

**GLOBALISATION, DEREGULATION AND FINANCIAL
SERVICES REFORM IN CANADA: LEGISLATING
CANADA'S "SUPERBANKS"**

by

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ABSTRACT

When analyses of globalisation first emerged, it was argued that globalisation would expand a “democratic deficit” by reducing the power of public officials to regulate economic activities. The pressures of global economic competition would constrain the range of available public policies. In the case of financial services, both international political economy approaches to globalisation and public policy scholarship argued that the sector produced a unique “esoteric politics” in which there would be little scope for public accountability. Global competitive pressures, the technical complexity of the sector, and the close relationship between large financial services companies and policymakers isolated the sector from domestic politics. Despite these assumptions, the Canadian financial services sector has gone through a period of “re-politicisation” and re-regulation over the last decade. Sectoral policy outcomes are now more clearly driven by domestic political struggles than was the case in the past.

This thesis argues that this “re-politicisation” is the direct long-term consequence of the deregulatory changes of the 1980s initiated, ironically, in response to “globalisation” and the policy demands of Canada’s “big banks.” Deregulation “opened” the policymaking environment to a wider array of organized interests. By collapsing the banking, insurance and securities policy subsystems into a single national financial services policy sector, and by expanding the responsibility of Parliament in an environment of weak state capacity, deregulation unintentionally created conditions in which groups pursuing new regulatory policy goals have been able to influence government policy. While globalisation might have further curtailed the importance of domestic politics in this sector, the institutional changes associated with deregulation ultimately opened a traditionally-closed policy network.

This evidence requires that we change our traditional analysis of the “closed” financial services policy network in Canada. It also suggests the utility of middle level theories, like policy networks analysis, in explaining state responses to globalisation. The policy networks approach offers significant insights, overlooked in much

conventional analysis of globalisation, regarding the importance of sectoral-specific domestic institutional arrangements in guiding how states will ultimately respond to the challenges and opportunities of globalisation.

Keywords:

Globalisation; Financial Services; Banking; Canadian Public Policy; Regulation

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GLOSSARY

Glossary:

- Bank:** A federally regulated financial institution that, in general, engages in the business of taking deposits, lending, and providing other financial services.
- “Big banks”:** Traditionally, the five largest Canadian Schedule I banks. Currently includes the Canadian Imperial Bank of Commerce (CIBC), Scotiabank, Bank of Montreal (BMO), Royal Bank of Canada (RBC) and TD-Canada Trust. See also: Schedule I bank.
- “Big shall not buy big” rule:** An informal commitment by the Government during the deregulatory period that mergers between large financial services companies would not be allowed. The intention was to ensure that deregulation would not reduce the level of competition in the industry.
- Closely held bank:** A bank in which a single shareholder can own more than 20 per cent of outstanding shares. Typically, a closely held bank is controlled by a single shareholder. A common example would be a domestically incorporated subsidiary of a foreign bank, controlled by the parent institution. See also: Widely held bank.
- Co-operative credit association:** An association organized and operated on co-operative principles. One of its principal purposes is to provide financial services to its members. See also: Credit union.
- Credit union:** A co-operative, deposit-taking financial institution owned by its members. Credit unions and *caisses populaires* are provincially regulated and are usually small and locally-oriented.
- Demutualization:** Mutalized insurance firms were traditionally owned by their insurance policy holders. In 1999 the Federal Government allowed these firms, some of the largest financial service providers in Canada, to become publicly traded corporations. Ownership was transferred into shares which policy holders could then sell as they wished. Demutualization has increased the opportunities for expansion, mergers, and acquisitions for these firms.
- Deposit-taking institution:** A bank, trust company, credit union, *caisse populaire*, or other financial institution that accepts deposits and provides basic banking services such as chequing and savings accounts.

Derivatives:	The more “exotic” forms of internationally traded financial instruments. A derivative is a security whose price is dependent on an underlying asset, such as stocks, currencies, and interest rate bearing assets like bonds. The derivative is a contract to provide that asset at a future price, normally on a highly leveraged basis. Derivatives include futures contracts, forward contracts, options, and swaps.
Disintermediation:	Normally banks intermediate between lenders and borrowers. Banks lend money to borrowers without depositors directly risking their savings. Other types of finance are disintermediated as borrowers raise capital directly such as by issuing securities. Historically, this difference has separated banking from the securities industry. Since the 1980s however, banks have become more directly involved in managing direct finance. As a result bank activities have become increasingly “disintermediated” as the boundaries between the two industries have blurred. See also, securitization.
Financial service provider (FSP):	Institutions such as commercial or investment banks, companies, brokerage houses, insurance companies, credit unions and <i>caisses populaires</i> , that participate in financial transactions involving cash or financial products. The primary role of these institutions is to facilitate the financing of investments, from home mortgages to the raising of funds via the issue of debt or equity for financing mega-projects. They also provide insurance, take on fiduciary responsibilities, and store cash and securities for safekeeping.
Insurance company:	A financial institution, which can be either federally or provincially regulated and engages primarily in the business of insuring risks. Insurance companies are generally divided into two categories: life and health insurers, and property and casualty insurers.
Interest rate spreads:	The difference between the interest rate paid to depositors and the interest rate charged to borrowers of financial instruments.
Loan loss reserves:	Reserves held by deposit-taking institutions to cover financial costs of non-performing loans. Loan loss reserves to cover debt arising from the LDC debt crises are tax deductible.
Mutual fund company:	A company that invests its capital in other companies. Its capital is a pool of funds gathered from investors. A form of disintermediated finance, mutual fund companies fall under the jurisdiction of Canadian provincial securities commissions.
Near banks:	Financial service providers that are not defined as banks under the Federal <i>Bank Act</i> but perform market functions similar to that of banks. In Canada this includes credit unions and trust companies.

Pillarization:	The Canadian system of functional market segmentation in financial services. Through a system of ownership restrictions and limitations on the types of products firms could sell, the “four pillars” system divided the industry into the banking, insurance, securities, and the mortgage and trusts sectors.
Public Interest Impact Assessment:	Statements required by the Minister of Finance for proposed mergers between large banks (i.e., banks with more than \$5 billion in equity).
Securitization:	Narrowly, the process of securitization refers to the creation of financial products that combine a range of financial assets for marketing to clients. In international banking this term is used to describe international banks’ diversification of their product base to include more direct forms of finance rather than traditional loans to compete with the securities industry. See also, disintermediation.
Registered Retirement Savings Plan (RRSP):	Savings plans for individuals, including the self-employed, which have been registered for the purposes of the Federal <i>Income Tax Act</i> . RRSP contribution limits are based on earned income. RRSPs provide retirement income at retirement based on accumulated contributions and return on investment in the plan.
Reserve requirements:	The portion of a bank’s assets under administration that must be retained on hand to ensure the bank’s soundness. Reserve requirements were traditionally set by the Bank of Canada.
Schedule I and Schedule II banks:	Federally regulated Canadian banks. Traditionally, Schedule I banks were comprised of the six large Canadian-owned banks which had to be “widely held.” Schedule II banks were smaller “closely held” banks that were subject to size restrictions. Schedule II banks were often subsidiaries of foreign banks. Currently, under Bill C-8, which was implemented on October 24, 2001, the Schedule I and II bank structures have been replaced with a new size-based ownership regime. Under this regime, banks with equity greater than \$5 billion are required to be widely held, with no person owning more than 20 percent of voting shares or 30 percent of non-voting shares. Banks with \$1 billion to \$5 billion in equity are allowed to be closely held, subject to a public float of 35 percent of voting shares, while banks with less than \$1 billion in equity have no ownership restriction other than a “fit and proper” test.
Schedule III bank:	Since 2001, the Federal <i>Bank Act</i> has allowed foreign banks to establish individual bank branches (schedule III banks) which can provide a wide array of basic banking services.

- Self dealing:** One of a number of potential conflicts of interest that can occur when financial service providers are allowed to offer a wide array of services. Most commonly “self dealing” is feared in situations where a financial service provider sells a firm’s stock to its clients without disclosing the nature of its relationship with that firm. For example, a bank could sell shares in a firm to its clients without informing them that the firm is deeply indebted to the bank or that the bank has a direct ownership stake in the firm. Pillarization prevented many of these types of conflicts of interest.
- Tied selling:** A coercive practice where a financial service provider demands that a client purchase additional products in order to receive a requested service. For example, in an unregulated environment a mortgage provider could require that a client purchase in-house insurance products in order to receive a mortgage.
- Trust company:** A financial institution that operates under either provincial or federal legislation providing fiduciary management. Trust companies can administer estates, trusts, pension plans and agency contracts, which banks cannot do. Trust companies also offer many of the same services as banks.
- Universal banking:** An approach to bank regulation in which banks are allowed functionally diversified business activities, like securities services and portfolio management, that make it a broader financial service provider than a traditional “narrow bank” that simply takes deposits and makes loans. Universal banks are commonly seen as “one stop shopping” financial service providers, offering a wider range of financial instruments. The system of pillarization in Canada did not allow this.
- Widely held bank:** A provision of the Federal *Bank Act* which is intended to ensure that large Canadian banks are not controlled by a single shareholder. Although the rules have been amended several times in recent decades, it ensures that no individual or firm can own more than a fixed portion of a Schedule I bank’s stock (or, of a bank with more the \$5 billion in equity since 2001). The restriction made it difficult to finance the start up of a new Schedule I bank and also acted to ensure that a foreign takeover of an existing Schedule I bank was unlikely.

List of Abbreviations:

- BIS:** Bank of International Settlements
- BOC:** Bank of Canada
- CAC:** Consumers Association of Canada

CBA:	Canadian Bankers Association
CBO:	Canadian Banking Ombudsman
CCB:	Canadian Commercial Bank
CCPA:	Canadian Centre for Policy Alternatives
CCRA:	Canadian Community Reinvestment Coalition
CDIC:	Canadian Deposit Insurance Corporation
CFIB:	Canadian Federation of Independent Business
CFSON:	Centre for the Financial Services OmbudsNetwork
CompCorp:	Canadian Life and Health Insurance Compensation Corporation
CPA:	Canadian Payments Association
CUSFTA:	Canada/United States Free Trade Agreement
FCAC:	Financial Consumer Agency of Canada
FSA:	Financial Services Agreement of the General Agreement on Trade in Services
FSP:	Financial Service Provider
GATS:	General Agreement on Trade in Services
IBAC:	Insurance Brokers Association of Canada
IBC:	Insurance Bureau of Canada
IDA:	Investment Dealers' Association
IR:	International Relations
IPE:	International Political Economy
LDC:	Less Developed Country
NAFTA:	North American Free Trade Agreement
OECD:	Organization of Economic Cooperation and Development
OIGB:	Office of the Inspector General of Banks
OSC:	Ontario Securities Commission
OSFI:	Office of the Superintendent of Financial Institutions

SBLA: Small Business Loans Act
WTO: World Trade Organization
TCAC: Trust Company Association of Canada

**CHAPTER 1: “GLOBALISATION, DEREGULATION
AND FINANCIAL SERVICES REFORM IN
CANADA”**

"The idea that politics determines national policies has gradually dissipated, and in its place has come the open assertion that economics is the deciding factor in more and more aspects of society."

