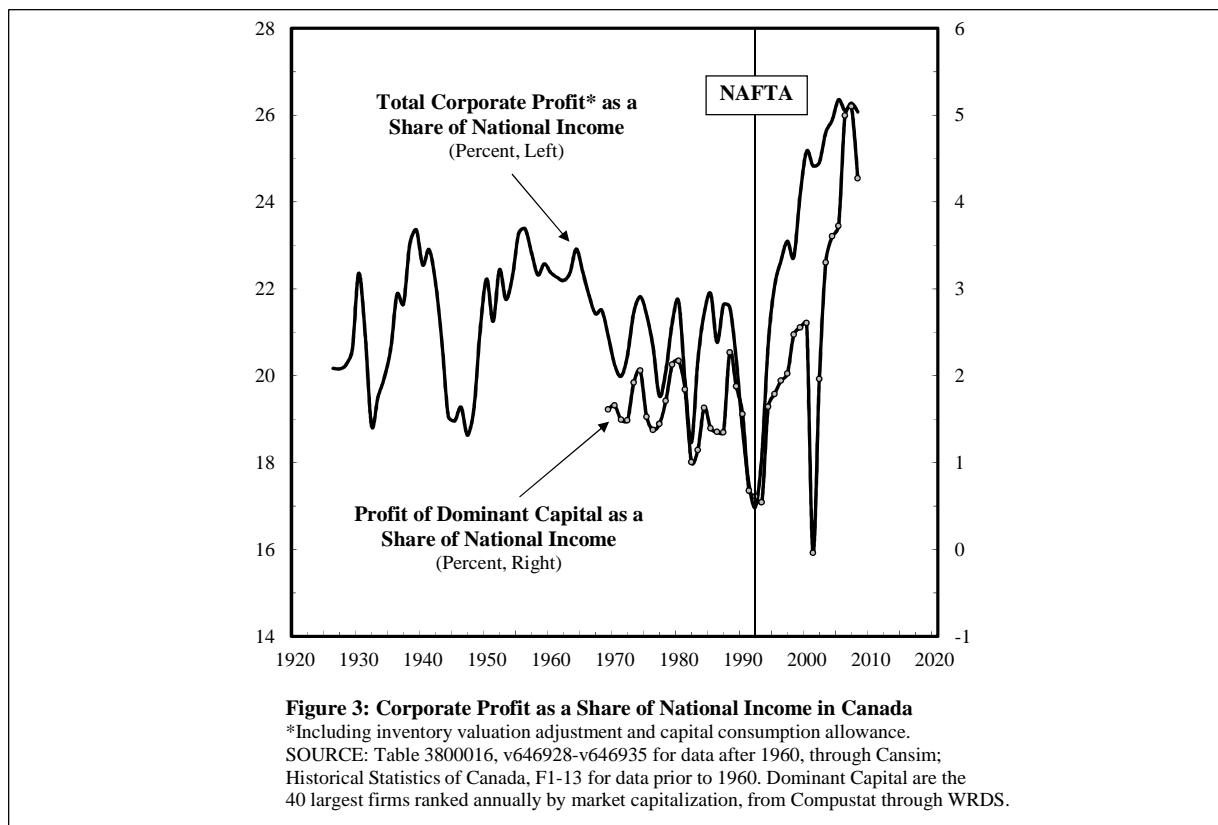
This power manifests itself in the universal quantitative logic of capitalization. The assets owned by investors stretch far beyond tools, machines and factories to include everything from inventions to ideas to human beings and nature itself. Control over an assets’ earnings stream involves shaping expectations, taming risk and managing hype. But this implies direct and indirect control over those very inventions, ideas, human beings and natural objects being held as assets. And to control something is to have power over it, to impose one’s will on it. Because power is a relational concept it only has meaning when compared with other forms of power. In the same way that force only becomes force in the face of counter-force or resistance, power must operate on something other than itself *to be* power. The implication here is that instead of thinking of accumulation in absolute terms we must think of it in differential terms. A further assumption, and this is key to the argument of this paper, is that material provision

("production") is a social-hologrammic process, not an atomistic-mechanical process. Liberal myths about Robinson Crusoe-style production aside, it is human communities collectively and as a whole that reproduce themselves. Thinking of production as a social-hologrammic process means that we have to shift away from querying absolute outcomes in favor of distributional outcomes, and distribution is an institutional phenomenon, which under capitalism, is rooted in power.

