Explaining Canadian Resilience to the Global Financial Crisis: The Role of Policy Networks

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There is already a vast literature on the 2007-2009 global financial crisis. Books, special journal issues, and reports continue to be published on the roots, causes and effects of the market collapse. There remain many important questions to be addressed looking at the specifics of this crisis. Was the financial crisis the result of a deregulated, or unregulated, marketplace? What role did government policy play leading up to the crisis? How did the crisis spread from the United-States to the rest of the world? How were regions across the globe affected by this crisis? How have governments worldwide responded to this particular challenge? How are financial markets to be better managed, better supervised and better regulated in the future? What are the policy reforms needed at the domestic level to better regulate markets? What type of collaboration is needed at the international level to govern finance? What sort of new order, if any, is to emerge from the crisis? What lessons are to be learned from the crisis? These are only a sample of questions that require attention, across scholarly disciplines, economics, management, political science, law, sociology, etc.

This paper focuses specifically on Canada. How has the Canadian government responded to the global financial crisis? Canada is an interesting case study in that it is only one of a handful of major industrialized countries that did not need to resort to bank bail outs. Canada did not escape unscathed, as evidenced by its own asset backed commercial paper (ABCP) crisis, though overall it has fared fairly well. Was Canadian policy, as some have suggested (Krugman 2010), more enlightened over the years than that of other countries? In the fall of 2009, Euromoney (Avery, 2009) named Canadian Minister of Finance Jim Flaherty, finance minister of the year. Does Canada have better policymakers than those found elsewhere? Were Canadian banks better managed and more prudent than those in other countries? What other factors might help explain the Canadian resilience? The Canadian case study provides an opportunity, among other advantages, to look at national variations in responses to the global financial crisis.

The paper suggests that policy networks absorb and filter global shocks, like that of the financial crisis. States’ responses to the global financial crisis depend on the structure of their policy network in the financial services sector, or to put it slightly differently on the interactions among key network participants. Canadian resilience can, thus, be explained by the specifics of its policy network in this field. Canada was spared the worst of the crisis because of the strong relationship that exist between public and private sector actors in the financial services sector. The relationship tends to be relatively open, positive and constructive. The Canadian experience is in stark contrast to that of the United States – analysis of the US network is admittedly beyond the scope of this paper – where the relationship between governments and market actors is one of, at the very least, ambivalence, if not outright conflict.

The paper is divided into two sections. First, the paper draws from the public policy literature to offer a short review of the policy network concept. The Canadian case study is presented in the second part of the paper.
Globalization of Finance, Policy Networks and External Shocks

Policy networks serve as conduits to absorb external shocks. We elaborate on this argument below, focusing primarily on network interaction in the broader policy subsystem.

Globalization provides broad parameters in which states, and policymakers, operate. The globalization of finance, for instance, has had varied impacts on the state. One potential perspective is that the globalization of finance has undermined the state. Governments, thus, find it difficult, if not quasi-impossible, to reign in financial markets. How can there be national supervision and regulation of a global industry? The liberalization of finance, however, as has now often been noted, reflected particular political choices (Helleiner, 1996). Financial globalization was also arguably accompanied by a re-regulation process. The re-regulation took different forms including the exercise of private authority (Cutler, Haufler and Porter 1999). Levi-Faur (2005) speaks, in fact, to the rise of regulatory capitalism. A key feature of this new capitalism is the important role played by technocratic expertise in policy and rulemaking (Porter, 2003). The international community did set up rules for governing financial markets; Basel I (1988) and Basel II (2004) were central to the governance and regulation of global banking (Wood, 2005). Domestically, states tried to adapt to the new parameters of global finance. Financial firms are not de-nationalized, and are present in specific locales. Governments still have the authority to elaborate and implement rules for financial markets. The United-States government adopted the Sarbanes-Oxley Act following the Enron scandal with the intent to minimize future abuses in the industry. Financial services sector policy reflects both the so-called global imperative and domestic considerations. When the subprime mortgage crisis hit, financial markets around the world were regulated through this fusion of public, private and technocratic forms of authority, spread across multiple levels of governance.