Gary Teeple, Globalisation and the Decline of Social Reform¹

I) Introduction: The 1998 “Mergers Debate” and the Re-Politicisation of Financial Services

The January 1998 announcement of a proposed merger between the Royal Bank and the Bank of Montreal generated a great deal of controversy in the financial services sector. Aware that their merger would require the approval of federal regulators, the banks argued that technological change, globalisation, and increased competition meant that “size mattered” in modern banking. The resulting bank would be the tenth largest in North America, increasing its economy of scale, and allowing it to make needed investments in new technology.² Furthermore, the efficiencies achieved would place it in a stronger position to challenge global competitors. For the banks, the merger was a logical extension of the government’s previous decisions to open the Canadian market to competition from foreign and non-traditional financial services companies.

While many among the business press assumed the merger would receive government approval, the situation was complicated. Within a few months, the Canadian Imperial Bank of Commerce and Toronto Dominion, in response to the earlier announcement, informed the government of their own merger proposal. If the mergers

¹ Gary Teeple, Globalisation and the Decline of Social Reform, (Garamond, 1995), p. 3.

² John Cleghorn and Matthew Barrett, “Remarks at the Announcement of the Agreement To a Merger of Equals With the Royal Bank of Canada,” Press Release, January 28, 1998.

were approved, Canada would go from five major banks to three. The proposals were also poorly timed. The Government had recently appointed a *Task Force on the Future of Canada's Financial Services Sector*, chaired by Harold MacKay, which was not due to release its final report until the Fall of 1998. This was only the first step in a comprehensive policy review of financial services. The mergers were also politically unpopular. While the banks might convince federal regulators and the *MacKay Task Force* that globalisation required that Canada have bigger banks, the public was not so easily convinced. Years of record-breaking bank profits and the proliferation of new banking service fees meant that an angry public was sceptical of the claims of impending doom for the industry in the absence of mergers.

Despite these obstacles, the mergers “fit” the existing policy paradigm. Prior to 1998 policymaking in the sector had entered a period of continuity. A consensus had emerged supporting the Canadian transition to a “universal bank” model in which Canada's big banks would be allowed to offer an ever increasing array of financial services to take advantage of their economies of scale, such as selling securities and providing insurance. Changes to the *Bank Act* in 1987 and 1992, and those expected after the completion of the *MacKay Task Force*, all seemed to support this policy orthodoxy. In practice, this consensus also supported widespread industry conglomeration because it was thought necessary to ensure that Canada's banks were large enough to compete with their global competitors. Thus, the banks expected that their merger proposals would be accepted by the government. They also expected that new legislation following the *Mackay Task Force* would remove the remaining regulatory restrictions that prevented

them from offering automobile leasing and a full array of insurance products.³ However, despite the *Task Force's* recommendations, which supported the existing pattern of deregulation and conglomeration, policy has moved in a different direction.

Since 1998, the financial services sector has entered a period of “re-regulation.” The government has rejected the banks’ merger proposals and has created new rules which block similar proposals. It has implemented new consumer protection measures and increased the level of domestic competition faced by the big banks. At the same time, the government has refused to implement the recommendations of the *Mackay Task Force* which would have relaxed restrictions on the range of financial instruments banks could offer. Politically, it has been a bad decade for the banks as they have found it harder to dominate the policy process than was the case in the past.

What makes this sudden erosion of the previously pervasive influence of the banks over sectoral policy interesting is that it is an unexpected outcome for those who study the financial services industry. Conventional analysis of policymaking in this sector, sensitive to the logic of globalisation, has assumed that large multinational financial service providers would increasingly dominate national policymaking. In a sector always notable for the degree to which financial services firms have been able to isolate and dominate the policymaking process, producing an extremely “closed” policy community, it was assumed that globalisation would accentuate this pattern. In the

³ Since 1992, banks could own insurance subsidiaries. However, they were eager to be able to offer those services directly to their bank customers. For example, banks wanted the right to have tellers sell insurance “in branch” to regular bank customers, taking advantage of their privileged access to their clients’ financial services information. The banks had been lobbying the government for this right since the 1980s. See Stephen Harris, “Financial Services Reform in Canada: Interests and the Policy Process,” *Canadian Journal of Political Science*, March 2004, pp. 161-184.

Canadian case, the big banks would continue to dominate policy.⁴ Accordingly, evidence of sectoral re-regulation, re-regulation opposed by Canada's largest banks, warrants closer attention.

Little attempt has been made to explain this "new politics" of financial services or, for that matter, to explore what the case suggests about the way scholars assume that globalisation affects public policy. While others have noted the surprising shift in policy priorities in the sector since 1998, explanations have been tentative. Stephen Harris, for example, emphasizes a partisan shift. The election of the Liberals in 1993 altered the governments' policy commitments favouring re-regulation.⁵ However, he argues that the Liberal caucus was responding to broader "opposition" to the banks' policy demands, suggesting the real cause lies elsewhere. Ian Roberge suggests that this shift in policies is illustrative of the process of "multi-level governance," an approach to the policy process which seeks to integrate different levels of policymaking (international, federal and provincial) into a single understanding of the policy universe. Roberge suggests that the transition to multi-level governance has widened the "actor constellation" bringing new actors and policy demands into the sector.⁶ While Roberge's analysis, like Harris', draws our attention to the domestic policy network and the range of actors involved, it does not systemically explore how, or why, the "actor constellation" widened. Beyond these

⁴ See William Coleman, Financial Services, Globalization and Domestic Policy Change, (London: Macmillan, 1996).

⁵ Harris, "Financial Sector Reform in Canada," p. 162.

⁶ In the case of Canadian financial services, he argues, "Non-governmental actors increasingly find their way into policymaking negotiations. Non-governmental actors include private sector actors such as business associations and private firms. They also include civil society actors such as consumer groups and anti-poverty organizations." See Ian Roberge, The Internationalization of Public Policy and Multi-level Governance: A Comparison of Financial Services Sector Reform in Canada and France, (Doctoral Dissertation, McMaster University, 2004), pp. 4-5.

observations, little has been said of Canada's "new politics" of financial services and what it suggests about globalisation.

This dissertation argues that analysis of globalisation and its effects on domestic policy sectors must pay closer attention to the domestic institutional settings in which policy networks operate. Drawing on institutional insights from policy networks analyses, this project argues that the explanation for the "new politics" of financial services in Canada lies in the institutional legacy of the Mulroney-era deregulation. By precipitously collapsing the boundaries between the different "pillars" of the Canadian financial services system, and by leaving Parliament with a large "residual" role in regulating the sector, deregulation unintentionally created conditions for a substantial opening in the policy network which has allowed new participants and new policy goals to affect outcomes. Thus, the combined effects of globalisation and domestic policy network change have unexpectedly redirected policy in this sector. Deregulation ultimately stimulated "re-politicisation" and re-regulation.

II) Canada's "New Politics" of Financial Services – Three Research Problems:

The events of the last decade in the financial services sector pose three interrelated research problems. First, there is a straightforward "policy puzzle." The transition from the traditional system of pillarization to universal banking, launched by Canada's deregulatory "little bang" in 1987, has stalled since 1998 as new policy goals have emerged. This requires explanation. Second, there is the political puzzle of just how and why this change occurred. Third, there is a globalisation puzzle: what has the role of globalisation been in guiding domestic policy choices in this sector?

a) The Policy Problem - Deregulation: Pillarization to Universal Banking:

Prior to 1998, Canada went through a two decade-long transition in financial services policy paradigms, from the traditional system of pillarization to a deregulated “universal banking” model. This involved a complex set of regulatory changes, the creation of new regulatory agencies, and a redistribution of jurisdiction from the provinces to the federal government. Despite the difficulties involved in this, it was thought necessary because of the competitive pressures unleashed by globalisation, and because universal banking had emerged as a dominant paradigm in other jurisdictions.⁷

Banking and financial services are crucial to the modern economy. Banks and other financial service providers (FSPs) ensure capital is available for investment and that businesses and consumers have a safe place to deposit their savings. Given past experience with bank failures, Canada had created a regulatory system to ensure public confidence in their banks. This system of “pillarization” restricted the kind of services which companies could offer. It also involved ownership restrictions preventing industry affiliations across sub-sectors, dividing the financial services industry into four “pillars:” banking, insurance, securities, and the trust and mortgage sector.⁸

⁷ See for example: Canada, Department of Finance, Reform of the Federal Financial Institutions Legislation: Overview of Legislative Proposals, (Ottawa: Minister of Supply and Services, 1990).

⁸ Pillarization meant that the financial service industry operated under a *theoretical* and *practical* separation of “finance” and “banking.” “Finance” from a functional perspective, “. . . is the process by which savings are transferred from one entity to another for a period of time in exchange for payment.” See Tony Porter, Globalization and Finance, (Polity Press, 2005), p. 4. This includes: 1) Loans – which are a form of intermediated finance in which banks, acting as an intermediary, take on the risk of loaning money to borrowers; 2) Securities – in which borrowers draw capital directly from an investor; and, 3) Insurance – in which savings are transferred to an insurer for a future payment. “Banking” was simply one sector of financial services. In practice, Canada maintained this distinction by limiting banks to banking activities regulated by the Federal Government, while other aspects of finance were primarily provincially regulated. The process of deregulation has eroded both the theoretical and practical distinctions. Modern “banking” often includes all types of finance, and thus the industry is better understood as “financial services.”

Pillarization served a number of purposes. It was thought to be necessary for prudential reasons. Limiting banks to deposit-taking and lending kept them out of riskier aspects of finance which might threaten their soundness. Pillarization also served to restrict the entry of foreign firms due to its often complex ownership restrictions. Pillarization was also used to promote positive externalities such as ensuring adequate credit for small businesses.⁹ Canada was not unique in pursuing “pillarization” as it was the core policy paradigm guiding regulation in most OECD countries.¹⁰

One of the benefits of pillarization was that it ensured that Canadian consumers and businesses had choices among financial service providers. Given the broader context in which a very small number of national banks dominated the banking sector, pillarization ensured that there were more potential providers than would otherwise be the case. Under the four pillars system borrowers were not limited to dealing with a bank. They could also secure credit from a securities firm or one of the smaller mortgage and trust companies.

In fact “Canada’s system of pillarization was hardly “watertight” heading into the era of deregulation. Virtually all of the players in the financial services industry had some interests in other segments of the market.”¹¹ The pillars were never clearly defined

⁹ Stephen Harris, “The Globalization of Finance and the Regulation of the Canadian Financial Services Industry,” in G. Bruce Doern et al., Changing the Rules: Canadian Regulatory Regimes and Institutions, (University of Toronto Press, 1999), pp. 361-381.