Let's begin then, with some basic distributional measures. Figure 3 presents the profit share of national income in Canada since the mid 1920's.<sup>9</sup> One series charts the profit share of the Canadian corporate universe fetched and the other charts the profit share of dominant capital. Delineating dominant capital is always going to be somewhat arbitrary. The top 40 firms are used as a proxy for dominant capital for two reasons. First, the standard measure of a large cap firm is \$10 billion and higher. The most recent figures for Canada indicate that the 40<sup>th</sup> largest firm has a market value of approximately \$10 billion, making the top 40 firms all large cap. Second, the Canadian political economy is approximately 1/10<sup>th</sup> the size of the US, and the S&P 500 is taken as one of the main benchmarks for business performance globally, so having a proportionate measure in Canada brings us somewhere between 40 and 60.

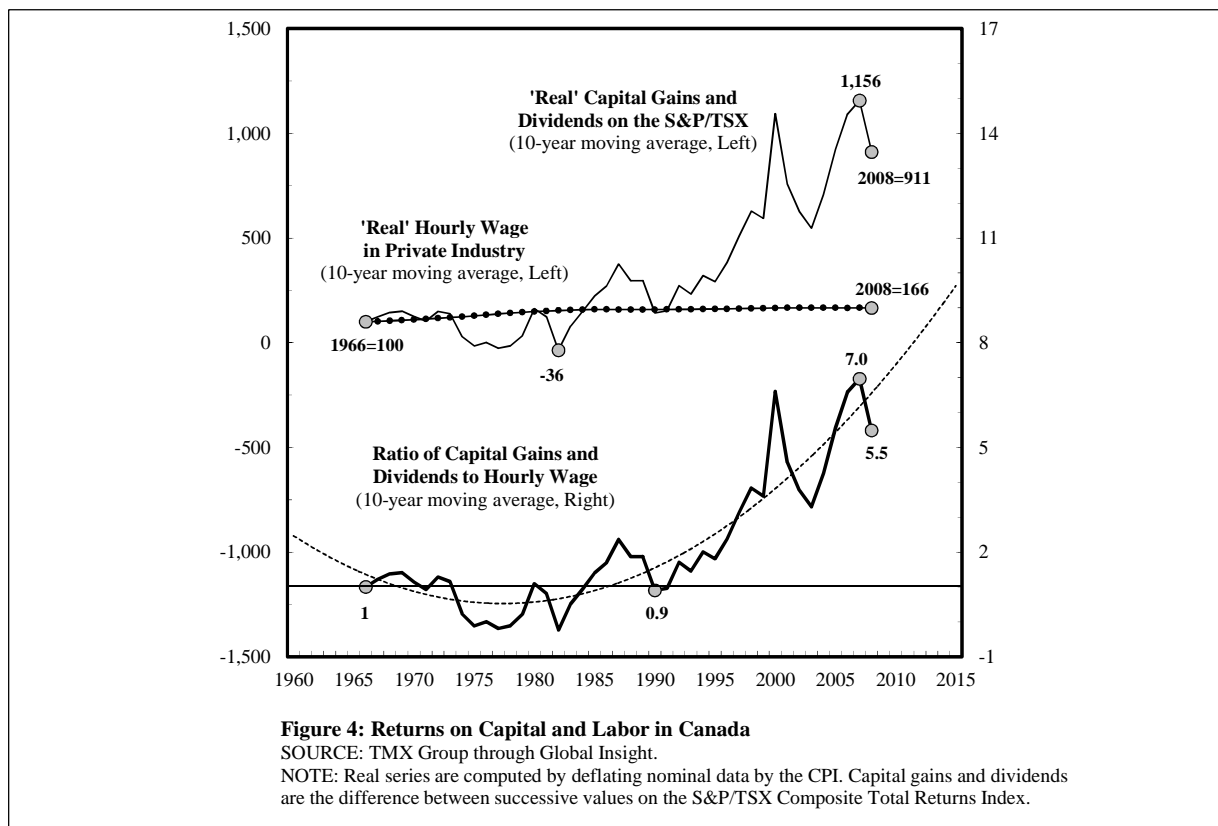
Putting these measures of capital's share of national income into historical context enables us to see just how remarkable the TAIL era has been. With respect to the Canadian corporate universe the pattern is uneven and erratic, but from the mid-1950's onward it shows a marked tendency toward decline. The post-war high reached in the mid-1950's is not matched again until the TAIL era. While the cyclical peaks remain relatively constant the cyclical lows become successively lower. The twentieth century saw a number of deep cavities, but what is perhaps most striking is the change in pattern exhibited on the eve of the TAIL era: capital's share of national income is at a historic low (worse than the period of price-fixing during the

Second World War and worse than the Great Depression) but will rise to an all-time high. The pattern for dominant capital is much the same, with cyclical highs relatively constant but cyclical lows successively lower. The pre-TAIL era was erratic to be sure, but the magnitude of the profit share changes dramatically in the TAIL era. It is important to note that the deep cavity in 2001 for dominant capital is driven by a single firm—Nortel—whose losses ran into the \$10’s of billions. Without that one firm the pattern for dominant capital would more closely mirror the Canadian corporate universe.