Beyond this broad framework, there is a need to understand specifically how states make policy in the financial services sector. Financial services sector reform, as just noted, reflects global trends, national priorities, institutional legacies, and specific market conditions. The analysis of the impact of the global financial crisis on states must, therefore, account for national debates. The policy network literature provides an avenue by which to understand the interplay between actors in the making of financial services sector policy. A network can be defined as,

... a set of informal and formal interactions between a variety of usually collective public (state) and private actors, who have different, but interdependent interests. Operating in a more or less institutionalized setting, these actors are engaged in horizontal, relatively non-hierarchical discussions and negotiations to define policy alternatives, or formulate policies, or implement them (Coleman, 2002).

The policy network concept has a long history, despite severe criticisms. The extent to which networks are anything more than descriptive tools, at best metaphors, remains a legitimate concern. The concept of policy networks, similar to that of epistemic communities in international relations, has staying power. Policy networks provide a way by which to determine
who is involved in policymaking, their role, and to speak to the type of interaction that exists among network participants. Networks are fluid and power struggles between actors help determine policy choices. Policy networks, therefore, are useful instruments when considering how and why states have responded differently to the global financial crisis.

Policy networks help filter external shocks. Speaking to the evolution of Canadian financial services sector policy, Williams (2009) suggests that globalization brought about policy subsystem adjustments, so that policy responses reflected as much external impetus as actors’ priorities in the policy arena. Presented in this way, actors in the subsystem use the pressure from the external to call for or justify a policy reform that they already favour. For instance, the globalization discourse is used extensively, by government and market actors alike, to promote new, or even previously rejected, policies. Globalization becomes a tool that actors can use to push their agenda forward. Specific examples can be drawn from Canadian financial services sector policy. For instance, the Canadian government is attempting, after forty years of inertia, to create a national securities commission. Securities markets have usually been deemed of provincial jurisdiction in Canada and some provinces are very reluctant to abandon their authority in this area. The central government uses as one of its justifications for its current initiative the need to better supervise and regulate securities markets in the country in light of the global financial crisis. Changes in policy parameters can provide an opportunity opening up a policy window for the adoption and implementation of a particular policy.

The policy subsystem is the arena in which policy network actors interact. Policy change, ultimately, reflects interaction in the subsystem. The advocacy coalition framework (ACF) addresses directly the conflict between various groups of actors, separated based on their core values and policy preferences, in the making of policy (Sabatier and Jenkins-Smith, 1993). There is, however, no need for the interaction among network participants in the subsystem to be conflict-based. Network characteristics will impact the way actors interact. Marsh and Rhodes (1992) refer to a continuum where there are tightly knit policy communities on the one hand and loosely-affiliated issue networks on the other. Actors in tightly knit communities are more likely, even when they disagree, to have built a confidence-based relationship. There is likely to be a mechanism by which to attend to actors’ differences. Policy confrontation is clearly much more likely in loosely affiliated networks, where there is a large diffused membership, with strong points of divergence pertaining to values and policy preferences. The solution comes, in part, from the decision-making process. Scharpf (1997), for instance, highlights four modes of decision-making: unilateral, hierarchical, majority-based, and consensual. The structure of the network is likely to lead to different modes of decision-making. ‘Networks matter’, more to the point, network interaction is particularly relevant to the process of public policymaking.

The discussion above still begs the question of how networks filter external shock. The structure of the policy network will help determine just how well it can absorb events in the policy parameter. The hypothesis is that smaller policy communities, with restrained membership, good communication and trust among actors, are likely to be better position to face external
pressures. They can respond more quickly when there is a crisis and they can act decisively. Issue networks, in turn, with a large and fluid membership, and little in the way of a coordinating mechanism, will find it difficult when confronted with an external shock. The Canadian financial services sector policy network fared well because, despite growth over the years, it resembles more of a policy community than an issue network. The Canadian network has remained fairly small and cohesive. The US network, in contrast, is large and divided. There are vastly different interests at play, and finding mediated ground among network participants is bound, whatever the initiative, to be arduous. The advantages and disadvantages to each network type have nuances. Policy communities, for instance, could foster situations of clientelism because of the closeness between actors. Issue networks provide an opportunity for legitimate public debates on issues that generate a lot of interest. The hypothesis does not speak to a preference for a network type or another. Rather, it helps in explaining why there is likely to be policy variations across states even when they are faced with a similar challenge.