¹⁰ *Ibid.*, p. 361. Harris argues that both the existing systems of market segmentation and the processes of deregulation were similar in countries like Canada, Britain and the United States. However, others have noted that market segmentation was traditionally less restrictive in Canada than elsewhere, particularly for Canada’s federally-regulated “big banks.” Throughout the early years of deregulation, jurisdictions like Britain and the United States were playing “catch-up” to Canada, where banks already enjoyed more privileges than was the case elsewhere. This is particularly notable in the case of the U.S. where bank interest rate ceilings were not deregulated until the 1980’s. For a discussion of market segmentation and deregulation in the U.S., see Theresa Morris, “Bank Mergers Under a Changing Regulatory Environment,” Sociological Forum, Vol. 19, No. 3, September 2004, pp. 435-463, or Benjamin Klebaner, American Commercial Banking: A History, (Boston: Twayne, 1990).

¹¹ Coleman, Financial Services, Globalization and Domestic Policy Change, p. 201.

as the divisions between them were not strictly reflective of their market functions. In large part the pillars were jurisdictional. They were constituted by which level of government was responsible for regulating that sector. For example, by the 1980s both trust companies and credit unions, which were not part of the banking “pillar,” had grown in such a way that their core business activities, taking deposits and lending money, were the same as the core activities of the banks. The major difference was that the trusts and credit unions (collectively, “near banks”), were provincially regulated, while the banks, chartered under the Federal *Bank Act*, were under federal jurisdiction. Normally a functional segmentation of financial services would result in three market segments: banking, securities and insurance. The provincially regulated near banks meant that Canada ended up with an extra pillar duplicating the bank segment. This meant that despite ownership restrictions which prevented inter-pillar conglomeration, firms in one pillar often competed with firms in another pillar, ensuring more choice for consumers of financial services.

However, when other jurisdictions around the world began programs of deregulation, Canada’s policy paradigm of pillarization came under pressure.¹² It was argued that globalisation made the idiosyncrasies of this system increasingly difficult to justify.¹³ In particular, “globalisation” was thought to pose challenges to the functional separation of commercial banking and the securities industry. Thus the system of pillarization was challenged by the “universal bank” concept for regulating the industry.

¹² The Thatcher government’s pre-emptive program of deregulation in Britain, aimed at ensuring the attractiveness of London as a major financial centre, is often seen as the first step towards redefining the purposes of domestic regulation around the world. See, Adam Tickell, “Restructuring the British Financial Sector into the twenty-first Century,” *Capital and Class*, Summer 1997, Issue 62, p. 2.

¹³ Coleman, *Financial Services, Globalization and Domestic Policy Change*, p. 203.

A “universal bank” is a bank with functionally diversified business activities. This makes it a broader financial service provider than a traditional “narrow bank”, which simply takes deposits and makes loans. A “universal bank” also provides brokerage services, investment, trust and estate management services, and is involved in secondary market trading in money, bonds, and foreign exchange.¹⁴ Essentially universal banks are “one stop shopping” financial service providers, offering a wide range of financial instruments.

In Canada, the transition to universal banking involved gradually allowing federally regulated banks to move into the other pillars of the financial services industry. For example, in the 1987 “little bang” banks were allowed to own securities firms as subsidiaries for the first time. Indeed, aside from the question of mergers between the small number of universal banks in Canada, the most divisive issue in Canadian policy debates since 1998 is whether this process should be completed and banks should be allowed to offer a full array of insurance services “in branch.”

The major beneficiaries of the transition to universal banking have been the federally regulated “big banks” and arguably, by default, the federal government, as de-pillarization has effectively expanded its jurisdiction in the sector. Given the subsequent evidence of re-regulation in this sector, the question is: what has undermined the pro-deregulation policy consensus that had dominated the sector in the 1980s and 1990s?

b) The Domestic Politics Problem: Canada’s “Closed” Policy Network

The complexity of policy change in this sector parallels a research problem: how have Canada’s most politically powerful corporations “lost” control of the policy agenda

¹⁴ Ibid., p. 21.

since 1998? Canada's "big banks" have traditionally enjoyed a relatively close and supportive relationship with the federal government, grounded in shared mutual interests. The change in this relationship in recent years is an important question requiring explanation.

In the 1960s Canada's banks were large, even by international comparison. Canada's five largest banks combined constituted 15 percent of the international banking industry.¹⁵ This success has been attributed to the domestic conditions provided by federal regulators who were "... instrumental in creating a protected market in which banks could develop competitive strengths, and these competitive advantages provided the cornerstone for international growth strategies."¹⁶

In return, federal governments achieved several important objectives. First, the government had historically sought to ensure a *stable* Canadian-controlled financial services industry to ensure the inward flow of foreign direct investment. By fostering the dominance of a few large Canadian banks, the government ensured both of these objectives.¹⁷ By ensuring that those institutions were federal banks, the federal government also achieved a significant expansion of its jurisdiction and control. While the Canadian Constitution divides jurisdiction in this sector, the federal power to regulate "banking" has never been functionally defined. Instead, "banking" has come to be seen as whatever Canada's federal banks do. Thus whenever the federal government expands the powers of the banks it, *de facto*, expands federal jurisdiction and influence over the financial services industry. Thus if the federal government wanted to play the leading

¹⁵ James Darroch, "Global Competitiveness and Public Policy: The Case of the Canadian Multinational Banks," *Business History*, 34:3 (July 1992), p. 153.

¹⁶ *Ibid.*, p. 154.

¹⁷ *Ibid.*

role in setting policy, even outside its traditional jurisdiction, it could do so by expanding the powers of federally regulated banks. Indeed, William Coleman argues that by supporting the development of the “universal bank” model, the federal government has achieved a degree of centralization and rationalization in the policy sector despite the pressures and challenges of globalisation.¹⁸ James Darroch has argued that this has created a mutually supportive relationship between the banks and the federal government such that “. . . the history of bank regulation . . . reveals that regulation did not handicap the banks, but rather the banks received new powers virtually for the asking.”¹⁹

From the 1960s onwards the big banks have faced a number of threats, first from domestic near banks and later from intensified international competition and the “disintermediation” of international banking associated with “globalisation.” In both cases the federal government was quick to meet these threats by expanding the banks’ domestic powers to ensure continued profitability and dominance. For example, the 1967 *Bank Act* revisions introduced a complex ownership regime for banks, which limited the likelihood that new bank competitors would be established in Canada. At the same time the government removed restrictions on bank interest rates. Both of these moves benefited banks at the expense of their domestic competitors in the other pillars.

The competitive pressures unleashed by globalisation were more complex. The advent of “offshore” euromarkets and transnational instantaneous electronic finance tended to blur the boundaries between domestic and international capital markets,

¹⁸ William Coleman, “Federalism in Financial Services,” in Bakvis and Skogstad eds., Canadian Federalism: Performance Effectiveness and Legitimacy, (Oxford University Press, 2002), p. 184.

¹⁹ Darroch, “Global Competitiveness and Public Policy,” p. 155.

particularly for large corporate clients seeking low cost capital.²⁰ Those firms were less likely to deal directly with Canada's big banks because capital could easily be secured "offshore," where FSPs faced lighter regulations and ". . . there were no limitations upon what services or products any competitor could provide. This created opportunities for product line diversification far beyond those supported by the 1967 *Bank Act* which maintained the traditional Canadian 'four pillars'."²¹ The development of offshore and deregulated metropolitan financial centres made it increasingly difficult for the federal government to protect Canada's banks from global competition. Global efforts to remove barriers to financial services via trade agreements made this prospect seem all the more likely.²² Indeed, the movement towards a General Agreement on Trade in Services (GATS) on financial services eventually would raise the prospect that the banks might face intensified international competition even in the basic banking services they provided to domestic consumers which were often their most profitable product lines.

The history of the Canadian response to these trends will be documented in Chapters Four and Five. What occurred fit the traditional pattern in which the federal government acted to ensure that the big banks would emerge from the process of globalisation as strong, internationally-competitive players. For example, the *ad hoc* "little bang" of 1987, in which banks were hurriedly given the right to enter into the securities pillar of the Canadian financial services industry, opened new business avenues

²⁰ For a discussion, see Susan Strange, Mad Money, (Manchester: University of Manchester Press, 1998), Chapter 2, pp. 22-42.

²¹ Darroch, "Global Competitiveness and Public Policy," pp.163-164.

²² Russell Alan Williams, "Liberalizing "Trade in Services": Ideas in International Political Economy" in Stephen McBride, Laurent Dobuzinskis, Marjorie Griffin Cohen and James Busumtwi-Sam eds. Global Instability: Uncertainty and New Visions in Political Economy, (Dordrecht, Netherlands: Kluwer Academic Publishers, 2002).

at a time when the banks were struggling with international competition.²³ The deregulation of the pillar system in Canada, although *ad hoc* and poorly planned, was intended to ensure stability, by ensuring the competitiveness and, as a side effect, domestic dominance of Canada's big banks.²⁴

The obvious question then, is what has changed? How has the relationship between the banks and the federal government become less harmonious since initial moves were made towards deregulation?

c) The Globalisation Problem:

The erosion of support for deregulation and the evidence of re-politicisation and re-regulation in the Canadian financial services sector raise a broader and more fundamental research problem. What does it suggest about theories of globalisation's impact on public policy?

The 1990s ushered in an era of regulatory re-evaluation and change in the financial services industry around the world. The industry was once notable for its tight regulation which moderated both domestic competition and cross border exchange in services. By the end of the 1980s, governments had adopted deregulation, liberalization, and a permissive attitude towards industry conglomeration. Many analysts argue that globalisation has driven these policy changes. However, this study, like others which examine the impact of globalisation on a policy sector, illustrates the need for international political economy (IPE) theories to integrate public policy models if we

²³ Darroch, "Global Competitiveness and Public Policy," p. 165.

²⁴ This is an argument explored by Coleman and Tony Porter in "'Playin' Along: Canada and Global Finance." In Wallace Clement and Leah Vosko, eds. Changing Canada: Political Economy as Transformation, (Montreal and Kingston: McGill-Queen's University Press, 2003), pp. 241-264.

wish to understand national policy responses. Indeed, this case is illustrative of shortcomings in IPE theory which ultimately can be traced back to the formative debates in the discipline and to the theoretically unsophisticated handling of “globalisation” in the “first wave” of globalisation studies.

IPE, Interdependence and Globalisation – A Role for Domestic Politics?

There are few theories in political science that address the “globalising” of public policy. International relations (IR) traditionally focuses on relationships between states, while political science focuses on domestic governance and the operations of the state. Despite ample research on globalisation, the conceptual tools for integrating globalisation into policy analysis remain underdeveloped.