Turning from distributional shares to returns on capital and labor yields a similarly extraordinary shift. Recall that one of the promises/predictions of the TAIL enthusiasts was that gains from trade would be widely distributed between capital and labor. But nothing near that has happened. Figure 4 contrasts returns to capital with returns to labor.<sup>10</sup> Smoothing each series as 10-year moving averages helps eliminate cyclicity and setting each series to 100 in 1966

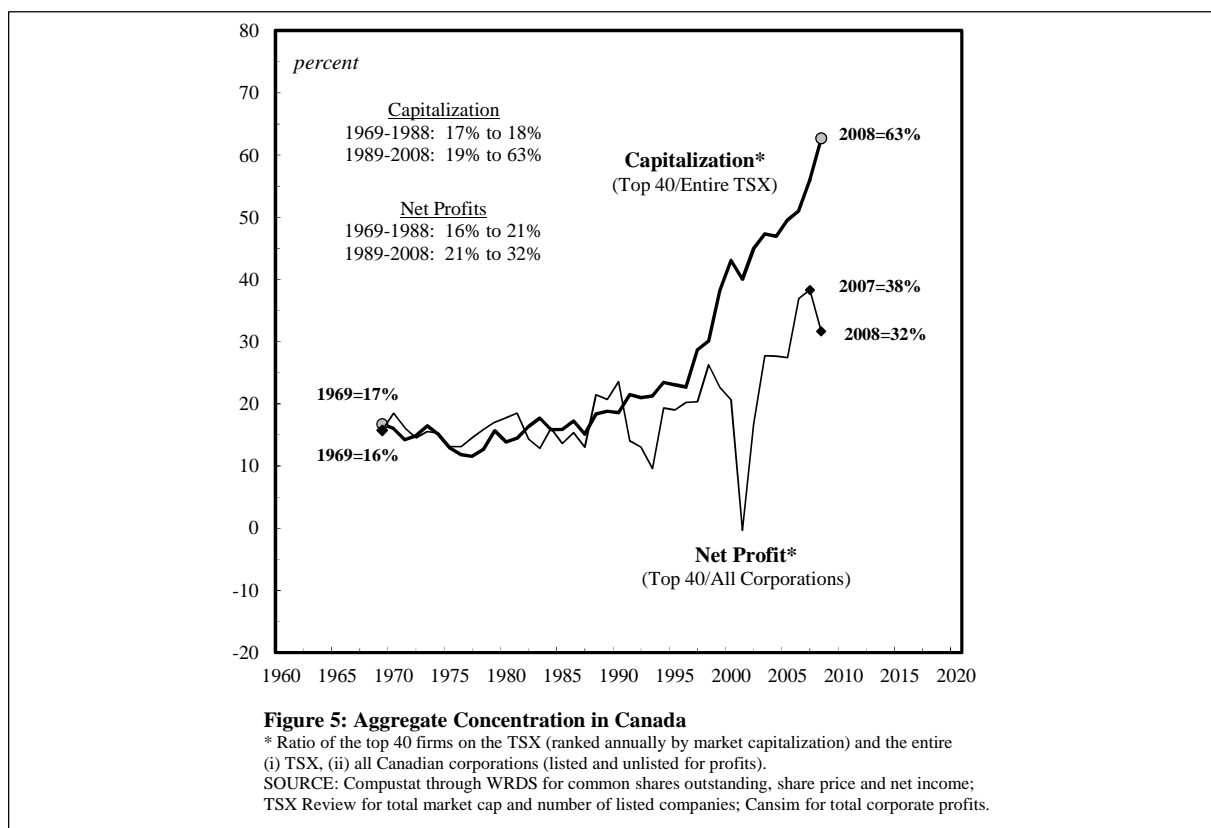
enables us to track their relative movement. In terms of the change in growth pattern at the inception of a TAIL regime the figure speaks for itself. From 1955 when the data begins to the inception of the TAIL era in 1990, the relative movements of capital and labor are almost equal. Hourly wage growth is at 158 and capital gains growth is at 143, so labor has actually *outperformed* capital up until this point, relatively speaking. But this is about to change. The growth rate of wages comes to a grinding halt while returns to capital skyrocket. Something dramatic happens right at this time to change the growth trajectory of each measure, and, as this paper will argue, a large part of that change can be attributed to the reorganization of social space and altered power relationships flowing from the institution of a TAIL regime.