The global financial crisis has been a substantial external shock for states around the world. States responded differently to the crisis, how they have done so depends in many respects on the structure of their policy network in the financial services sector. To substantiate this argument, we now turn to a discussion on Canadian financial services sector policy.

Canada

Canada like others has felt the impact of the global financial turmoil of the last few years. Overall, though, Canada has emerged in relatively good shape from the crisis. How is it possible to explain the Canadian resilience? As just noted, the country's specific political dynamics in the financial services sector, the nature of its policy network in this field, act as an important explanatory variable.

Financial services sector policy in Canada is of divided jurisdictional authority. Banks are of federal jurisdiction; securities and investments firms are under provincial jurisdiction; insurance is of mixed responsibility; and, trusts are of provincial authority. The Canadian financial services sector underwent drastic changes from the 1980s onwards. The Canadian system had operated according to pillars, clearly delineated from one another. Government policy facilitated the dismantling of these pillars starting in 1987 when it allowed Canadian banks to own investment firms. Later in 1992 banks were allowed to own insurance firms and trusts. As a result of these policies, the country's large five banks became dominant actors across pillars. Coleman (2002) argues that concurrently there was a centralization of political, supervisory and regulatory authority to the federal government since banks fall under its jurisdiction. The last bank failures in Canada occurred in the 1980s and since then the system has been stable and sound. There is, thus, a bank oligopoly in Canada, unlike the United States, for instance, where there are thousands of banks across the country.
In the late 1990s, the Canadian government undertook a lengthy review of financial services sector policy, leading to the adoption of Bill C8 in 2001. The legislation focused on competitiveness and consumer protection (Roberge, 2006). Prior to, Canadian Imperial Bank of Commerce and Toronto Dominion, on the one hand, and Royal Bank and the Bank of Montreal, on the other, proposed to merge. The merger debate engulfed Canada through most of 1998. The banks’ proposals were turned down, some would argue strictly for political, populist, reasons (Harris, 2004). The banks’ arguments for merging were that they would profit from economies of scale, be in a better position to respond to clients’ needs, and be more competitive internationally. The general public mistrusted the banks. The Canadian government in turn wanted to be sure that the Canadian marketplace would be properly served, a real concern if Canada were to go from five to three major banks. In hindsight, the political decision to turn down the merger may have helped shield Canadian banks from the global crisis that occurred ten years later. Bill C8 had many objectives, one of which was to try to make the market more competitive through the entry of new firms. As a counterweight to these measures, the legislation created the Consumer Financial Agency of Canada (FCAC) to ensure Canadian consumers were better protected. The globalization of financial markets was affecting Canada, but policy responses largely reflected domestic considerations.

At the time of the global financial crisis, the Canadian marketplace had been relatively stable for a number of years. It is beyond the scope of this paper to offer an evaluation of Bill C8, though almost a decade in it is fair to suggest that the policy did not have as important an impact as was envisaged. The debates leading to Bill C8 are only now starting to be revisited. There are not a great deal many new firms in the Canadian marketplace, and consumer choice remains restricted. Canadian banks no longer look to merge; they are still not allowed to sell insurance in bank branches; they are not allowed to enter the vehicle-leasing business, though that is under discussion, and so on. Canadian banks are too big to fail by national standards, though by international standards they have remained relatively small. Their international activities are mostly concentrated in the United States North East. The system has reached a state of equilibrium, where it is a fair assumption that though actors are not always pleased, they do not believe that it in their advantage yet to push for major reform initiatives.

The Global Crisis

The Canadian case study cannot be understood independently from the global crisis. The subsection, thus, presents in broad strokes key elements of analysis pertaining to the 2007-2009 financial crisis and how they relate to Canada.

There are multiple views pertaining to the financial crisis, though there is a generally shared sentiment that the events were of great significance. The popular press, in particular, has highlighted the severity of the disruption. The press has tended to stress the unfettered nature of capitalism, combined with market overconfidence and greed as leading causes of the financial meltdown (Lanchester, 2010). Patterson describes the role of the quants in financial services sector firms. Lewis (2010) in the title of his book simply refers to the ‘doomsday machine’. 
Beyond such provocative accounts, there are important questions on both the political and economic causes and effects of the crisis.