When IPE first emerged as a clear subfield of IR in the 1970s, scholarship was dominated by primarily American, and primarily “liberal” responses to realism’s insistence on the role of anarchy and the distribution of power as the primary drivers of state behaviour. This primordial liberal analysis largely focused on how economic interdependence also affected the calculations of states.²⁵ Much like realism, however, early liberal analysis tended to avoid consideration of domestic politics and domestic political institutions as an explanation for state policy choices.²⁶ Instead, studies focused

²⁵ Realism, in its contemporary “neo-realist” variant understands states as unitary, rationally calculating actors that necessarily respond to insecurity generated by international anarchy and the uneven distribution of power in the international system. Since anarchy ensures that states find it difficult to trust one another, international cooperation to achieve mutual goals, like the benefits of economic interdependence, is thought by realists to be difficult. Early institutional liberal perspectives suggested that states were also motivated by the pursuit of wealth that could be generated through economic cooperation.

²⁶ For an example of this liberal institutional analysis see Robert Keohane and Joseph Nye, Power and Interdependence. (Boston: Little Brown, 1977).

simply on how economic “interdependence” might alter state policy preferences, by altering the economic interests of states.

This early thinking about globalisation was synthesized in Helen Milner’s influential work, Resisting Protectionism.²⁷ Milner, in attempting to explain why states have not pursued increased trade protectionism in light of declining US hegemony, claimed that economic interdependence had created wider webs of domestic interests committed to free trade. Through some sort of under-specified pluralism, Milner suggested that the altered preferences of domestic interest groups were in turn affecting the policy preferences and behaviour of states. Her analysis was the background for early, or “first wave” studies of globalisation which tended to emphasize the way international market forces affected state policy preferences, while paying little attention to more sophisticated models of domestic policymaking that stressed, for example, the role of institutions in affecting policy outcomes.

“First wave” Globalisation Studies

While there has been a confusing array of approaches to “globalisation,” when the concept first emerged in IPE and comparative politics, it was conceptualized primarily as an objective economic process – the global integration of markets.²⁸ Pioneers of the concept tended to emphasize a straightforward and economically deterministic notion of globalisation. Much of the purpose of this literature was to downplay the importance of

²⁷ Helen V. Milner, Resisting Protectionism: Global Industries and the politics of International Trade, (Princeton University Press, 1988). See also Peter Gourevitch, “The second image reversed: the international sources of domestic politics,” International Organization, 32, (1978), pp. 881-912. Gourevitch proposes an approach to IPE in which international factors (interdependence) drive state policy choice at the domestic level.

²⁸ Grace Skogstad argues that Canadian scholarship in particular was often most closely associated with economic interpretations of the concept, arguing that deepening economic integration had direct political effects. Grace Skogstad, “Globalization and Public Policy: Situating Canadian Analyses,” Canadian Journal of Political Science, XXXIII:4 (December, 2000), pp. 805-828.

domestic political models of analysis, perhaps because such concerns undermined the traditional parsimony of IR/IPE approaches.

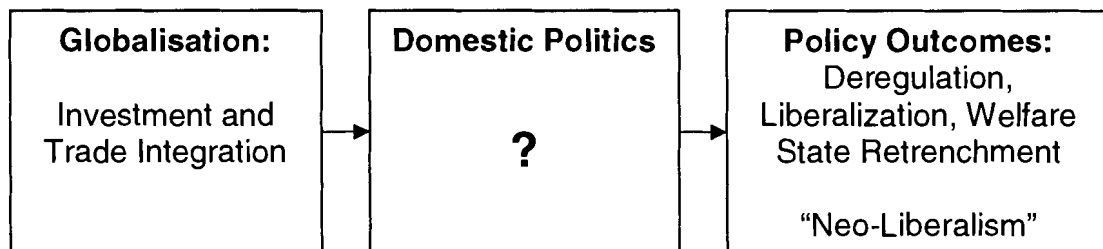
Responding to works like Kenichi Ohmae's hyper-liberal Borderless World, scholars suggested that due to improvements in communications and transportation technologies, market forces were acting to integrate the world economy more deeply than ever before. This economic integration produced new structural pressures on states to alter domestic policies in a way that was reflective of the competitive realities of global markets.²⁹ While most of this work was derived from liberal economic analysis which sought to highlight the importance of markets in constraining the activities of modern states (the thrust of Ohmae's analysis), some critical perspectives, highlighting the structural limitations placed on states by capitalism, suggested much the same thing.³⁰ Scholars working from a variety of theoretical perspectives focused on "market oriented theories" of globalisation and emphasized the pressure it created for states to alter domestic policies and adopt the pro-market and deregulatory thrust of neo-liberalism. While alternative views of globalisation were evident at the time,³¹ first wave globalisation analyses mainly offered a simple hypothesis – perhaps the principle reason why it has been such a popular target for critics (Figure 1.1).

²⁹ Held refers to this type of argument as "hyper globalization" hypothesis. See, David Held et al., Global transformations: politics, economics and culture, (Cambridge: Polity Press, 1999).

³⁰ Tony Porter notes this in Globalization and Finance, (Polity Press, 2005), p. 16. Many Marxist and critically-informed scholars suggested similar analyses to that provided by liberal celebrants of globalisation like Ohmae. See, Stephen Gill and David Law, The Global Political Economy, (London: Harvester, 1988), Philip Cerny, "Paradoxes of the Competition State: The Dynamics of Political Globalization," Government and Opposition, 32, no. 2., 1997, p. 253, or Gary Teeple, Globalisation and the Decline of Social Reform, (Toronto: Garamond Press, 1995).

³¹ See for example, Philip Cerny, "Globalisation and Other Stories: The Search for a New Paradigm for International Relations," International Journal, 1996, 51(4), pp. 617-37.

Figure 1.1: The Economic Globalisation Hypothesis:



Essentially, an independent variable of “globalisation,” originally understood narrowly as an economic process, required dependent variable changes in public policy, commonly associated with “neo-liberalism.” Obviously, many globalisation scholars assumed that the pressures of globalisation worked their way somehow through domestic political processes to produce new policy outcomes, but they did not specify what those processes were. Domestic politics remained an intervening “black box.”

This conception of globalisation has been particularly evident in analyses of finance and financial services. Following general arguments about the increased mobility of capital in the 1990s, most analysts assumed that increased global competition and changing technology were gradually forcing a liberalization and deregulation of banking at the domestic level.³² In order to ensure the competitiveness of national FSPs, states needed to deregulate the industry, allowing firms to offer a full array of services and to pursue widespread industry conglomeration and internationalization. States are assumed

³² See for discussion, Laura MacDonald, “Going Global: The Politics of Canada’s Foreign Economic Relations,” in Wallace Clement, *Understanding Canada*, (McGill-Queen’s University Press, 1997), pp. 172-96.

to have little choice - IPE literature was particularly clear on this point.³³ Indeed, analysis of the financial services sector was often deployed in early globalisation scholarship as evidence for claims that the “state” was facing a fundamental crisis.³⁴

This analysis was also evident in the study of the Canadian financial services industry. Stephen Harris has argued that the advent of the eurodollar market in London effectively let the deregulatory “genie out of the bottle.” It launched an:

. . . iterative process of competitive liberalization across the industrialized democracies. National authorities were fearful that if they did not respond to the emerging international phenomenon their indigenous financial centres would become backwaters with important negative externalities for their economies.³⁵

Harris argued that these competitive pressures would directly produce convergence at the national level. Deregulation and liberalization were inevitable, particularly in regards to the abandonment of domestic market segmentation, like Canada’s system of pillarization.³⁶ Indeed Harris assumed deviations from these choices would be irrational and to the detriment of the industry and the national interest.

³³ A range of IPE scholarship suggested that the end of capital controls, the breakdown of Bretton Woods, and the emergence of offshore financial services centres pressured states to deregulate financial services by abandoning restrictions that imposed costs on domestic firms. These studies, though often offering different accounts of the emergence of globalised markets, suggested an overwhelming logic in which there would be a “race to the bottom” in regulatory standards if states wished to continue to attract the global financial services industry to locate within their jurisdiction. See, Susan Strange, Casino Capitalism, (Oxford: Basil Blackwell, 1986), Susan Strange, Mad Money, R. McKenzie and D. Lee, Quicksilver Capital :How the Rapid Movement of Wealth Has Changed the World, (New York: The Free Press, 1991), and P. Cerny, “International Finance and the Erosion of State Policy Capacity,” in P. Gummert, ed. Globalization and Public Policy, (Cheltenham: Elgar, 1996), pp. 83-104.

³⁴ See for example: V.A. Schmidt, “The New World Order, Incorporated. The Rise of Business and the Decline of the Nation State,” Daedalus, 1995, 124(2), John Dunn ed., Contemporary Crisis of the Nation State?, (Oxford: Blackwell, 1995), and Strange, Susan, The Retreat of the State: The Diffusion of Power in the World Economy, (Cambridge: Cambridge University Press, 1996).

³⁵ Harris, “The Globalization of Finance,” p. 363.

³⁶ According to Harris the Canadian pillar system was eroding “as a consequence of the globalization of markets.” The only option was to move to a universal bank model. See, Harris, “The Globalization of Finance,” p. 375. Harris also argued that convergence was inevitable in regards to restrictions on foreign ownership and entry, p. 364.

Initially, study revolved around attempts to falsify this straightforward, “structurally-deterministic” analysis of how the globalisation of financial flows may have directly altered the trajectory of domestic public policy. Scholars sought to assess the impact of globalisation across a range of policy sectors, including monetary and fiscal policy, tax policy, business regulation, social policy and even the future of the Keynesian welfare state. Indeed, the original “economistic” analysis of globalisation drew a lot of criticism as scholars contested both the independent and dependent variables (see Figure 1.1).

1) Contesting the Independent Variable

The simplest criticism came from those who challenged the independent variable of “globalisation” itself. For example, some challenged the objective economic measurements of globalisation, questioning the degree to which something radically new was occurring in the global economy that required such precipitous changes in domestic public policy.³⁷ This response to globalisation analysis was particularly popular in Canada where the legacy of Canadian political economy had sensitized scholars to the historical continuities of international economic dependency for Canadian development. Many wondered what was really “new” about globalisation.³⁸

Other studies attacked the basic ontology of globalisation. One set of arguments suggested that states themselves were key actors constructing globalisation.³⁹ While these works were more ambivalent about the meaning of globalisation for contemporary

³⁷ See for example, P. Hirst and G. Thompson, *Globalisation in Question*, (Cambridge: Polity Press, 1996), or, Linda Weiss, *The Myth of the Powerless State*, (Ithaca: Cornell University Press, 1998).

³⁸ See for example, Stephen McBride, *Paradigm Shift – Globalization and the Canadian State*, (Halifax: Fernwood Press, 2001).

³⁹ In the finance area see Eric Helleiner, “Explaining the Globalization of Financial Markets – Bringing States ‘Back In’,” *Review of International Political Economy*, 1995, 2(2), pp. 315-41.

state autonomy and policymaking, they nonetheless undermined the operationalization of the independent variable in first wave globalisation studies – the process was not about market forces and powerless states.