We move now to focus a little more closely on the composition and performance of dominant capital. Aggregate concentration is often taken as a proxy for the power of big business. Figure 5 presents this measure for market capitalization and net profit from the late

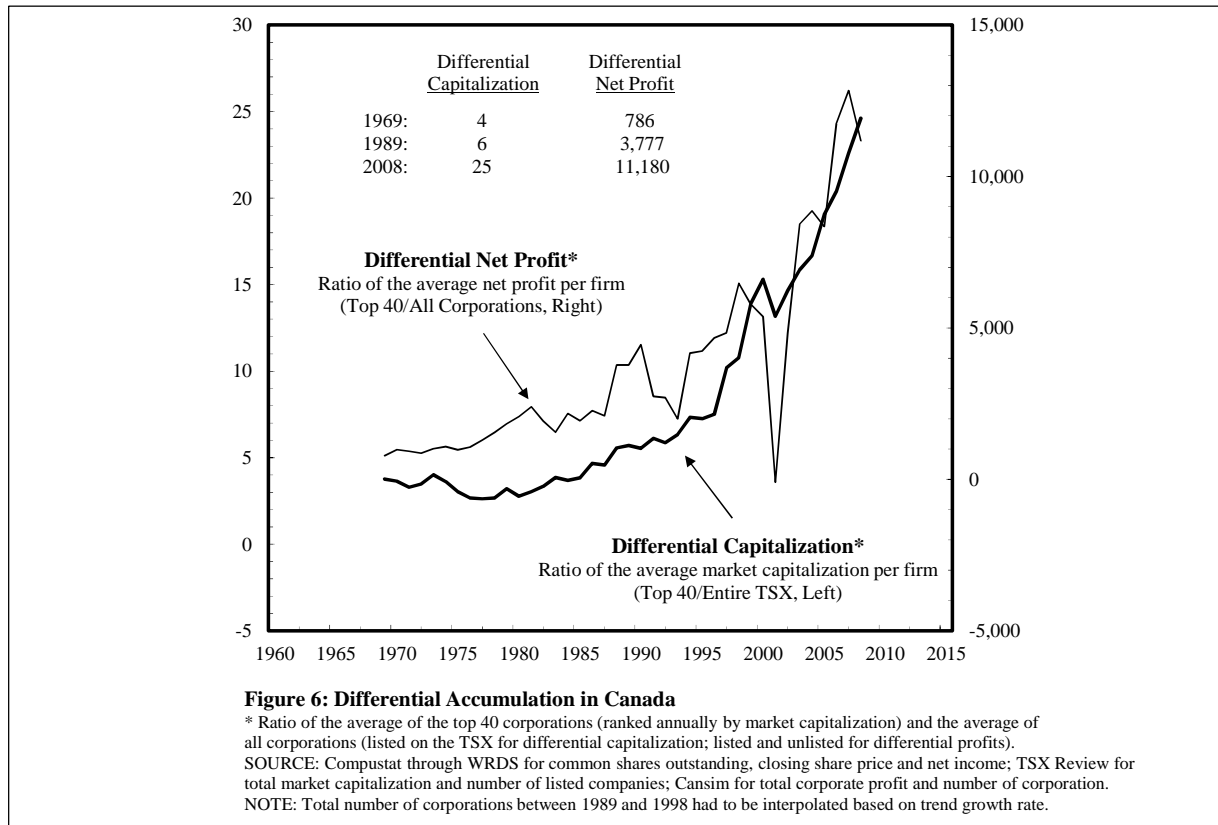
1960's onward. The concentration index for market capitalization uses the top 40 firms ranked annually by market capitalization on the S&P/TSX as the numerator and the combined market capitalization of all listed firms as the denominator. The concentration index for net profit has a slight difference: it uses the net profit of the 40 largest firms listed annually on the S&P/TSX as the numerator, but uses the net profit of all Canadian corporations, listed and unlisted, as the denominator.