From a political science-global governance-international relations-public policy perspective, the crisis represents a failure of the political (Friedman, 2009). Governments failed in properly regulating markets, and in minimizing the possibility and threat to society from a financial meltdown. Etzioni (2009) suggests that policymakers, supervisors and regulators were ‘captured’ – it might be possible to argue that they were lulled to sleep – by market experts preventing public authorities from adopting appropriate policies and regulations. The political choices, therefore, favouring liberalization led to poor supervisions and regulation of markets.

There have also been many observers that have suggested that specific government policy helped bring about the crisis. Carmassi, Gros and Micossi (2009) blame lax monetary policy as the main cause of the financial crisis. Calomiris (2009) in the Cato Journal identifies four factors that led to the crisis in the United States; 1) artificially low interest rates, which led to the over-accessibility of credit; 2) government policies which favoured access to housing, prompting in turn subprime risk taking; 3) government regulation pertaining to corporate governance policy in large financial institutions, impeding stockholder discipline; and, 4) the failure of prudential supervision. Firms’ incentive structure was skewed leading many to be over-leveraged and to take too much risk. The role of governments during the crisis itself has also been questioned. Concerns have been raised, for instance, about the government’s role in bailing out firms that are said to be too big to fail in relation to the issue of moral hazards. The concept of moral hazard suggests that a firm may be willing to take on more risk, it if knows that the government is likely to come to its rescue if it encounters serious financial difficulty.

The crisis equally highlighted market failures. The complexity of financial products, inadequate corporate governance structure, the failure of risk modeling, the interdependence across firms, remuneration, among many other factors, all played a role in this crisis. Some attention has also been paid to the psychology of markets (Akerlof and Schiller, 2009). The big issue now is whether markets can just operate the way they used to, or whether they need, or are even able, to be more conscious of their public and social role.

The common theme throughout is for government to regain authority over financial markets, internationally and domestically. Governments, it is argued, need to become again more active in the supervision and regulation of financial markets. Garrett (2010) discusses the role of the G20, and more specifically that of the G2, in the post-global financial crisis world. In the same issue of *Global Policy*, Woods (2010) argues for a new multilateralism, and Goldin and Vogel (2010) speak to the need for the global community to better manage systemic risk. There is some scepticism, however, in the ability of states to act collectively and cooperatively in the supervision and regulation of markets. Helleiner and Pagliari (2009) quickly dismiss the notion that the first G20 leaders’ summit represented the start of a new Bretton Woods. In a different forum, Helleiner (2009) speaks to the fragmentation of financial services sector global governance resulting from the crisis, as national governments attempt to rein in markets. The
Basel Accords have also been blamed for their pro-cyclical tendencies. Nouy (2008) agrees that the Basel II accord will need to be altered, though he notes that the crisis began before the accord was fully implemented, and he suggests it should be left to settle before new negotiations are undertaken. Wade (2009) wonders in fact just how much change is really to come out of the financial crisis, especially over the long-term, though he suggests that at the very least, there will be more space in society for criticisms of laissez-faire market economics.

The Canadian situation was different from the onset of the market turmoil. There are reasons to believe that sound policy, along with relatively good bank management, helped Canada avoid the worst of the crisis. John Chant (2010) in a presentation at Rutgers University emphasized Canadian monetary policy as the primary difference between the Canadian and the US experience in relation to the subprime crisis. He also stressed the difference in the mortgage market in Canada and the US. Canadian financial institutions did not much enter into the subprime market and favoured quality mortgages. The default rate in Canada remained fairly low, especially compared to the situation down South. One of the reasons for that is that Canadians who put less than 20% down payment must purchase mortgage loan insurance to protect from default. The Canadian housing market, despite a slump, also fared fairly well despite slower economic times. Canadian banks are fairly prudent and they are generally risk-averse, despite some evident exceptions. The fact that the Canadian marketplace was in a good position prior to, obviously, put it in a favourable position once the crisis began and as contagion spread across borders putting firms worldwide into dangers due to lack of confidence and the credit crunch.