Others, working from a range of critical approaches, questioned the “economic determinism” of this approach to globalisation. Many suggested that globalisation needed to be thought of less as a narrow economic phenomenon, and more as an international social and ideological process in which explicit international political efforts were promoting the adoption of neo-liberal policy at the domestic level. Stephen Gill’s Gramscian approach to IPE was an early example of this kind of analysis. It offered an alternative interpretation in which globalisation was seen as a process of transnational class formation which involved both economic forces and ideological and social processes.⁴⁰ Much of the work in the “second wave” of globalisation studies has drawn on this understanding of globalisation.

2) Contesting the Dependent Variable:

More important were the critiques levelled against the reading of the dependent variable. Many studies empirically tested the link between globalisation and domestic policy change, often through “large N” comparative analyses.⁴¹ This work severely undermined the first wave understanding of globalisation as a wide range of studies illustrated that the direct one-way causality of the argument could not be sustained.

⁴⁰ Stephen Gill, *American Hegemony and the Trilateral Commission*, (New York: Cambridge University Press, 1990).

⁴¹ See for examples, Geoffrey Garrett, “Global Markets and National Politics: Collision Course or Virtuous Circle,” *International Organization*, 52(4), 1998) pp. 787-823, T. Iversen and T. Cusack, “The Causes of Welfare State Expansion: Deindustrialization or Globalisation?” *World Politics*, 52, 2000, pp. 313-49, or Hirst and G. Thompson. The list of examples here could be quite extensive. Because the economic globalisation hypothesis was so simple, it was an attractive target for falsification. Given the evidence it is now hard to argue that economic globalisation directly produces a list of predictable domestic policy choices.

Variations in public policy at the domestic level persisted and arguments for policy convergence had been overstated. However, scholars were loath to suggest that global market integration did not have a large impact on domestic policies. Rather, what was needed was either a new theory of globalisation itself (a re-specification of the independent variable) or, perhaps, a more specific understanding of how globalisation was transmitted or “filtered” through domestic politics, producing different kinds of policy outcomes in different settings. Both of these research strategies are being actively pursued in a second wave of globalisation studies.

“Second Wave” Globalisation Studies:

Given the empirical shortcomings of the first wave economic understanding of globalisation, subsequent work on the role of international factors in domestic policy processes has tended to assume that the effects of globalisation vary from one state to another (and increasingly, from one policy sector to another).⁴² The question is: how do we theorize this in a way which would enable us to predict policy choices at the national level?

Two approaches have emerged that seek to correct the deficiencies of earlier analysis. The first of these focuses on the problematic narrowly-economic understanding of globalisation. It suggests that globalisation needs to be understood more loosely as international economic, ideational, political, or social factors that have some sort of influence over what occurs at the domestic level. In particular, mainstream IPE approaches have taken an increasing interest in the role of internationally-disseminated “ideas” as an aspect of globalisation. Arguably this literature is simply “catching up”

⁴² William Coleman and Anthony Perl, “Internationalized Policy Environments and Policy Network Analysis,” *Political Studies*, September 1999, Vol. 47, Issue 4, pp. 691-709.

with what a whole host of “anti-globalisation” scholars from critical perspectives had long insisted was the case – that ideas, “hegemony,” “neo-liberalism,” or other transnational social phenomena were themselves important explanations of policy convergence.⁴³

In terms of financial services, the “transformational” analysis of globalisation embodies this kind of argument.⁴⁴ Transformationalist analyses see a more diffused system of governance as having emerged in which transnational political and social processes may affect policy choices at the domestic level.⁴⁵ This type of analysis is particularly evident in Canada in regards to the financial services industry. Tony Porter, for example, argues that despite hyper-globalists’ insistence that the “seamless” electronic movement of finance around the globe has eroded the power of states to regulate financial service industries, these transactions are actually governed by a web of formal and informal political institutions at the international level.⁴⁶ Thus the modern regulation of finance is a site of multi-level policymaking rather than a case of market forces reducing and supplanting political regulation. Porter, like others, argues that there has been a re-regulation of finance at the international level as a result of cooperation

⁴³ While the critical literature has always insisted that ideological factors are important in globalisation, it is an increasingly popular argument across IPE as a whole. A recent example of this is Ben Rosamond, “Babylon and on? Globalization and International Political Economy,” Review of International Political Economy, 10:4 (November 2003), pp. 661-671.

⁴⁴ Transformational approaches to globalisation are part of Held’s influential typology. See, David Held et al., Global Transformations: Politics, Economics and Culture, (Stanford: Stanford University Press, 1999).

⁴⁵ As an example, Philip Cerny seeing, “. . . globalization as a political phenomenon basically means that the shaping of the playing fields of politics is increasingly determined not within insulated units, i.e. relatively autonomous and hierarchically organized structures called states; rather it derives from a complex congress of multilevel games played on multilayered institutional playing fields, above and across, as well as within, state boundaries. These games are played out by state actors, as well as market actors and cultural actors. Thus globalization is a process of political structuration.” See, Philip Cerny, “Paradoxes of the Competition State: The Dynamics of Political Globalization,” Government and Opposition, 32, no. 2, (1997), p. 253.

⁴⁶ Tony Porter, Globalization and Finance, (Polity Press, 2005), p. 25.

amongst states. The intent of this kind of inquiry is to reconfigure globalisation as a political rather than simply an economic process.⁴⁷

While Chapter Two explores this question in detail, the point here is that many scholars now argue that these political processes of globalisation are more important than the market changes emphasized in first wave globalisation arguments.⁴⁸ However, such approaches, though highlighting problems with the way globalisation was originally theorized, are somewhat nebulous about globalisation's likely impact on domestic policy choices. For example, they do not explicitly respond to evidence of non-convergence in state policies in many sectors. Something is missing from this analysis. Re-theorizing the nature of globalisation does not in itself give us much ability to predict why states respond to globalisation differently. As will be suggested in Chapter Two, this type of inquiry will need to carefully specify the meaning of globalisation in a specific policy sector, or specify the *particular processes associated* with "globalisation" in a sector, if we wish to clarify its domestic policy implications. Most globalisation scholarship needs a more careful operationalization of globalisation as an independent variable.

Globalisation and Institutional "Stickiness" – The New Institutionalism:

The second major tendency in recent globalisation analyses has been to focus on explanations for sustained cross national variations in policy outcomes. This literature, borrowing from the insights of comparative politics, builds on lessons drawn from those

⁴⁷ Another example of this more political understanding of globalisation and finance in Canada is Randall Germain's work. See, "Globalizing Accountability within the International Organization of Credit: financial governance and the public sphere," *Global Society*, Vol. 18, no. 3 (July 2004).

⁴⁸ This analytical shift also has important normative implications. As Porter points out, understanding the political nature of globalisation is important because it reminds us that we could choose alternative regulatory goals and purposes in global finance – we are not simply the victims of uncontrollable global financial markets. Porter, *Globalization of Finance*, p. 16.

who falsified the first wave globalisation hypothesis. Since a range of comparative studies found non-convergence in public policy at the domestic level, this was taken to be evidence for the importance of domestic institutions in creating path dependent policy outcomes. Domestic institutions were more important than the homogenizing logic of international markets:

. . . all too often, the two sub disciplines ignore each others' results and arguments. While in IR it was taken for granted that new conditions had rendered the nation state's capacity to act impotent, and thus the focus was shifted to the necessity for strongly increased inter and supranational cooperation in order to make up for that loss . . . [comparative politics has]. . . demonstrated in a variety of studies that this loss is by far not as extensive as often presumed.⁴⁹

This evidence was taken to illustrate that the state is still very much the key site of governance.⁵⁰

One current trend in IPE scholarship is the attempt to bridge this gap by combining "societal-preference" based explanations for state behaviour in which the state is little more than a transmission belt for internationally-generated societal preferences, with "new institutional" approaches that examine the domestic structure of states as a possible explanation for eventual policy outcomes. The "internationalization and domestic politics" literature advanced by Milner and Keohane illustrates this kind of "combinational" analysis of the importance of domestic politics.⁵¹ From this perspective, the state is seen to be influenced by societal preferences which are influenced by globalisation, while at the same time the very structures and institutions of the state are

⁴⁹Andreas Busch, "The Resilience of National Institutions: The Case of Banking Regulation," in Schirm, Stefan A., ed., New Rules for Global Markets: Public and Private Governance in the World Economy, (New York: Palgrave MacMillan, 2004), p. 87.

⁵⁰See Weiss, or, Saskia Sassen, Globalization and its discontents, (New York : New Press, 1998).

⁵¹Robert Keohane and Helen Milner, eds. Internationalization and Domestic Politics, (Cambridge University Press, 1996).

seen to influence how those preferences are organized and how much impact they will have on policymakers.

For example, Thomas Risse-Kappen argues that society-based models of state preferences have tended to reduce the state to little more than a “transmission belt” of domestic political preferences. Some liberals, heavily influenced by a kind of superficial pluralism, have assumed that the state neutrally reflects some aggregation of societal interests.⁵² Some Marxist IPE scholarship does likewise, emphasizing the degree to which state policy is determined by the dominant interests of societal elites.⁵³ In some sense the state is “theorized away” and we are left with an extreme anti-statist perspective that is at the opposite end of the spectrum from traditional realist accounts which assume the state is a concrete and rational actor.

To avoid this, the majority of contemporary liberal and Marxist approaches to international politics tend to combine societal-based preference assumptions with some sort of notion that state institutions themselves pre-shape the political opportunity structure of domestic politics and thus have a deep impact on policy outcomes.⁵⁴ Many in IPE recognize the need to think about the interaction between internationalization, societal preferences and state institutions.

⁵² Helen Milner’s early work on trade negotiations illustrates this kind of straightforward, “pluralist” understanding of how actors’ preferences vis a vis a globalised economy were unproblematically assumed to direct the decisions of policymakers. See Helen V. Milner, Resisting Protectionism: Global Industries and the politics of International Trade, (Princeton University Press, 1988).

⁵³ See for Example, Samir Amin “The Challenge of Globalisation,” Review of International Political Economy, 3 – 2, Summer 1996, pp. 216-59.

⁵⁴ This is an argument made by Risse-Kappen in his influential edited volume, Bringing Transnational Relations Back In, (Cambridge University Press, 1995). See also, Peter Gourevitch, “Squaring the Circle: The Domestic Sources of International Cooperation,” International Organization, 50-2, Spring 1996, pp. 349-73; and Andrew Moravcsik, “Taking Preference Seriously: a Liberal Theory of International Politics,” International Organization, 51, Autumn, 1997, pp. 513-53.