There are a number of striking features about this chart. First, note the dramatic rise of both measures. In the late 1960's the top 40 firms accounted for 16 percent of profits and 17 percent of market capitalization. By the latter part of this decade their share had risen to 32 and 63 percent respectively. Second, and importantly for this argument, is the *timing* of the rises. In the 20-year period preceding the TAIL era the share of net profit and market capitalization rose from 16 to 21 percent and from 17 to 18 percent, while in the 20 years since the instituting of TAIL the share rose from 21 to 38 percent (at its peak) and from 19 to 63 percent, a very dramatic change to be sure. The third thing to note here is the divergence between the two measures. In the pre-TAIL era the two move very closely together, but in the TAIL era capitalization pulls away from net profit. The reasons for this are unknown, but we should recall that while earnings drive market capitalization, it is not earnings alone which do so. Other "elementary particles" include investor expectations about future earnings, the hype surrounding earnings, the perceived risk associated with earnings and the discount rate.<sup>11</sup>



Shifting from measures of aggregate concentration to differential accumulation brings us into the capital as power framework proper because the relevant measures of power are not aggregate but disaggregate [Nitzan and Bichler 2009, p. 319]. Differential capitalization and differential net profit are ratios which are computed in three steps: the first step is to calculate the average capitalization/net profit of a dominant capital firm; the second step is to calculate the average capitalization/net profit of a listed firm (and of all firms for net profit); and the third is to divide the first computation by the second. These ratios provide us with the differential power of capital and they are plotted in Figure 6. While they are tightly and positively correlated over time (despite the scale differences on the axes), again what is striking for the subject at hand is the change in the rate of growth with the inception of a TAIL regime. In 1969 an average firm within dominant capital was four times as large as an average listed firm on the S&P/TSX according to market capitalization. Twenty years later that ratio had risen from four to six. But in the 20 years

since the inception of TAIL, the ratio rose from six to 25! This suggests that something dramatic happened at the very time that a TAIL regime was instituted.



To briefly recap, whether we want to look at aggregate distribution (figure 3), aggregate concentration (figure 5), returns to capital (figure 4) or differential accumulation (figure 6), the picture that is emerging with respect to business performance is rather clear. The level and pattern of accumulation changes markedly with the inception of a TAIL regime. Capital has never enjoyed a higher share of national income (since measurement began) and the power of dominant capital, as captured in aggregate and disaggregate measures, is at its highest level in 40 years. The major claim here is that these measurements find their domestic analogue in Figures 1 and 2 and Tables 1 and 2, that is to say, the rising inequality and concentrated income gains for high income earners that we've witnessed in the TAIL era are the mirror image of the rising power of capital, especially dominant capital. As has already been expressed, accounting for this

with reference to marginal productivity or the blind forces of technology and globalization just won't do. Thinking of these processes from a power perspective might help us explain the facts we've encountered so far.

## **THE INSTITUTIONAL REORGANIZATION OF POWER**

We might think of these distributional changes in earnings as a reflection of the institutional reorganization of power relations at three levels: capital, labor, and government. It should be noted that in claiming that the institution of a TAIL regime had a large impact on these distributional outcomes it does not imply that it is the *only* factor at work. It is the entire political program of deregulation, privatization, shifting of the tax burden, etc., that has come to be known as neoliberalism that is likely driving these changes. But the timing of many of these distributional changes coincides with the onset of a TAIL regime and this suggests that TAIL is a significant factor. What we can take this to mean is that TAIL is not simply one policy option among others; it is a reorganization of social space through the reorganization of power relations. These trade deals have given capital new disciplinary powers with respect to labor and government. Also note that the following illustration of the institutional reorganization of power relations is meant to be suggestive rather than conclusive.

### **A new bill of rights for capital**

The proliferation of trade agreements since the close of the Cold War have tended to be encompassing from the standpoint of investment, and CUFTA and NAFTA are no exception [the following discussion draws extensively from Shrybman 2007]. These agreements include areas of law, public policy and government services that had previously been confined to the domestic sphere and rule upon such broad matters as investment, regulation, public services, procurement, intellectual property and environmental protection. International tribunals have been established

that impose upon governments at all levels severe restraints, and threats of retaliatory trade sanctions or damage awards for “expropriated earnings” are part of the ordinary mandate of these tribunals. One of the more striking features of these tribunals is the extremely broad definition given to “expropriation.” The conventional understanding centers on the confiscation of property, but NAFTA understands this term to include “covert or incidental interference with the use of property which has the effect of depriving the owner...of expected economic benefit of property” [Supreme Court of British Columbia, quoted in Shrybman 2007, p. 303]. In other words, it is not just actualized losses, but potential future losses as well that get compensated.

