CANADA AMONG NATIONS 2014

CRISIS AND REFORM

Canada and the International Financial System

Edited by Rohinton Medhora and Dane Rowlands

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CIGI

NPSIA

The Norman Paterson School of International Affairs

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Preface

Rohinton Medhora and Dane Rowlands

This is the 28th edition of the Canada Among Nations series. While the series was conceived and developed at the Norman Paterson School of International Affairs (NPSIA) at Carleton University, it has, over the years, been produced in partnership with other Canadian institutions. This edition is the result of a continuing partnership between NPSIA and the Centre for International Governance Innovation (CIGI), which was first forged for the 2005 edition. This partnership has been enhanced with the generous support of the International Development Research Centre (IDRC). This is the second of three years in which NPSIA, CIGI and the IDRC have worked together on the series, and we all look forward to a productive and innovative collaboration.

From among the many worthy candidate topics for this year's volume of Canada Among Nations, we settled relatively easily on an examination of Canada and the global financial crisis. This choice inevitably reflects the bias of the series co-editors, both of us being economists with an interest in international finance. Since the crisis and associated recession represent the largest decline in global economic activity since the Great Depression of the 1930s and continues to be the prevailing focal point for recent international economic diplomacy, we felt it merited attention in a series dedicated to Canadian international policy. The complication is that the duration and the varied rate at which the crisis appears to be receding from different countries make it difficult to balance the desire for both immediacy and perspective. With the ripples of the crisis still reverberating in many parts of the world (particularly in the euro zone) and with new manifestations of the crisis emerging elsewhere (for example, in some previously unscathed emerging markets), some might argue that this volume is too early. Canada, however, despite remaining vulnerable to the economic anemia and continued financial instability in its key partners, appears to have switched from crisis mode to desultory recovery. While risks remain that the accumulated debts of other countries and the unwinding of their extraordinary monetary measures could yet generate new shocks for a fragile global economy, postponing further our examination of Canada and the crisis risks a response from relatively cosseted Canadians of "Crisis? What crisis?"

Canada Among Nations was established to explore different topics in order to shed light on how Canada's foreign policies are formed, how Canada is affected by world events and they, in turn, by developments here, and to strengthen Canada's research community around a particular theme. We at NPSIA and CIGI, with the IDRC's generous support, look forward to working together in coming years to continue this tradition.

Foreword

Tiff Macklem

Canada's financial sector employs about 700,000 people or roughly five percent of Canadian workers. Last year, it generated activity of more than CDN$100 billion or about seven percent of our GDP. These are big numbers, but the contribution of the financial system to Canada's economic growth and prosperity is in fact much larger. More important than its direct contribution is its role as an *enabler* of growth and stability in the rest of the economy. Every day, the financial system channels savings to productive investments, helps households and businesses manage a myriad of risks, and settles billions of transactions to buy and sell goods, services and assets. Many of these credit flows, risks and transactions cross international borders, so it is not only our own financial system that concerns Canadians, but indeed the global financial system.

The global financial system has also helped propel global economic integration, with enormous benefits to Canadians and citizens the world over. Despite frequent shocks to the system, it has facilitated a remarkable postwar expansion in advanced economies and ushered in a new era of rapid economic growth in newly integrated emerging market economies.

But, as the financial crisis that erupted in late 2007 reminded us, the global financial system can also be a source of instability, with devastating consequences. In an integrated world economy, all economies suffer when the financial system of a major country falters. The International Monetary Fund estimates that 30 million people lost their jobs worldwide in the wake of the global financial crisis that began in the United States. That's almost the entire population of Canada. Trust in the global financial system has been undermined, and many are questioning the wisdom of economic integration. The anemic global recovery has done little to dispel these misgivings. In Canada, we weathered the storm better than most. Our financial system proved to be resilient, but the collapse in global trade hit us hard. Our exports plummeted by 21 percent, and today, more than five years after the crisis, they remain below their pre-recession peak.

Reforming financial services and rebuilding trust in the global financial system are essential if we are to return to strong, stable and sustainable growth.