In fact Benjamin Cohen notes that most case studies in IPE have attempted, in an often problematic and haphazard fashion, to blend the consideration of societal preferences with institutional factors when interpreting policymaking.⁵⁵ Keohane and Milner's work was an attempt to bring some sort of synthesis to what scholars were already doing. Keohane and Milner attempted to combine analysis of how internationalization alters the mix of societal preferences in different policy sectors, with a "new institutionalist" analysis of how different domestic structures "filter" societal preferences before producing policy outcomes.⁵⁶ Thus, they provide us with a methodologically clearer interpretation of globalisation and public policy which brings American liberal IPE much closer to critical perspectives.⁵⁷

Thus, contemporary IPE scholarship increasingly encourages us to look to domestic politics for explanations of state behaviour and policy responses to globalisation. It suggests that while international systemic level change may be a crucial factor in driving public policy, we need to pay much closer attention to how those structural factors play themselves out in the societal preferences of actors and domestic political institutions. Comparative public policy accounts have reached similar conclusions. Much comparative work on economic policy suggests that regulatory

⁵⁵ Benjamin Cohen, "The Political Economy of International Trade," *International Organization*, 44, (1990), pp. 261-281.

⁵⁶ See Geoffrey Garrett and Peter Lange, "Internationalization, Institutions and Political Change, in Keohane and Milner, eds. *Internationalization and Domestic Politics*, (Cambridge University Press, 1996), pp. 48-78.

⁵⁷ As James Caparaso noted more than a decade ago, what Gramscians like Robert Cox and Stephen Gill ultimately wanted to tell us was that societal preferences, be they ideologically or materially based, emerge from global class relations and are manifested at the domestic level affecting the trajectory of state policy. See, James Caparaso, "Global Political Economy", in Finifter, ed., *Political Science, The State of the Discipline II*, (Washington, APSA, 1993), pp. 451-81.

environments follow a path dependent pattern in which we should not expect any rapid convergence in regulation across all states as a result of globalisation.⁵⁸

This blending of domestic public policy institutional accounts with IPE perspectives of how globalisation may alter domestic interests is undoubtedly a step forward from the early analysis of globalisation. Theoretically, this offers something to fill the middle box of Figure 1.1 (“domestic politics”) that plays an intervening role in how globalisation may influence policy outcomes. In practice, it could overcome the empirical problems generated by persistent evidence of non-convergence in many policy areas. Convergence is inhibited by path dependent outcomes generated by existing institutional arrangements.

There are, however, a number of shortcomings to this approach as well. First, evidence of different policy outcomes can only be explained by institutional “stickiness.” There seems little scope in such a method for explaining policy change, a critique often made against new institutional approaches. Nor does the approach offer much scope for sectoral variations in adaptation to globalisation, as national institutional settings are not clearly specified for particular policy sectors in this literature. In short, the approach is still crude.

There is a need for middle level, or “meso” models of policymaking, drawn from public policy scholarship, that allow us to consider both the importance of institutional settings *specific to a policy sector* and processes associated with globalisation in explaining domestic political struggles and policy patterns. One way to pursue this is

⁵⁸ Michael Howlett and M. Ramesh, “Globalization and the Choice of Governing Instruments: The Direct, Indirect, and Opportunity Effects of Internationalization,” *International Public Management Journal*, 9(1), 2006, p. 6. For an example in the financial services sector, see, Susanne Lütz, “Convergence within National Diversity: The Regulatory State in Finance,” *Journal of Public Policy*, 2004, 24, 2, pp. 169-197, p. 170.

through the “policy networks” literature - an approach that has much to offer IPE scholarship on globalisation. Elmar Rieger and Stephan Leibried in Limits to Globalisation suggest such a path. They argue that the first phase of globalisation scholarship amounted to little more than a discourse “about the future” and, as such, it eschewed deep empirical analysis of how policy was actually being made in favour of some sense of how it would (or should) be made in the future.⁵⁹ Instead they argue that the goal should be to explore the substance of policymaking, where globalisation is an important context, rather than to simply test a prematurely “iron clad” theory of globalisation. They advocate the development of a “social science of globalisation,” rather than a theory of globalisation, through detailed case studies concerned only with “the facts” of each sector.⁶⁰

III) Developing a Model - Globalisation and Policy Networks:

A clearer model of how globalisation affects public policy is needed. This is particularly evident in the case of the Canadian financial services sector, where a domestic politics “re-regulation,” or “re-politicisation” of the sector, despite global pressures towards deregulation and liberalization, suggests fundamental problems with the existing literature on the subject. While globalisation may have played a role in encouraging Canadian policymakers to deregulate and liberalize the industry, since 1998 domestic political interests have succeeded in reasserting some domestic political control over the industry. This “u-turn” requires an approach to globalisation that can explain

⁵⁹ Elmar Rieger and Stephan Leibried, Limits to Globalisation, (Blackwell, 2003), p. 1.

⁶⁰ Ibid., p. 2

not simply path dependent “stickiness” due to existing institutions, but that can also explain *redirections* in policy.

Policy networks analysis offers insights into why such redirections in policy might occur and therefore provides a way in which globalisation might be integrated with domestic institutional analyses:

Coinciding with the growing impact of globalization on public policy making, but not usually linked to it theoretically, has been the development of policy network and policy community concepts. These constructs grew out of theoretical debates in the 1970s and 1980s about the nature of governance and the properties of state-civil society relations. Initially centered around the concept of corporatism, these debates also sought to explain empirical findings showing changes in governance patterns. Specifically governance structures that take the form of relatively stable sets of private and public organizations that negotiate in a horizontal, coordinating manner have been discovered in a growing number of investigations of the policy process. Public authorities increasingly deal with corporate actors possessing a well-developed power base rather than with an amorphous public or with broad groups like social classes.⁶¹

While networks analysis will be explored in some detail in Chapter Three, a few points are worthy of attention here. First, from a policy networks perspective, domestic policy outcomes are largely driven by *domestic processes*. This is not to deny that globalisation has an influence in policy outcomes. Rather, globalisation may deeply affect the kind of demands actors make: it simply suggests that the most important policymaking site is domestic.

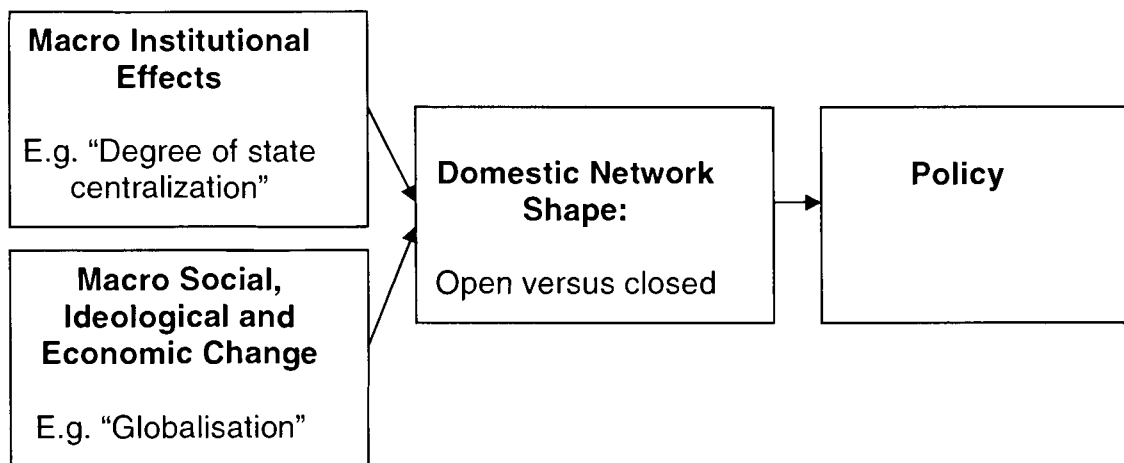
Second, as suggested above, the networks literature does not investigate domestic politics as a whole. It focuses on the relationship between key state institutions and actors that have influence or power in a particular policy sector. As such it has similar concerns to theories of political economy that emphasize the power of elites. Indeed,

⁶¹ Coleman and Perl.

David Marsh sees political economy approaches to policymaking, like pluralism, elite theory, and Marxist theories of state-society relations, as supplying hypotheses for networks analysis about what kind of state-society relations we should expect. The “policy network” is seen as a policy-area-specific way to understand these kinds of state-society relations.⁶²

Third, as will be discussed in some detail below, policy networks analysis links policy change with changes in network “shape.” Shape measures the range of actors involved in a policy sector combined with their access to real influence. Network shapes, how “open” or “closed” they are to actors, change over time, contributing to changes in policy. In turn, network shape is affected by both exogenous macro social and economic forces (like globalisation) operating across society as a whole, which may increase the strength of some actors in relation to others, and by domestic institutional factors, which may increase or decrease the scope for new actors to influence policy (See Figure 1.2).

Figure 1.2: Macro-level Factors and Network Shape



⁶²See “The Development of the Policy Networks Approach,” in D. Marsh ed., Comparing Policy Networks, (Philadelphia: Open University Press, 1998).

In a broad sense, returning to Figure 1.1 (the economic globalisation hypothesis), networks analysis provides us with something more nuanced to put in the intervening box of “domestic politics.” Domestic political processes in a specific sector are generalized through the “meso level” policy network. Similarly it allows us to draw on new institutionalist understandings of how existing institutional structures may affect policy outcomes. Most importantly, the approach does not lead us to believe that macro-social processes like globalisation will produce uniform policy choices at the national level. Instead, policy outcomes are subject to political struggle within a policy network, and responses will vary given both the broader institutional structure in which those networks operate and the structure of the network itself. In order to predict policy outcomes, detailed knowledge is required, both of the particular domestic policy network as well as how macro influences, like globalisation, interact with it.

Other scholars have noticed the potential of networks analysis in “internationalized” policy sectors like financial services. William Coleman’s study of the financial services sector is illustrative of many of the strengths of networks analysis. Coleman suggests that the domestic politics of financial services regulation has traditionally been subjected to a unique “esoteric politics,” in which large financial firms work informally with the government, behind closed doors, to regulate the industry and set policy. In Canada, this had led to a “closed” policy network dominated by the big banks and the Department of Finance:

Policy communities were exclusive, often dominated by financial services firms themselves, and highly informal. Understandings rather than agreements were reached, customs were favored over statutes, and most matters were considered to be ill-suited for discussion in cabinet or in the legislature.⁶³

⁶³ Coleman. Financial Services, Globalization and Domestic Policy Change, p. 4.

Coleman argues that since globalisation strengthens the economic position of leading FSPs and makes the industry even more complicated to regulate, it would further entrench the kind of closed-door esoteric politics of the past. Coleman sees this as a “new esoteric politics.” Because of this dynamic, ultimately globalisation would mean a decreased role for domestic politics and the state in setting policy goals in the sector. Globalisation would “close” the policy network to other social constituencies ensuring the political dominance of leading FSPs. Thus while Coleman argues that states have responded to globalisation differently, given different domestic institutions and existing policy frameworks, ultimately he suggests that globalisation has contributed to a “limited democracy” in the sector.⁶⁴

Unfortunately Coleman’s study, which included Canada, was conducted long before the events of 1998 and thus may have overestimated the robustness of esoteric politics. Given the subsequent evidence of a backlash in the wake of the 1998 mergers question, and the sustained epistemic uncertainty over the direction of policy, we need to re-evaluate the interaction of globalisation and esoteric politics. In this case, globalisation, working through domestic institutional settings, has contributed to the “re-politicisation” of the sector.