Canada’s Challenge: The ABCP Crisis

The Canadian picture, however, is not perfect. The ABCP crisis demonstrates that there was still some turbulence in the Canadian financial services sector marketplace. The ABCP crisis represented one of the most, if not the most, daunting challenge in the history of the Canadian financial services sector. The collapse of the ABCP market could have had devastating affects for financial firms, large institutional investors, and small investors alike. Had the ABCP crisis not been properly resolved, Canada would have likely felt the global financial crisis more severely.

The $35 billion Canadian ABCP market froze in August 2007 when it became apparent that the alleged safe product was, in fact, quite risky since some of the paper was tied to US mortgage-backed securities. Up until that time, the product had been considered safe since it has received a top rating from Canada’s credit rating agency, Dominion Bond Ratings Services (DBRS). It is of interest that US credit rating agencies had refused to give the product a rating because of the particular structure of the ABCP note as sold in Canada. On 13 August, Coventree Inc. was unable to find buyers for its maturing notes. The market, which had steadily been growing, had to be frozen to avoid its total collapse. A Coventree Inc. email communication in July had already enunciated concerns about the exposure of ABCP notes to the US subprime market. Coventree Inc. continued to sell notes after that email, and is now under investigation from the Ontario Securities Commission (Greenwood, 2010). The scope of the crisis went much beyond Coventree
Inc., however, impacting the whole of the financial services sector. For instance, Dundee Bank of Canada was rescued in September of that year by the Bank of Nova Scotia, one of Canada’s five large banks. The largest institutional investor in ABCP notes was the Caisse de dépôt et placement du Québec which at the time the market froze owned almost $13 billion worth of notes (Vailles, 2009). The Caisse is a Québec crown corporation tasked with making profitable investments with the funds of public and private pension and insurance plans and organizations. The ABCP crisis threatened the stability of the Canadian financial services sector marketplace.

To respond, the Montréal Group later renamed the Pan-Canadian Investors Committee for Third Party Structured ABCP, a private sector ad hoc group, was formed. The group was headed by Purdy Crawford, a well-established industry insider. The objective of the group founded on 16 August was to stabilize non-banks ABCP notes. The group’s initial accord was known as the Montréal Proposal and reflected a standstill agreement which allowed in the subsequent months the market to settle. In December, the Committee reached further agreement in principle to the effect that 30 and 60 days notes be restructured into long-term notes of up to nine years. Though the plan would be adjusted thereafter the result of diverse pressures and considerations, especially by small investors, the core of the proposal remained the same. The Committee also needed to consider how the plan was going to be approved by the investors and implemented. The plan became subject to the Ontario Companies’ Creditors Arrangement Act, thus the restructuring became court supervised. Though the procedure is unusual, the situation after all did not reflect a company bankruptcy, the court’s help was deemed essential for the proposal to be approved by creditors and acted upon (Myers and Abiscott, 2009). In late April 2008, shareholders voted 96% in favour of the restructuring plan, which would finally be endorsed by the court in June of that year. The court’s decision was challenged on the account that the plan did not allow note holders to sue for fraud firms that had sold ABCP, but the appeal was rejected (Carhart and Hoffman, 2009). The federal government, along with Ontario, Québec and Alberta’s provincial governments provided a senior funding facility to help sustain the agreement. In December 2009, Scotia Capital Inc., CIBC World Markets, and National Bank of Canada agreed to pay $138.8 million to settle regulatory allegations by the Ontario Securities Commission; an amount that has been considered insufficient by some due to the harm done to the Canadian marketplace as a result of this crisis (Middlemiss, 2009). For its part, Canaccord Capital Inc., who had been a major seller of the product, agreed to pay back clients who had purchased the notes (Mavin, 2008).

The ABCP crisis raised supervisory and regulatory issues. The ABCP market was largely unregulated and it grew unchecked. John Chant (2009), thus, argues that the crisis was predictable and preventable. Among loopholes utilized, Canadian and foreign banks sponsored ABCP conduits, but they did not need to provide liquidity unless there was major market disruption. The banks also kept the conduits off their balance sheet to avoid capital requirements. The OSFI has been accused of having failed to properly supervise large banks as it pertains to their role in the ABCP market. Julie Dickson, who heads OSFI, has responded that the
organization’s mandate is to focus first and foremost on banks’ solvency, and that many of the firms that sell this type of product are not federally supervised and regulated (Canada, 2008).