The core message in this volume is that Canada has an important role to play in that process. This excellent collection chronicles the evolution of the global financial system, from the founding of the Bretton Woods institutions following World War II, through to the 2007–2009 global financial crisis and beyond. It reviews and assesses Canada's priorities and influence in shaping the global financial system, and looks ahead to Canada's role in a post-crisis and increasingly multipolar world. The central theme that emerges is that as a mid-sized economic power that relies heavily on an open global trade and financial system, Canada has long invested heavily in promoting a sound global financial system with clear rules and responsibilities for all players. This has been particularly true in the wake of the global financial crisis.

As the chapters by Eric Helleiner and James A. Haley bring to life, Canadian policy makers played a prominent role in the design and formation of the Bretton Woods institutions, and have worked to strengthen these consensus-based institutions and their system of rules and responsibilities. The Group of Twenty (G20) was created in the late 1990s and, as Barry Carin outlines, Canada played an instrumental role in its birth. Tony Porter highlights that Canada's leadership also extends to key financial standard setters and international financial institutions, including the Basel Committee on Banking Supervision, the International Organization of Securities Commissions, the Bank for International Settlements, the Financial Stability Forum and the newly formed Financial Stability Board (FSB).

The 2007–2009 financial crisis increased the demand for Canadian thinking at the global table. The question that I have been asked more than any other in capitals around the world during recent years is: how is it that no banks failed or had to be rescued in Canada? Canada is right next door to the United

States and its financial markets are the most integrated with the US financial system, yet in the wake of the Lehman failure, it was UK and European banks that failed or had to be rescued. The chapters by Eric Santor and Lawrence Schembri, David Longworth, Louis Pauly and Randall Germain argue that the resilience of the Canadian financial system reflects a combination of factors, including the lessons learned from our own earlier failures, higher financial regulatory standards, more rigorous supervision on the ground and better coordination across our financial authorities.

These chapters, together with the contribution by Domenico Lombardi and Pierre Siklos, review the important role Canada has played in the sweeping financial reform agenda launched by the G20 at the London summit in April 2009 and assigned to the FSB. This has included importing Canadian thinking into the Basel capital standards and introducing a Canadian-style leverage cap; Julie Dickson's leadership of the FSB initiative to strengthen supervisory practices around the world; my own chairmanship of a new FSB peer review process to transparently assess the adoption of and adherence to the new standards; Mark Carney's chairmanship of the FSB; and the Canada-India co-chairmanship of the G20 "Framework for Strong, Sustainable and Balanced Growth." Canada has had a prominent place at the global table in recent years.

Other chapters in this volume draw the links to trade (John Curtis), development (Roy Culpeper) and the European Monetary Union (Juliet Johnson), and also reflect on what has been accomplished and where we go from here. These are more difficult questions. Together, the chapters in this volume provide a comprehensive analysis of what went wrong, what worked, what's been fixed and where the jury is still out. They also candidly assess where Canada has made a difference and where it has missed opportunities.

There can be no doubt that the crisis was the catalyst for a tremendous burst of reform to the global financial system; Canada has had a significant influence on this reform, and much has been accomplished. Banks are safer, crisis management has been strengthened and the plumbing of the financial system has been reinforced.

Still, some Canadian humility is required. There is much work to be done to fully implement the reforms that have been agreed. In many global banks it is more than the capital and liquidity rules that must change — a shift in culture is required to return the focus of banking to serving clients in support of the real economy. Financial fragmentation must be avoided if we are to reap the benefits of economic integration. And continued vigilance will be needed on the part of supervisors and central banks to identify and mitigate new systemic vulnerabilities as they emerge.

There are also some bigger issues. The inflexibility of the international monetary system remains a problem and the governance of the global financial system is a patchwork. As James Boughton writes in the final summary chapter, “There is no institution with a mandate to oversee, much less guide, the [international financial system].” At the same time, there is a risk that Canada’s influence could wane. As Boughton highlights, with the urgency of the crisis fading and now large emerging market economies taking a bigger seat at the global table, it is going to be more difficult for Canada to make its voice heard.

Fortunately, this volume concludes with a range of suggestions on what Canada can do to remain an influential player in the design of the global financial system. The stakes are high. This volume leaves us all better prepared.