In fact, two recent studies, one by Coleman himself, offer important clues about what has been occurring inside the Canadian financial services policy network. First, Michael Howlett’s policy networks analysis illustrates a massive change in the number of participants in the federal banking policy network in the decade between 1987 and

⁶⁴ Ibid., p. 10.

1997.⁶⁵ Howlett suggests that this change correlated with substantial change in overall policy goals. This is a valuable supplement to Coleman's earlier work. Coleman's esoteric politics framework places a great deal of emphasis on network structure. While Coleman concludes that the policy sector was still closed to all but the most powerful of financial services companies, he does suggest that within the policy community, changing membership between the "sub-government" and the "attentive public" (an "inner" and "outer" circle) of the policy community may be illustrative of changing power relationships.⁶⁶ These factors could provide us with crucial insights into the current politics of the sector. Indeed, the central empirical observation of this dissertation is how the policy network changed subsequent to Coleman's work and what lasting effect that has had on policymaking. The dissertation will argue that there were shortcomings in the "esoteric politics" model of the policy network that require re-assessment if we are to understand the events subsequent to Coleman's work in 1996. As Chapter Three argues, Coleman provides us with a starting place for thinking about policymaking in the era of globalisation, but given recent events more attention needs to be paid to the institutional legacy of deregulation in the 1980s and how it has laid the groundwork for a new politics of financial services in Canada.

In fact, Coleman's more recent work has focused on precisely these kinds of institutional considerations – how the changing regulation of the sector since 1990 has had an impact on the distribution of powers between the federal and provincial governments. Coleman argues that the changes engendered by globalisation and

⁶⁵ Michael Howlett, "Do Networks Matter? Linking Policy Network Structure to Policy Outcomes: Evidence from Four Canadian Policy Sectors, (1990-2000)", *Canadian Journal of Political Science*, 35:2 (June 2002), pp. 235-267. See Chapter Six, Table 1, for evidence of this network expansion.

⁶⁶ Coleman, *Financial Services, Globalization and Domestic Policy Change*, p. 12.

deregulation have strengthened the role of the federal government relative to the provinces.⁶⁷ The effective centralization of jurisdiction over financial services by the federal government is an extremely important explanation for policy developments in the sector. While the federal government saw centralization as a necessary response to globalisation, ultimately its failure to create a central overarching regulator of the industry has meant that Parliament has been left residually responsible for some aspects of regulation. As a result, Parliament and partisan politics have become more important in policymaking in the sector than might have been expected.

Understanding the new politics of financial services in Canada thus requires us to pay close attention to both the changing nature of the policy network and to the post-deregulation institutional context of this sector. Both of these factors have contributed to the “re-politicisation” of the sector. Ultimately this thesis argues that the initial response to globalisation, the *ad hoc* program of deregulation in the 1980s, radically reconfigured the domestic institutional context of the policy network. This, in turn, contributed to an unintentional “opening” of the policy network which has allowed new actors, actors opposed to further deregulation in the interests of the big banks, to have greater access to policymaking. This has re-politicised a previously closed policy network.

Deregulation – Centralization and the Role of Parliament:

The system of pillarization divided FSPs by jurisdiction, with the federal government exclusively overseeing the banking industry, while much of the insurance, mortgage and trust, and securities industries were subject to provincial jurisdiction. De-

⁶⁷ William Coleman, “Federalism in Financial Services,” in Bakvis and Skogstad eds., Canadian Federalism: Performance Effectiveness and Legitimacy, (Oxford University Press, 2002), p. 184.

pillarizing and allowing different FSPs into other sectors effectively eroded the divide between jurisdictions, creating considerable confusion, “Once embarked along these policy paths, Canadian policy-makers would come to face broader questions about the very governance of financial services, questions that promised to add to frictions already existing between the federal and provincial levels of government.”⁶⁸

Prior to 1998, federal-provincial frictions in financial services tended to work to the benefit of deregulation, as government jurisdictions in Canada competed to attract the financial service industry. However, as deregulation progressed, more and more focus on policymaking fell on the federal government. Where once there had been a federal “banking policy sector,” increasingly there has been a national “financial services policy sector.” In Chapter Three it will be argued that this has helped stall deregulation since 1998, because the major effect of the collapsing of federal and provincial jurisdictions has been to increase the number of interests involved in federal policymaking. More actors have a stake in federal government policy than was the case in the past, eroding the basis of the cosy “esoteric politics” relationships.

Deregulation has also expanded the role of Parliament in this sector. In the past, policymaking in the sector, as in most other countries, had been the isolated preserve of major financial services companies and key state agencies. The sector was thought to be too complex or too important for Parliament and the public to play a role. However, since deregulation, a major struggle has emerged between the banks and the government over Parliament’s role in overseeing this sector.

This was most apparent in the struggle over the 1998 mergers, but it remains an important institutional context. Ultimately, the merger proposals were evaluated in an

⁶⁸ Coleman, *Financial Services, Globalization and Domestic Policy Change*, p. 205.

“*ad hoc*” or unprecedented way, as there was no established policy process for evaluating a merger proposal between two of Canada’s largest banks. The mergers would obviously require some sort of review by the Competition Bureau and the Office of the Superintendent of Financial Institutions (OSFI), but it was unclear how the government and the finance minister would handle the ultimately-political decision of approving or rejecting the mergers. The government would have to make this decision in the midst of significant parliamentary activity on financial services in relation to the *MacKay Task Force Report* and the subsequent parliamentary investigations. In the end, Parliament, supported by widespread public hostility and a range of new network participants, played a key role in rejecting the mergers.

Since 1998, one persistent political context for the merger question has been the struggle between the banks and the government over defining the process of evaluating such mergers. The banks, embittered by their encounter with the House of Commons and anti-bank groups, have sought to minimize the direct role of Parliament. They have struggled to reduce “political interference” in the sector. The government, on the other hand, has crafted new rules that expand the role of parliamentary committees in evaluating the public interest in any mergers between big banks. The outcome of this struggle is still in question; however, it remains a crucial factor in explaining events in the sector. The expanding role of Parliament is an important institutional development which helps explain why deregulation has stalled since 1998. Parliament has been an important access point for groups normally excluded from the policy process.

Other studies of this sector underplay the importance of these institutional factors, either because they emphasize globalisation, or because they believe that esoteric politics

was inevitable in such a complex sector. Following deregulation, the altered jurisdictional divide and the expanded role of Parliament have created ideal conditions for an expansion of the policy network to include groups which had been excluded from serious federal policy deliberations in financial services.

Networks analysis, by drawing our attention to the importance of the macro-institutional context in which a specific policy subsystem operates, draws our attention to the factors that explain the “re-politicisation” of financial services in Canada. The IPE-new institutional literature offered by Keohane and Milner explains continued variation in domestic policies as being somehow path dependent. However, in this case, policy change has ultimately been generated by the unintended institutional consequences of a poorly planned and *ad hoc* program of deregulation.

Evidence of the central importance of domestic politics and institutions in the Canadian financial services sector suggests that the study of globalisation must move in the direction suggested by institutionalist and networks analyses. The study of globalisation and its impact on policy requires the combined contributions of both international studies and comparative politics. However, because of the analytical separation of these disciplines and the different models they propose for explaining state behaviour, it has been difficult to bridge the gap.⁶⁹ Much work remains to be done, despite the huge interest in the topic. The policy networks approach has much to offer. It provides important analytical correctives to the problems that other approaches to globalisation have encountered, provides useful insights into likely policy responses in any sector, but most importantly, it offers a useful guide to understanding what has

⁶⁹ For an incisive discussion of this question, see Busch, “Divergence or Convergence?”

occurred inside the Canadian financial services sector over the last decade. Policy networks insights offer a first step toward an improved “social science of globalisation.”

IV) Method and Plan of the Work:

This project analyzes the Canadian financial services policy network through actor-centred institutionalism.⁷⁰ The approach focuses on how actors’ interests and strategies are defined by the institutions and structures in which they operate, and also focuses on how institutions determine who has access to policy influence. The policy networks approach used here attempts to link macro level considerations like globalisation with institutional factors like federalism and the role of Parliament. In turn these “macro” considerations are linked to public policy decisions through the meso level notion of a policy network. The “policy network” is a heuristic device which clarifies arguments about how these macro structures may affect the policymaking environment in which actors find themselves and how these structures contribute to policy outcomes. The approach suggests that through deep empirical examination of a policy sector we can discover who has influence and thus make predictions about the likely direction of policy. As such, good networks analysis requires clear empirical demonstrations of the relevant actors and their policy orientations. Only then can we theorize things like network “shape” and predict the course of policy.

This study draws on the existing secondary source literature on this sector, particularly in regards to the older “esoteric politics” period of financial services policymaking. The study is also based on an extensive examination of the available

⁷⁰ See, Fritz Scharpf, Games Real Actors Play: Actor-Centered Institutionalism in Policy Research, (Westview Press, 1997).

primary sources; government documents, reports, and consultations, as well as press accounts. To further illustrate the claims made for a new politics of financial services over the last decade, fourteen interviews were conducted with key members of this policy network. They include government ministers, senior bureaucrats in the relevant state agencies, Members of Parliament, Senators, leading lobbyists and officials from major financial services companies. Particular attention has been paid to participants who had been involved in the sector for over a decade and who played a role in important policy struggles.

The Plan of the Work:

Section One: “Globalisation, Policy Networks, and Financial Services”

The first section investigates the possible impact of globalisation on the financial services industry and develops a policy networks model and hypotheses for this sector. Chapter Two operationalizes the independent variable of globalisation, examining all of the processes associated with globalisation in this sector. It summarizes the broad market changes that have occurred in the industry since the 1970s. It also explores international political efforts to promote deregulation and liberalization in the sector, demonstrating how international organizations became important sites for influencing the thinking of domestic policymakers about the regulation of financial services. The chapter’s major argument is that globalisation is a multifaceted phenomenon. However, while an important “backdrop” supporting arguments for deregulation, globalisation did not directly require specific policy changes at the national level.

Chapter Three develops a policy networks model of globalisation and policy change. The chapter suggests there are two hypotheses about policy change in this sector, one drawn from Coleman's "esoteric politics" analysis and another that pays closer attention to the legacy of deregulation. Ultimately, the esoteric politics analysis, by underemphasizing the institutional impacts of deregulation and centralization in Canada, fails to explain events from 1997 onwards. Deregulation, through largely unintended consequences, has loosened the grip of Canada's big banks on the direction of policy.

Section Two: "Canadian Financial Services Reform in an era of Globalisation – Esoteric Politics"

Section Two, covering the "old politics" of financial services, examines the "deregulatory period" up to the 1998 mergers debate. It demonstrates the value of Coleman's "esoteric politics" approach in understanding the initial responses to globalisation. The section explores the transition to the universal bank policy paradigm, the big banks' "esoteric" hijacking of deregulation and the resulting conglomeration in the sector. It highlights the government's failure to develop a comprehensive regulatory structure in response to deregulation. This oversight has meant that residual regulatory concerns, such as the level of industry conglomeration, were left to Parliament to oversee. The section lays the groundwork for the subsequent argument that the growing array of groups attempting to influence policy in the 1990s, all opposed to further powers for the big banks, in combination with Parliament's residual role in regulating the sector, ultimately undermined esoteric politics.