The investment provisions of NAFTA empower capital to sue governments to enforce the exclusive rights the treaty accords them. In some cases these encompassing investor rights are not mirrored in domestic law and would be unenforceable in national courts. When a claim is made under chapter 11 of the agreement it is determined by a secretive international tribunal operating wholly outside the framework of domestic law and without consideration of ordinary constitutional guarantees. This enables investors and corporations to constrain government policy and regulation by submitting damage claims for alleged “interference” with their “rights.” By providing capital with these powers NAFTA marks a dramatic departure from the norms of international law in two ways. First, capital is given a broad range of rights even though it is not actually party to the contract and does not have any obligations under it. Historically, only nation-states had access to the powerful dispute mechanisms of international trade law. Second, chapter 11 provides capital the right to bring into play private and secretive international commercial arbitration processes that rule upon important issues of public policy and law. In short, the deal enables capital to put any law, program or policy of a NAFTA signator that it happens to oppose on trial, and those parts of civil society that might be affected by a NAFTA ruling are ignored. These legal-institutional changes constitute a reorganization of the framework

of accumulation, further empowering capital. It should be noted that this power does not have to be utilized to be effective. The actual application of this power is infrequent and its direct connection to distribution is probably partial. That said, capital has acquired new legal possibilities which condition government policy, making the enactment of laws in its favor more probable.

### **De-unionization of labor**

Recall that the official purpose of eliminating tariffs and reducing other trade barriers was to free capital from narrow national constraints, thus enabling it to move to more productive sectors. The assumption was that more jobs will be generated in the productive sectors to absorb the losses of jobs in the unproductive sectors. But the institutionalization of a TAIL regime was about more than tariff reductions and the cross-border flow of commodities. The facilitation of capital mobility further empowers capital over labor, especially at the level of collective bargaining. The real threat is not just that capital will leave declining sectors and flow to more productive ones, but that it will leave the domestic economy altogether. This puts downward pressure on wages in the sectors most exposed to the threat of relocation by weakening the bargaining position of labor. The wage stagnation that we see in Table 1 and Figure 3 is probably closely tied to the enhancement of capital mobility. Increased competitive pressures help explain the very sharp decline in the unionization rate in Canadian manufacturing, which has fallen from 46 percent in 1988 to 32 percent in 2002 [Jackson 2003]. It is important to consider that this is a self-reinforcing cycle. As more jobs are lost in unionized workplaces and as new workplaces are created that are not unionized, organized labor will be put in an even worse bargaining position, and so even those jobs that aren't relocated will face wage compression. Union decline also implies that non-unionized sectors will be less able to bid wages up. So wage compression for unions implies wage compression for all. Now, union decline is not a process rooted in "nature"

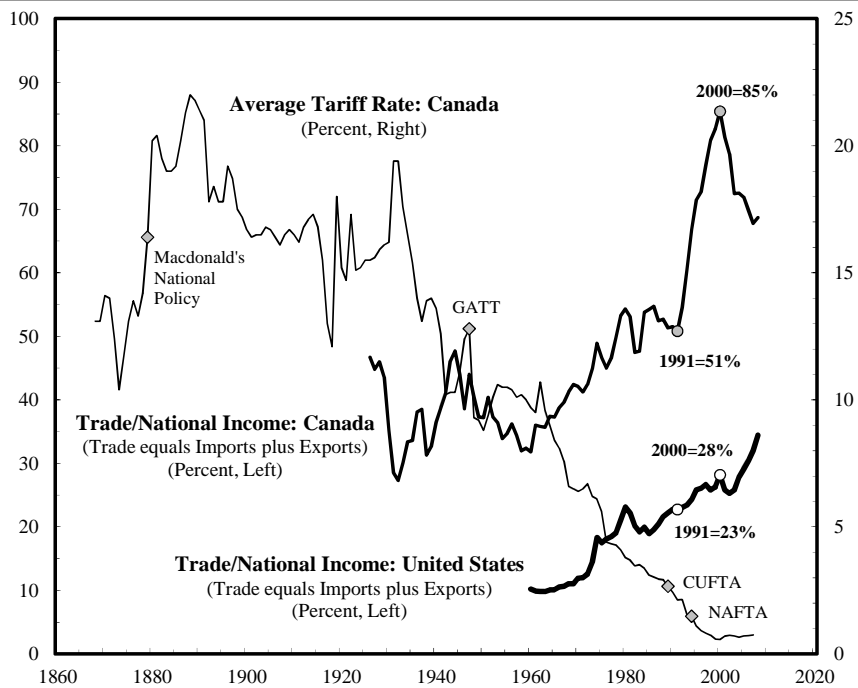
or other impersonal forces. It is the product of decisions made by flesh and blood human beings and these figures seem to suggest that the disproportionate closures of unionized plants and the disproportionate concentration of new hiring in non-union plants has contributed to these distributional changes in earnings.