Introduction

Rohinton Medhora and Dane Rowlands

MOTIVATION

The period from 1985 until near the end of 2008 has been referred to by some economists as the "Great Moderation," in reference to the marked reduction in economic volatility in key global economies such as the United States. Some analysts went so far as to wonder whether central banks and finance departments in most major industrial countries had found the key to economic stability, and now possessed the tools needed to tame the business cycle into the distant future. Like some classical Greek tragedy, that hubris came to an abrupt and humiliating end by the close of 2008. Global output growth of over five percent in 2007 slowed and became a decline of over one percent in 2009 (International Monetary Fund [IMF] 2009). Advanced economies fared even worse, with their output declining by 3.4 percent. When blame for the crisis came to be assigned, much of it was placed at the door of financial markets.

The most frequently cited trigger for the crisis was the popping of the US housing market bubble in 2006, which then set in motion a chain of shocks that were transmitted around the world by the international financial system (IFS). What had been seen as worrying but minor and isolated domestic problems in different parts of the world, became catastrophes as financial systems became paralyzed with paranoia about counterparty risks and the real values of financial assets. Inevitably, these financial sector difficulties had real sector implications, as liquidity in the market dried up and buyers were incapable of financing purchases, firms were left bereft of working capital to pay employees and suppliers, and investment opportunities were left dormant for want of capital. For many, the main villain was the financial system, and it was the IFS that transmitted the disease, even to countries that had declined to partake in the excesses of financial innovation.

International finance is a big part of the economic lives of Canadians, even if we don't always have much direct contact with it. The Bank for International Settlements (BIS) estimates that turnover in the global foreign exchange market reached US$5.3 trillion per day in 2013, a 35 percent increase over the 2010 level of US$4 trillion per day (BIS 2013). This rapid growth of international transactions hit a peak at 72 percent from 2004–2007 in the lead up to the global financial crisis exchanges (ibid.). Over the main crisis period of 2007–2010, this three-year growth slowed markedly, but was still at 19 percent. The financial system's expansion seems inexorable, even in the face of dramatic crisis.

In contrast to the more freewheeling nature of the financial systems in many other wealthy countries, Canada was seen as a bit of a financial backwater. A cozy oligopoly of banks anchored a stable if uninspired system, where financial innovation was slow and profits assured by high transaction fees on a captive market. Prior to the crisis, there was pressure on the banks and bank regulators to modernize the system faster in areas such as mortgage finance. Canada was seen as having erred too much on the side of stability at the cost of efficiency. Fast-forward to the post-crisis era and the Canadian system is seen as worthy of emulation, while its alternatives attract opprobrium. But the perceived optimal trade-off between stability and efficiency in financial regulation is a pendulum that swings with the times, and the crisis has set off yet another round in this long-standing debate about the financial system.

THE FINANCIAL SYSTEM AND SCOPE OF THIS VOLUME

A key role of the financial system is to mediate between savings and investment. This quite simple description means that "financial markets facilitate such central economic actions as producing and trading, earning and spending, saving and investing, accumulating and retiring, transferring and bequeathing" (Friedman 1987). These functions are just as true today as they were when the subject was first treated by classical economists over two centuries ago. Indeed, financial development is correctly seen as integral to the larger process of economic development. However, as financial systems have grown and become more complex and connected, they have gone beyond neutral mediation and enablers of growing economies to sources of disturbance to them.

The wide array of sometimes quite opaque assets generated by financial innovation has confounded national authorities even in advanced countries, where capacities and regulatory structures are well developed. Many of these financial innovations and their economic consequences — good and bad — occur even in the absence of national borders. Finance has become complicated in most countries, even without the international context.

With globalization, however, finance has become exponentially more difficult to control. The movement of capital has outpaced the capabilities of domestic regulators to monitor and manage their own savings and investment systems, and the presence of international financial linkages offer opportunities for firms to circumvent domestic regulations and arbitrage across competing national rules. The development of these extra-national financial activities and linkages has proceeded far faster than the evolution of an international capacity to regulate capital at the global level. This dichotomy between the need for institutional capacity at the global level and the inability of the state-based system to deliver such governance is common in all areas of international affairs, but it is, perhaps, most pronounced in the hyperactive and instantaneous field of global finance.

The speed of innovation and the complexity of financial instruments have left regulators, and many others, at a loss as to how to evaluate the trade-off between the risk and efficiency of new financial products. Thus it was that the act of bundling mortgages of varied quality into seemingly self-standing financial instruments in the United States was first seen as an ingenious new financial instrument, and only later recognized as a key trigger and transmission mechanism of global crisis. There are dozens of other fractured links that brought the global financial chain to the breaking point in 2008, from an incomplete monetary union in Europe to the over-accumulation of foreign exchange reserves in China. In the end, the net result is that financial systems have gone well beyond the classical ideal role of a neutral and efficient mechanism for allocating savings to productive investment activities, liquidity provision and risk mitigation, and have emerged as a major source of national and international economic instability.