The members of the policy network involved in the ABCP market were able to find together a solution to avoid a more major market collapse. Support for the process and approved plan were not unanimous. Small investors in particular felt cheated in the resolution of the crisis. They believed they had purchased a safe product, akin to a guaranteed investment certificates (GIC), only to find out that the product was a lot more risky. They suffered important financial losses in the crisis. The new notes, in fact, trade at a 40% discount to face value (Greenwood, 2010). Protection for small investors in the investment business is a long running concern, above and beyond the ABCP crisis, in Canada. Purdy Crawford himself has acknowledged that the restructuring plan was not perfect, but that it nonetheless reflected ‘the art of the possible’ (quoted by Greenwood, 2009). The cohesiveness of the Canadian financial services sector system is partly illustrated by this rapid analysis of the ABCP crisis and its resolution.

Explaining Canadian Resilience

The broader question at hand is of Canadian financial services sector resilience in the face of the global financial crisis. So, how did the Canadian government and financial services sector actors react to this particular external shock? The response has been threefold. First, the Canadian public authorities took concrete and practical measures to ease the credit crunch. The Bank of Canada favoured low interest rates to facilitate economic recovery. The Canadian government bought $125 billion of mortgage bonds (Tedesco 2009), which increased banks’ capacity to lend. Second, the federal government has sought to address administrative concerns. The government amended the Bank of Canada Act to give the Bank more powers in managing the financial crisis. The government has also promised to strengthen the Office of the Superintendent of Financial Institutions (OSFI), the federal financial services sector supervisor and regulator. The organization, as just noted, had been criticized for its inability to help prevent the ABCP crisis. The government has also moved to adopt rules to better regulate principle protected notes, investment in which the bank guarantees the investor will not lose money on the asset. Third, the federal government has seized the opportunity, as we referred to earlier, to seriously push for the creation of a national securities commission. Compared to major bailouts of financial services sector actors in the United States, Great Britain, Germany and elsewhere the Canadian situation remained fairly under control.

Canadian resilience can largely be explained by the structure and workings of the country’s financial services sector policy network. The Canadian policy network in the financial services sector has always been relatively small, and as such, it has been fairly cohesive. The network is probably larger than a policy community per se, but it shares many of the same attributes. Prior to market desegmentation in the 1980s, the policy network was composed of the Canadian Department of Finance, the Bank of Canada, and the Office of the Inspector General of Banks, OSFI’s precursor, the Canadian Deposit Insurance Corporation (CDIC), and the Canadian Bankers Association, with potentially a few big banks. Policymaking during this period was largely
insulated. The policy network grew through the 1990s to reflect the dismantling of pillars. There were more actors involved in the review that led to Bill C8 including all of the actors above, as well as the Canadian Life and Health Insurance of Canada, the Insurance Bureau of Canada, and the Credit Union Central of Canada. Foreign financial institutions, provincial regulators, and the Investment Dealers Association, now known as the Investment Industry Regulatory Organization of Canada, a self-regulatory organization, were on the network periphery. At the time of Bill C8, consumer groups, including the Canadian Community Reinvestment Coalition, were pressuring the federal government. The FCAC created by Bill C8 is also now, obviously, part of the network.

The network has broadened, but the network’s mode of operation has largely remained the same. The federal government, through its different departments and offices, still exercises authority directing the network, or at times acting as final arbiter. As it pertains to bank supervision and regulation, Minister Flaherty (Canada, 2010) refers to Canada’s ‘coordinated regulatory approach’. The Financial Institutions Supervisory Committee (FISC), made up of all key government actors, the Department of Finance, the Bank of Canada, OSFI, CDIC, and the FCAC, meets regularly to ensure cohesion. The Committee was created as a result of the 1987 reforms. The FICS ensures that there exist open lines of communication across governmental actors. The one potential weakness pertaining to the Canadian system is that there is not clearly an actor in charge of financial services sector stability. John Crow (2009), the former Governor of the Bank of Canada, specifically recommends that the Bank be strengthened further to be in a better position to manage crisis situation and address systemic stability. Despite this limitation, the IMF (2008) has commanded Canada for its ‘effective and nearly unified framework’.