### **A new “conditioning framework” for governments**

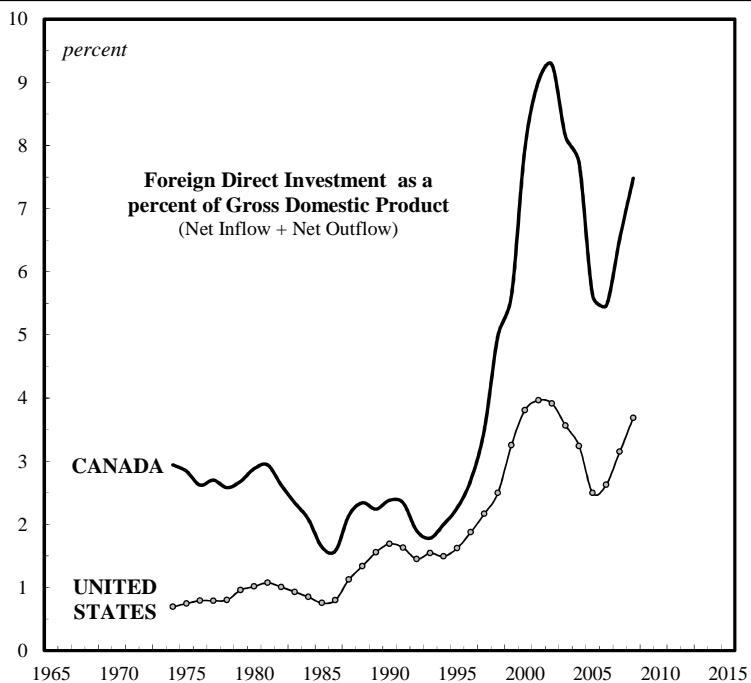
These trade agreements serve as institutional mechanisms that effectively restrict the policy choices at the nation-state level. Ruling elites have used these international obligations to impose policies that would not otherwise meet with general domestic support and many of the institutional mechanisms are “supraconstitutional” in function, meaning they are so broad in scope and have such unusual judicial authority that they are capable of transforming the domestic political order from the outside-in. In other words, they are able to shape government behavior even though they do not fall under the constitution. In the words of one scholar, “NAFTA tied the government’s hands...a clear illustration of how international agreements can be used to constitutionalize a domestic ideological position” [Clarkson 2002, pp. 51-52]. The new rights provided to capital also make it extremely difficult to bring public and social services back into the public sector once they have been privatized or commercialized, thus giving practical significance to Thatcher’s ideological acronym: TINA (there is no alternative). Not only is it extremely difficult to reverse some of the privatization and deregulation measures of previous neoliberal governments, it becomes very difficult to establish new social services. For instance, if Canadians ever wanted to expand their Medicare system to include home care or pharmacare it would be very difficult to do so, because investors could sue the Canadian Government for expropriated earnings.

### **Disentangling causality: tariff cuts or the reorganization of power?**

Figures 7 and 8 show changes in the tariff rate, trade and foreign direct investment for Canada and the US. Canadian firms saw tariff protection negotiated away through the GATT and had already gained reciprocal access to the US market. The average tariff on Canadian exports to the US was negligible at the time of CUFTA with the majority of Canadian exports entering the US market duty-free. If the reduction in tariff rate in the TAIL era was historically insignificant how do we account for the massive expansion of trade and investment? A sizable proportion of the change in trade flows is probably linked to a highly devalued Canadian dollar which made exports more cost competitive than American rivals. But perhaps it follows that the powerful new rights and measures that capital received, including guarantees on government action and an enhanced bargaining position vis-à-vis organized labor had changed the earnings expectations and risk perception of capital. Capital no longer had to fear that a new government would mean a change in the “investment climate.” Even the threat of progressive social change coming from the election of a (progressive) New Democratic Party government was nipped at the bud because the government would not be able to reverse the neoliberal policies instituted in NAFTA. Because the Canadian political economy is so much smaller than the American, we would expect the effects of TAIL to be proportionately greater in Canada, as these figures indicate. The dramatic distributional and differential outcomes that unfolded in Canada are mirrored by dramatic changes in cross-border trade and investment flows, which cannot be meaningfully explained with reference to tariff cuts.



**Figure 7: Trade and Trade Protection in North America**  
 SOURCE: Historical Statistics of Canada, G485 for Average Tariff Rate (1868-1975); Cansim Tables 384007, 3840027 and 3840028 (1975-2007); Historical Statistics of Canada, F71 and Table 3800017 for Imports, Exports and GDP. Bureau of Economic Analysis through Global Insight for Imports, Exports and National Income (US).