Any examination of the financial crisis encounters the additional problem of scope. Even a focus on Canada requires choosing one of many specific, but ultimately fairly narrow, perspectives that others might regard as unbalanced, even misguided. Our chosen emphasis is on understanding the evolution of the IFS that transmitted the crisis around the world, and the Canadian policy response and role within that system. As many notable commentators such as Carmen Reinhart and Kenneth Rogoff (2009) have observed, the virulence of this particular recession arises primarily from the accompanying financial crisis that rendered many domestic and international financial markets incapable of playing their core roles of liquidity provision and financial intermediation. Our chosen focus on history and interconnectedness, however, comes at the cost of having to subordinate other important dimensions of the crisis.

The three key omissions that we recognize as editors of this volume, and that the contributors correctly raised during our discussions, but did not have as part of their specific chapter mandates, are: the real economic and social implications of the crisis for Canadians; the other areas of public policy response (notably fiscal stimulus); and an integration of the details of some of the other real-economy dimensions of the crisis' origins and transmission (specifically trade and investment flows). To provide appropriate context and offer some penance for these omissions, these items are briefly reviewed here.

Canadians felt the pain of the economic and social dislocation caused by the crisis. In terms of the accompanying recession, quarterly Canadian GDP (income-based) fell from its pre-crisis high of CDN$1.682 trillion in the third quarter of 2008 to a low of CDN$1.545 trillion in the second quarter of 2009, a decline of around eight percent; output did not return to pre-crisis levels until the fourth quarter of 2010 (Statistics Canada 2014a). Mirroring these output numbers, unemployment rose from 5.9 percent at the beginning of 2008 to 8.7 percent by August 2009, slowly declining thereafter to its current level of around seven percent towards the end of 2013 (Statistics Canada 2014b). The percentage of the unemployed out of work for more than a year almost doubled from 7.1 percent in 2008 to 13.5 percent in 2011 (Organisation for Economic Co-operation and Development [OECD] 2014). The poverty rate (percentage of the total population with disposable income that is 50 percent below the median disposable income level) increased from 11.3 percent in 2007 to 12.3 percent in 2009, representing almost 340,000 more Canadians below the defined poverty line (ibid.). While the comparisons of economic and social statistics often show that Canada did relatively better and suffered relatively less than its Group of Seven (G7) partners and many or most OECD countries, the fact that the crisis had serious, even tragic, consequences for many Canadians cannot be ignored. The authors of the chapters in this book are clearly aware of this important and wider social context, but were constrained to focus on their more narrowly defined tasks of examining the financial policy implications of the crisis.

While the volume focuses on finance, we must also acknowledge that the public policy response went beyond the domestic and international dimensions of monetary policy and financial supervision. We made the decision not to address these responses directly because most were undertaken largely within the context of purely domestic policy frameworks, and with only minimal international spillovers and coordination. For example, the Canadian government's discretionary and automatic fiscal expansion in response to the crisis certainly contributed to our stronger aggregate economic performance relative to many other wealthy nations. Canada's structural fiscal surplus moved from 1.1 percent of GDP in 2007 to a deficit of 0.8 percent the following year and, ultimately, to a maximum deficit of 3.3 percent of GDP in 2010 (IMF 2013). The cumulative magnitude of Canada's associated fiscal expansion over the five years after the crisis (2008–2013), relative to what it would have been had the 2007 structural surplus been continued, amounted to 19.7 percent of GDP. This was the third-largest expansion of the G7 countries, exceeded only by Japan (28.5 percent) and the United States (20.2 percent). By contrast, Italy had a contractionary fiscal position over the 2008–2013 period relative to their 2007 balance, amounting to a total of 4.5 percent of their GDP. Therefore, the Canadian government had a fairly robust fiscal expansion following the crisis, despite having a perceived relatively shallower recession.[1] In theory, the Canadian government's fiscal policy could have been affected by the international attempts to coordinate an expansion, as was