Canada’s supervisory and regulatory regime helps to explain Canadian resilience. Minister Flaherty (Canada, 2010) in this regards speaks to ‘effective regulation’. To be understood by such an expression, the rules are important, but so is their proper implementation. The role of OSFI and how it executes it need to be stressed. Julie Dickson (as quoted by Freeland, 2009), Superintendent at OSFI, in a media interview highlighted some of the specificities of the Canadian system. Referring to regulation, Dickson notes that Canadian banks since 1999 have been required to hold 7% tier 1 capital, which is superior to the Basel requirements. Canada is one of three OECD countries, along with the US and soon Switzerland, to impose a leverage ratio on banks. OSFI has well established supervisory practices. Dickson explains, for instance, that as superintendent she personally attends board meetings of the major banks at least once a year. She, thus, has a personal in-depth look at the banks’ behaviour. The relationship between OSFI and Canadian firms has been built throughout the years. The majority of OSFI employees are career civil servant which means that they know their file well, along with their counterparts across financial institutions. OSFI enjoys credibility among market participants. There is some trust and confidence between the regulator and the firm.

The cohesiveness of the Canadian policy network is most obvious when it is quickly compared to its opposite in the United States. The history of Wall Street demonstrates the ambiguous nature of the relationship between governments and financial markets in the United States, especially between Washington and Wall St. (Van Der Yeught, 2009). The fragmentation of supervisory and
regulatory authorities is striking, and in this case provided an opportunity for financial firms to cherry pick regulator, to play one regulator off another (US Department of the Treasury, 2009). Regulators do not cooperate well with each other, and they are under-resourced. The relationship between the regulator and the firm itself is often confrontational, with negotiations conducted by lawyers on both sides.

Finally, the Canadian government has been quite active on the international scene, as discussions continue about possible reforms to the governance of global finance. Canada presides the G8, and is co-presiding the G20 along with South Korea in 2010; it is to host both the G8 and the G20 summits in June. The Canadian government has taken strong positions on key reform topics. The government has made clear that it does not want to pursue a punitive strategy towards banks (Canada, 2010). Canada has indicated that it opposes a tax on the banking sector for the creation of bail-out funds. Officials suggest that such a tax would create moral hazard for large firms who would know for sure that in case of trouble they would be rescued. Canada has instead proposed that firms be forced to hold contingency capital. The Canadian government also notes that ‘effective domestic regulation’ remains essential to ensure the proper functioning of financial markets. The Canadian position, clearly, is driven by its own experience with the financial crisis.

**Concluding Remarks**

The global financial crisis was as much a failure of politics as a failure of markets, but it did not unfold everywhere in the same way. Canada was relatively successful in avoiding the worst of the crisis. The argument in this paper is that policy networks help filter external shocks, and important changes in the policy parameter. Different network types across states, even when countries are faced with similar pressure, serve to explain national variations. The Canadian case tends to support such a claim. Canada fared well in the face of the financial crisis because of domestic political dynamics, because of the cohesiveness and strength of its network. The Canadian financial services sector is not without reproach. The ABCP crisis demonstrates what can happen when the regulator looks in another direction. Pertaining to the global crisis, the role of OSFI in working with private sector actors is of particular relevance. The broad argument as it pertains to external shocks and policy networks is sustainable looking at another country than Canada. The paper has offered parsimonious comparisons to the US where in the subsystem diverse coalitions, and a multiplicity of actors, collide. Financial services sector policy in the US has its own dynamics, institutional legacies, which are not about to change. Financial services sector reform in the US is so difficult in part because of the variety of interests at stake.

The Canadian experience demonstrates that constructing strong relationships, with roles clearly defined, is a definitive asset to ensure the soundness and safety of the financial services sector. The Canadian case makes clear that new policies and new regulations are not going to suffice to address important issues relating to the governance of the financial services sector. Serious consideration needs to be given on how government actors relate to market actors, and vice versa. The Canadian performance as it turns out represents a challenge to those who support
strong new rules to reign in financial markets, highlighting that they may not necessarily work and that a key factor for success is good network cohesion. The case also represents a challenge, however, for free market advocates, in light of the country’s effective supervisory and regulatory regime. Or, just maybe, Canada is everybody’s favourite example!
References