**Figure 8: Foreign Direct Investment in North America**  
 NOTE: Series smoothed as 5-year moving averages.  
 SOURCE: World Bank through World Development Indicators.

## CONCLUSION

The public promises and theoretical predictions of TAIL have gone unfulfilled. The TAIL era has not delivered broad-based prosperity for Canadians, but instead has brought differential income gain for the few and income stagnation or outright decline for the many. The great philosopher of science, Imre Lakatos, reminds us that “in scientific reasoning, theories are confronted with facts; and one of the central conditions of scientific reasoning is that theories must be supported by facts” [1978, p. 2]. The facts do not appear to support existing theories of TAIL and its connection with the level and distribution of earnings. Mainstream economics is compelled then, to generate what Lakatos calls “rescue hypotheses,” namely an account of the failed prediction and rationale for why it should be thought of as an “anomaly.” But we don’t need to generate rescue hypotheses (much as science does not need “sacred tenets”) once we step into a new theoretical framework. The mystery of TAIL’s failed predictions disappears once we begin to think of the political economy and capital accumulation as rooted, not in marginal utility, but in power. The political engineering of a North American space for accumulation and the institutional reorganization of power relations—granting capital new disciplinary powers—would deliver the results that we see: rising returns to capital, a change in aggregate distribution in favor of capital, deepening aggregate concentration, a big boost to differential accumulation and a further skewing of the distribution of earnings in favor of the highest income echelons. After 100 years of protectionism and economic nationalism, Canada’s ruling elites, at the behest of dominant capital, inaugurated a TAIL regime. And 20 years into this regime we can see the affects of this political-economic transformation. Much as we may dislike having to agree with that great Florentine political thinker, he thought long and hard about power and perhaps had it right when he said:

...men are inclined to think that they cannot hold securely what they possess unless they get more *at others' expense*. Furthermore, those who have great possessions can bring about changes with greater effect and greater speed. [Machiavelli 1517, p. 118, emphasis added]

## Notes

1. In 1985 the Royal Commission on the Economic Union and Development Prospects for Canada (known as the Macdonald Commission) presented its report to the Government of Canada. One of its key recommendations was for Canada to pursue a free trade agreement with the United States, a move the Report referred to as a “leap of faith.”
2. Interestingly, in attacking the privileges and protections of the mercantilist system, Smith’s arguments in favor of free trade neatly anticipate Ricardo’s theory of comparative advantage. By anchoring an argument for free trade in cost competitiveness [Smith (1776) 1987, Book IV, chapter II] Smith goes some way towards Ricardo’s comparative advantage [Ricardo (1817) 1977, p. 81]. Two centuries later Milton and Rose Friedman can do no better than recycle the arguments Smith and Ricardo made without adding anything substantively new [Friedman and Friedman 1980, chapter 2]. This indicates that the strongest arguments for TAIL are still to be found in the works of Smith and Ricardo.
3. Blaug [1992] discusses this state of affairs and it is possible that his book is, in a way, devoted to a critical *apologia* of the discipline despite its empirical inadequacy.
4. Lipset [1990] and Horowitz [1968] make convincing arguments for the divergence in political values between Canada and the United States, including why the political culture of the former has elements averse to TAIL.
5. Marx and Engels’ concept of ideology [(1845) 1998] has three main components: it depicts social arrangements as natural, rooted in extra-human forces; it justifies social arrangements by claiming that all members benefit; and the interests of the dominant class are passed off as the interests of all. The proponents of TAIL in Canada were almost certainly innocent of Marx and Engels’ ideas, but it is always remarkable to see a centuries old idea hold up so sturdily.
6. The gini coefficient is commonly used as a measure of income inequality. It ranges from 0 (perfectly equal distribution of income) to 1 (perfectly unequal distribution of income).
7. The reason for omitting the lowest quintile is that anyone who submits a tax-return but who does not work a stable, full-time job will fall into this category, including teenagers with paper routes. The second lowest quintile approximates those people who try to survive in Canada off the minimum wage, many of them trying to support a family with their earnings.
8. Even though these are just snapshots, the virtue of their timing resides in that these data all correspond to a post-recession moment. The data all come *after* the recession of the early 1980’s, early 1990’s and early 2000’s. This enables us to compare like with like.
9. What gets included in capital income share is debatable. In this chart I focus on corporate profit, leaving aside net interest, rent and the income of unincorporated business.
10. Figure 4 reproduces for Canada, with similar results, the US chart from a graduate course assignment offered by Jonathan Nitzan at York University.
11. See Nitzan and Bichler 2009, chapter 11 for a discussion of the “elementary particles” of capitalization.

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