1 It should be noted that the magnitude of the fiscal expansion and the recession are, of course, not independent, since the fiscal response could be seen as having caused a relatively shallower recession. It is difficult to identify the counterfactual of what the recession would have looked like in the absence of the fiscal and other policy responses.

the case with discussions within the Group of Twenty (G20), but in the end, these decisions primarily reflect domestic policy-making processes designed to address domestic economic priorities. There was no international attempt to introduce any formal regulatory or organizational framework to coordinate fiscal responses in the same manner as there was for financial regulation or even monetary policy. With no real international regime or formal framework for fiscal discussions, there was really no critical international dimension to Canada's policies in this regard. Similarly, while there were some discussions about social protection, these were typically parallel to the crisis response rather than integral to it, and despite its earlier origins in the same discussions that created the Bretton Woods system (see chapter 1), such discussions were largely a response to the anticipated and impending expiry of the United Nations Millennium Development Goals initiative. Hence, from the perspective of international policy, it did not seem that much attention needed to be lavished on these additional responses to the crisis.

Finally, our contributors were not asked to dwell on the origins of the crisis. These debates do inevitably emerge in some of the chapters, and the links between the financial sector and the international economy do get some specific attention (see chapter 9). While much of the blame for the crisis has been attributed to some combination of "financial excess" (however defined) and inadequate regulation, the pre-crisis debate about potential economic risks focused on imbalances in external accounts, conflicting exchange rate regimes and unsustainable debt. There are, thus, dimensions of the crisis debate that encompass a wider set of connections and linkages beyond the financial sector. These links are clearly seen in the standard measures of international imbalances. For example, in the third quarter of 2008, Canada had a current account surplus of just over CDN$5 billion. By the next quarter, this balance had switched dramatically to a CDN$10 billion deficit. That deficit has persisted ever since, reaching a high of over CDN$18 billion in the third quarter of 2010, remaining until now (third quarter 2013) at over CDN$16 billion (Statistics Canada 2014c). More broadly, many observers saw the pre-crisis US current account deficit (which had reached six percent of GDP in 2007, twice the typical threshold of three percent for avoiding a payments crisis) as unsustainable and at critical levels. Whether these imbalances arose from pathologies in either the current account or its obverse, the capital account, or whether they arose from more fundamental and deeper domestic economic imbalances, is an important question, but one we do not seek to answer in this volume.

Our policy focus has instead guided us toward how this crisis has affected the policy responses to the problem of how to manage an international financial and monetary system. The typical starting point for such a discussion is the post-World War II system created at the Bretton Woods conference, where illustrious experts and public officials wrestled with the same sorts of policy questions that arise in this volume: who should provide surveillance of the global system and how should they do so; how will we apportion the burden of adjustment when imbalances emerge; what is the proper framework for determining exchange rates; how should we constrain or shape domestic monetary and financial rules to support a stable international system; and how much domestic sovereignty should be given up for the common good? Calls for a "new Bretton Woods," a phrase that emerges in several chapters in this volume and was a recurrent theme at our authors' workshop, is effectively a recognition that the current post-Bretton Woods system has failed to deliver international stability, and thus there is the need to revisit the same fundamental conundrums and attempt once again to solve them with a new, improved comprehensive and integrated system. By implication, piecemeal and incremental reform is unlikely to be adequate, and certainly not in the absence of acknowledging and resolving the core tensions at the heart of any such system.

THE CHAPTERS

It is, therefore, at Bretton Woods that this volume starts, with an overview of the fundamental elements of international financial policy cooperation being provided in the first two chapters by Eric Helleiner and James A. Haley, respectively. In many ways, this broader conception of the core tensions within the IFS frames the more detailed analyses about the subsequent evolution of the related institutional arrangements (chapters by Barry Carin and Tony Porter, as well as Haley), its links to trade (the chapter by John M. Curtis), the operations of monetary authorities (chapters by Eric Santor and Lawrence Schembri, and Domenico Lombardi and Pierre Siklos) and financial regulators (the chapter by David Longworth). The remaining chapters examine these matters from the perspective of other country groups

(Juliet Johnson and Roy Culpeper) or address even broader questions about national sovereignty (Louis W. Pauly) and the overall balance between the indulgence and restraint of the interests of private capital (Randall Germain). Their arguments are reviewed in more detail below.

A common theme for all chapters, however, is a focus on Canadian policy responses to the crisis. How did Canada's integration with the global economy cause it to respond to a crisis that was largely created outside its borders? What lessons did Canada learn from others? To what extent were its policy responses shaped by its obligations to the international system and its partner countries, and in coordination with them? Did Canada provide new ideas and examples of best practice to the world stage? Was Canada able to leverage its limited power in support of its own domestic interests? To what extent do Canada's interests coincide with those of the global community and international system? These are the challenges we posed to our authors.

A principal objective of this volume is to situate contemporary discussions of Canada and the IFS in a historical context. The logical place to start is the Bretton Woods conference, held over three weeks in July 1944. In the opening chapter to this book, Eric Helleiner signals the leading role that the Canadian negotiators took at the conference, particularly in three areas that might have formed the contours of a stable and effective postwar economic order — "inclusive multilateralism"; support for capital controls and, more broadly, international macroeconomic cooperation; and social protection worldwide. It is striking how resonant these themes are to current debates in the field.

The conference resulted in the creation of two and a half institutions — the International Bank for Reconstruction and Development, the IMF, and the General Agreement on Tariffs and Trade — that together were meant to underpin a liberal postwar economic order. In practice, the system has been more stovepiped than the founding fathers might have anticipated, with the IMF the clear lead in all matters related to international money, finance and macroeconomics. Chapters 2, 3 and 4 (by James A. Haley, Barry Carin and Tony Porter) treat three aspects of the evolution of the global financial system and Canada's role in it.

James A. Haley provides an account of the key debates in the IMF that, in his words, are meant to "complete the work of Bretton Woods." Incidentally, like Eric Helleiner, he too shows that the quality and breadth of proposals put on the table at Bretton Woods were high and wide indeed, almost belying the narrower bandwidth of such discussion subsequently. A series of debt crises starting with Mexico in 1994 once again highlighted the age-old question of the balance between adjustment in creditor and in debtor nations under fixed and flexible exchange rates. A parallel challenge was the nature and pace of capital account liberalization. A third connected stream was the orderly resolution of sovereign debt, surveillance more broadly and the minimization of moral hazard. Canada has worked with the IMF on all of these questions, and particularly on the basic one of IMF governance, for the credibility and effectiveness of the IMF depends on it.

Canada's role — indeed seminal role — in the broader governance issues of the international monetary system is described by Barry Carin through the lens of the G20. Born in crisis (first at the economic ministers' level in 1999, and then at the leaders' level in 2008) and by necessity structured in an ad hoc manner, this group continues to see itself as the "management board" of the global economy. The obvious trade-off here — between balanced representation and effectiveness — has yet to be addressed, particularly as there is growing disappointment about the concrete impacts of the G20's deliberations. Carin suggests a series of these discussions in which Canada is well placed to take the lead, mainly to keep the focus on economic management, add longer-term problems, such as climate change, within this context and strengthen the quality of analysis on which the leaders deliberate.

The development of the Financial Stability Board (FSB) (née Financial Stability Forum [FSF]) has tracked that of the G20, and Tony Porter covers its evolution. Just as former Prime Minister Paul Martin did in the G20, Canada has had an outsized role in the FSF/FSB with Mark Carney, Tiff Macklem and Julie Dickson. They, in turn, have no doubt had "wind on their backs" by the widespread recognition that Canada's banks have received for their resilience and probity in the face of financial distress all around them. Still, Porter notes, "For a country Canada's size, it is unusual to have this number of regulators with this level of recognition." Clearly, here is a case where policies and the persons who steward them are mutually strengthening. But Porter ends on an appropriate note of caution in two regards — the still fractured nature of securities regulation in the Canadian federation and the sideswipes from such developments as the implementation of the Volcker rule in the United States.

This theme continues in subsequent chapters. David Longworth (chapter 5) reiterates the exceptionally active nature of Canada in the financial regulation arena, due to both its policies and its people. Five elements of a "Canadian model" in financial regulation might be discerned from his exposition: exceeding minimum international standards (for example, in capital adequacy); creating an environment that fosters cooperation among domestic regulators; avoiding a legalistic, confrontational regulatory regime, and instead relying on principles and guidance; using mortgage insurance rules to buttress macroprudential policies; and more broadly, viewing supervision as an "art." He, too, ends on a cautionary note, observing that countries, such as Australia, Canada and Sweden that weathered the crisis, have ongoing credit and housing booms that might still "end badly." Properly, there is no claim that the Canadian model can or should be exported, as is, to other countries.

Eric Santor and Lawrence Schembri (chapter 6) relate Canada's response to the crisis and lessons learned from it, from the perspective of serving officials at the Bank of Canada (BoC). Two important lessons, one domestic and the other international, are derived from their experience. The first is that since the economic consequences of the crisis are high and persistent, financial stability is now given the same prominence as monetary policy is in central banking. Second, thanks to financial integration, global cooperation must be privileged. The FSB is held up as a salient example. They also recognize the limits of central banking actions in dealing with all of the outcomes of the crisis, notably on the real and microeconomic side. Global recovery, as opposed to global crisis management, requires "appropriately timed fiscal consolidation in the advanced economies," structural reform in the euro zone and East Asia, and greater exchange rate flexibility in emerging market countries with current account surpluses.

Domenico Lombardi and Pierre Siklos (chapter 7) also centre their contribution to this volume on the role of the central bank, but focus on what has come to be termed the unconventional part of central bank policies. The starting point for unconventional action is agility, a "recognition that monetary policy strategies are not timeless." Although, on account of having weathered the crisis better than many other countries, Canada's central bank did not have to resort to unconventional policies, it did establish principles to create — and procedures to operate — extended liquidity facilities. These, coupled with the pre-existing ability to target specific market segments (such as housing), bode well for whatever a future crisis might bring.

All chapters in this volume explicitly or implicitly buy into Louis W. Pauly's (chapter 8) dictum that integrated markets require integrated oversight. Put another way, countries must cede autonomy in dealing with matters of money and finance to existing and emerging supranational bodies. How much autonomy, and when and why depends on the country and the state of the multilateral organizations themselves. While the role of the FSB is defined and strengthened, and the IMF continues its quest to reform its own governance and enhance its purview to include the impact of countries' monetary and financial policies nationally and (crucially) beyond, Canadians will "buy insurance just in case." This insurance is in the form of the domestic power of all of the national institutions that stood Canada in such good stead these past few years — notably the BoC, the Office of the Superintendent of Financial Institutions and the federal Department of Finance. There isn't a better indicator of Canada within the global financial system than this — extraordinarily active multilaterally to create the right global structures, yet just as prudent domestically to ensure that stability remains a hallmark of policy.

The principals at the Bretton Woods conference foresaw the links between trade and finance, but they did so in a world that was not as integrated as it is currently, and consequently, their analytical tools did not stand the test of time. In this world, international capital movements essentially accommodated domestic savings-investment imbalances, which in turn manifest themselves through trade imbalances. In reality, there are several channels that connect international trade and finance. To be sure, capital flows are triggered by domestic savings-investment imbalances. But with integrated capital markets and constant financial innovation, capital flows are multiples of the value of trade flows and trigger short-run exchange rate volatility as well as lock in persistently misaligned exchange rates. Moreover, financial sector fragility has consequences on the availability of finance for trade. These and the related questions of real financial linkages and side effects are covered in the chapters by John M. Curtis (chapter 9), Juliet Johnson (chapter 10) and Roy Culpeper (chapter 11).

Curtis notes that the institutional links between the IMF and the World Trade Organization (WTO) are pro forma, and have not resulted in any meaningful appreciation of the consequences of monetary policies on trade at the IMF or the obverse at the WTO. Picking up on the point made by several authors in this volume about the intellectual leadership that Canada has shown in the financial regulation arena, he notes that Canada has considerable credibility intellectually in the trade-finance nexus of issues as well. The pioneering work of Harold Innis and W. A. Mackintosh on "staples" anticipated the literature on the "resource curse." Robert Mundell is recognized for his seminal contributions to our understanding of open economy macroeconomics and optimum currency areas. The list must also include Richard Lipsey (theory of the second best), and James Brander and Barbara Spencer (strategic trade policy). While Curtis does not point to a unique way forward, the first step in seeking it is mapping the connections in this complex set of issues. He ends his chapter on a more pragmatic note — the way ahead might lie in assessing the role of the US dollar in the global economy, and the incentives and disincentives that the United States faces in revisiting the status quo.

Nowhere else has the complex web of issues related to the current financial crisis gone more awry — and predictably so — than in the euro zone. Indeed, in this region, the crisis is not simply financial, but increasingly social and political. Juliet Johnson outlines what went wrong under the label of four challenges: lack of adherence to the fiscal compact that underlay the monetary union; the "original sin" nature of the limits to the role of the common central bank; inadequate financial sector oversight nationally and regionally; and disparate growth models, particularly between the northern and southern members. Canada is not directly involved in the euro-zone situation nor is it among those most affected by events there. But it inserted itself into the global debate on this issue in three ways: by vocal support for the European Central Bank's foray into unconventional monetary policies; by overtly supporting the non-European candidate Augustin Carstens, rather than France's Christine Lagarde to head the IMF in June 2011; and by joining the United States in not contributing to the European stabilization fund cobbled together by the IMF. The latter two are particularly telling, not just for their substance, but also the forthrightness with which Canada expressed its views, vis-à-vis a region considered a traditional ally and intellectual soulmate of Canada. Johnson's prognosis for what remains a messy situation: the union "staggers on."

The narrative about the current financial crisis is — correctly — mostly about advanced economies, mainly the United States and Western Europe. This is where the roots of the crisis lie, and this is where its consequences are felt the most. In this narrative, developing countries and particularly the emerging economies escaped the worst of the crisis, either because they were on hyper growth paths and/or had achieved structural transformations that made them more resilient to exogenous events. Roy Culpeper puts this group's performance in context. No country has been immune from the crisis. Growth rates have slowed appreciably everywhere in the developing and emerging worlds. And currency volatility or misalignment, already high in many countries, has only increased in late 2013 and early 2014 on account of the announced tapering by the US Federal Reserve. What has looked like resilience in developing countries might be damaging, nationally and globally, in the long run. The list here would include holding abnormally high levels of currency reserves (so-called self-insurance), a reliance on domestic savings, investments and markets, and forays into commodity derivatives. While the association of Canada with the development enterprise is a long and honourable one and should be seen on its own merits, Canada's active role to make the IMF more inclusive and effective, and create a more stable international financial architecture holds additional benefits for developing and emerging economies.

A second narrative about the current financial crisis is that liberalization and economic integration has reached a limit. While national finance grew, but was fettered by national regulatory institutions and policies through most of the post-World War II era, global finance grew unabated because of the absence of parallel institutions and regulations internationally. The consequences of an unfettered global financial system were felt, starting with the implosions in the United States and Western Europe in 2008, and continue to be felt today. As a result, nationally, governments have implemented new measures to oversee and control their financial players, and they continue to work to do the same internationally as well. Randall Germain (chapter 12; emphasis in original) fleshes out this thesis and largely agrees with it — "we have turned a corner towards what might be identified as an increasingly *deliberalized* and somewhat *deglobalized* global political economy." But the conclusion is a nuanced one. The forces whose interest lies in financial globalization are powerful and rich; the vast amounts of liquidity pumped into the system during the monetary stimulus years will lend only more strength to them. In Canada, where banks have historically readily traded heavier regulation for a captive domestic market, the turn away from innovation towards stability is only more of the same.

In his concluding essay to the volume, James M. Boughton reminds us of the web of international institutions tasked with governing the IFS, and the rules and norms under which each operates — "to call this structure a 'non-system' is clearly a misnomer, and yet it would be just as wrong to pretend that it is a complete and integrated system." Building on the theme recurrent throughout the volume about Canada punching above its weight, he reminds us that Canada might have played an even larger role in all of this (if, for example, one or more of its three candidates to run the IMF had ever been properly promoted by the Canadian authorities and selected to do the job). It is precisely the gap between the needs of the current day to encourage and regulate a global financial system and the imperfection of current propositions such as the G20 and International Monetary and Financial Committee that provides Canada with the opportunity to continue to play its outsized role in the future.

Financial sector development and regulation is a work in progress within individual states at the national level, and collectively at the global level. The instruments the global community has to manage these complex national and international systems are varied, potentially powerful, but also imperfect and almost certainly hold consequences — good and bad — not yet foreseen. Canada, the dispassionate player with capabilities that belie its size, can continue to play a powerful role in these developments, even as Canadians continue to face the consequences of the actions of their government, business people and those in other countries. Here, as in so much else, Canada is indeed among nations.

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