Chapter Four summarizes the original deregulatory policy changes - the 1987 revisions of the *Bank Act* which signaled the shift from pillarization to universal banking in Canada, known as the Mulroney Government's "little bang." Illustrating the banks' domination over this process, it also argues that events were influenced by debates about "globalisation," and by federalism which provided proponents of deregulation with multiple opportunities to pressure governments into a more radical set of policy changes.

Chapter Five provides an overview of the politics of de-pillarization after the "little bang," arguing that the banks were the major beneficiaries of policy outcomes during the period. The 1992 *Bank Act* changes, the government's response to financial difficulties in the sector, the insulation of policymaking from other constituencies, and government support of massive industry conglomeration, all illustrate the closed "esoteric" relationship between the banks and federal agencies in the decade after securities deregulation.

Section Three: "Canada's Backlash Against Esoteric Politics"

Section Three explores the "new politics" of financial services arguing that the policy network has "opened" to new actors. This has led to a more confused set of policy struggles at the expense of the previously pervasive influence of the banks.

Chapter Six explores the emerging sources of opposition to the closed policymaking environment of the financial services sector following deregulation. It argues that the institutional legacy of deregulation, general public and parliamentary antipathy for the banks, and growing opposition to the banks' policy agenda from small business and the insurance industry, were all important challenges to the status quo.

Taking advantage of improved access to the policymaking process, many new groups entered the policy network and undermined esoteric politics.

Chapter Seven explores the collapse of the esoteric politics of financial services as a result of the bank mergers question. The chapter illustrates that in 1998 the network clearly expanded. Parliamentary committees became crucial in evaluating the mergers, and a host of “anti-bank” constituencies were able to influence policy, ultimately forcing the government to reject the merger proposals.

Chapter Eight illustrates the legacy of the 1998 bank mergers decision. New and somewhat surprising policy goals have replaced the government’s earlier obsession with producing a small number of globally competitive “universal banks.” The government has committed itself to expanding domestic competition (at the expense of the “big banks”), increasing consumer protection and bank public reporting, establishing a formalized parliamentary merger review process, while at the same time withholding any further deregulation. The major implication is that domestic politics and political struggles are now more important than was the case in the deregulatory period.

The concluding chapter draws these complex elements together, synthesizing what this case says about theories of globalisation, about the utility of policy networks analysis in a globalised policy environment, and about the likely trajectory of policy over the next few years.

SECTION ONE: “GLOBALISATION, POLICY NETWORKS, AND FINANCIAL SERVICES”

CHAPTER 2: “GLOBALISATION AND FINANCIAL SERVICES: OPERATIONALIZING THE INDEPENDENT VARIABLE”

“There is already widespread anxiety about the “democratic deficit” that accompanies globalization – the degree to which decisions are made in international institutions that appear remote and unaccountable to the average citizen. The large disparities in wealth and knowledge that are associated with global finance make the democratic deficit in this area especially troubling.”

Tony Porter, (2005).¹

I) Introduction:

Initial analyses of globalisation suggested that the information technologies revolution, in combination with the emergence of offshore financial centres, created powerful economic pressures and incentives for states to liberalize and deregulate their financial services industries. This chapter also explores international political efforts to promote deregulation and liberalization. It illustrates how international organizations became important sites for reconfiguring the way domestic policy makers thought about the regulation of financial services. The chapter documents efforts to liberalize “trade in services” and explores how this particular understanding of the changing nature of the financial services industry promoted new domestic policy paradigms that would encourage liberalization and deregulation. It also explores international efforts to harmonize prudential banking regulation to facilitate globalised finance. In short, this chapter illustrates the various ways in which processes associated with globalisation may have strengthened the demands of Canada’s banks’ for domestic deregulation.

¹ See, Globalization and Finance, (Polity Press, 2005), p. 10.

Many of the early “first wave” studies of globalisation saw changes in policy and political arrangements, such as domestic deregulation, or increased emphasis on international prudential oversight, as being driven by direct, inexorable market forces:

There are innumerable variants of this prevailing model among both critics and supporters of integration, including liberal economists who applaud neoliberal political restructuring, carried out at the international and domestic levels in response to global market pressures, protesters who fear that powerful economic actors favoring market integration will seriously undermine the capacity of states to protect vulnerable citizens, or older political theories of integration, such as functionalism, that saw political authority as arising unproblematically from transborder transactions or from collaborative functional projects.²

While many were also critical of this view, particularly those who rejected the economically-deterministic analyses of first wave globalisation studies from the outset, it was nonetheless a popular analysis in the study of financial services. Conventionally, as a result of increased mobility of capital since the 1960s and 1970s, most analysts of the financial services industry have assumed that intensified global market competition and changing technology gradually forced a liberalization and deregulation of the industry at the domestic level.³ The emergence of unregulated, and often tax free, offshore financial centres as well as increased competition from major metropolitan financial centres, aided by the advent of improved communications technology, created new challenges for policy makers. In order to ensure the competitiveness of Canada’s national financial services firms, state policy makers were “forced” to deregulate the industry, normally by

² Heather McKeen Edwards, Tony Porter and Ian Roberge, “Politics or Markets? The Determinants of Cross-Border Financial Integration in the NAFTA and the EU,” New Political Economy, vol. 9. No. 3, September, 2004, p. 325.

³ See for discussion, Laura MacDonald, “Going Global: The Politics of Canada’s Foreign Economic Relations,” in Wallace Clement, Understanding Canada, (McGill-Queen’s University Press, 1997), pp. 172-96, or Michael Howlett and M. Ramesh, “Globalization and the Choice of Governing Instruments: The Direct, Indirect, and Opportunity Effects of Internationalization,” International Public Management Journal, 9(1), 2006, p. 6.

allowing financial service providers to offer an ever-wider array of services and to pursue widespread industry conglomeration and internationalization.

Conversely, some scholars, seeing globalisation as a transnational social and political process, have emphasized the role of states and of international political arrangements in paving the way for such market forces. From this perspective, the increased “exit options” provided to firms seeking to avoid domestic regulation was the result of states’ international political efforts to remove barriers that had kept domestic financial services industries relatively isolated in the Bretton Woods era. Not only had states created a system of bilateral tax treaties that made the existence of offshore financial centres viable, but the competitive “metropolitan” abandonment of capital controls in the 1970 and the subsequent market deregulations of the 1980s made globalised financial markets possible.⁴ States are seen as the “mid-wives” of globalised finance. Britain, Australia, Canada, Denmark, Finland, New Zealand, Norway, Portugal, and Sweden all engaged in “preemptive” deregulation of financial markets in the 1980s to lure business to their jurisdiction. These moves obviously facilitated the deepening of global financial markets.

Others emphasized political explanations for globalised finance, highlighting international regulatory cooperation. For example, international agreements, in particular the World Trade Organization’s General Agreement on Trade and Services (GATS), by prompting states to engage in regulatory harmonization along neo-liberal lines for the

⁴ See for example of this line of argument Eric Helleiner, States and the Re-Emergence of Global Finance. (Ithaca: Cornell University Press, 1994).

purposes of freeing “trade” in financial services, promote an internationally-integrated market.⁵

Both the economic and political interpretations of the contemporary deregulation and liberalization of financial services emphasize “second image reversed” understandings of the process. Global forces, be they technologically, market, or politically based, have driven policy at the domestic level.⁶ They tend to downplay the importance of domestic politics, institutions, and policymaking in contributing to the global trend in financial services reform. They deploy globalisation as an independent variable which drives contemporary domestic policymaking at the national level, while each offering a competing conception of just what globalisation “is.”

Problematically for the study of globalisation, these competing understandings of globalisation, and how it affects policy at the national level, blur the analytical clarity of the concept, rendering it too vague to deploy as an independent variable in this kind of study. While it is possible to choose one particular conception of globalisation and, on that basis, test a deductive theory of globalisation, this work will proceed in a different direction. Rather than arguing about whether globalisation is economic, political or ideological, this study seeks to identify the different processes associated with

⁵ Examples of this argument are almost too numerous to recount. One notable early exploration of the role of international agreements in entrenching neo-liberal policies domestically can be found in Leo Panitch, “Rethinking the Role of the State,” in James Mittelman ed., Globalisation: Critical Reflections, (Lynne Rienner Publishers, 1996), pp. 83-116.

⁶ International relations scholars, when attempting to explain the causes of conflict and cooperation amongst states developed three “images,” or interpretations, of why states would come into conflict. The first image focused on the innate shortcomings of man, the second on the internal failings of states (which caused them to act irrationally in relation to one another) and the third image was that of international anarchy which generated collective action problems for the possibility of cooperation amongst states. See Kenneth Waltz, Man, the State and War, (New York: Columbia University Press, 1959). When the study of globalisation emerged, scholars noted that it focused on the second image, but in a reversed fashion. Rather than looking at how the internal structures of states impacted the international system, this scholarship focused on how the international system altered the internal operations of states. See Peter Gourevitch “The Second Image Reversed: the International Sources of Domestic Politics,” International Organization, 32:4, Autumn 1978.

globalisation in this sector. Examining the range of processes involved in internationalizing financial services policy deliberations will more clearly operationalize globalisation's effect on domestic policymaking.

In fact, in practical terms it is difficult to separate the economic and political processes. Political efforts to remove national restrictions on globalised finance along with efforts to internationally coordinate the prudential oversight of banks are closely intertwined with, and essential to, the deepening of global markets. Globalisation needs to be understood more broadly.

Along these lines, Michael Howlett and M. Ramesh, seeking to clarify just how "globalisation" might affect domestic policy instrument choice encouraging deregulation, argue that the process has three potential effects. It has direct effects, such as policy changes required by international trade agreements; indirect effects, such as policy spillovers from other jurisdictions as new ideas or beliefs spread around the world; and opportunity effects, as it may serve to open "policy windows" by altering power relations amongst domestic actors, which create more opportunities for domestic actors to advance their particular demands for policy change. While much of the attention of globalisation scholarship has been on its direct effects, Howlett and Ramesh argue that it is really the indirect and opportunity effects of globalisation that should draw our attention. By reinforcing general belief in the desirability of more market-based regulatory instruments, and by increasing the number of "opportunity windows" for policy entrepreneurs to drive policy change in self interested directions, globalisation can have significant impacts on domestic policy.⁷ As a result, Howlett and Ramesh argue that the explanation for changes in the pattern of policy outcomes should focus more on domestic policy processes since

⁷ Howlett and Ramesh, pp. 9-10

indirect and opportunity effects have no direct causal outcome on how states are likely to respond to globalisation.

Analysis of financial services suggests that this is the case. While there are some “direct” effects of globalisation in this sector, the indirect and opportunity effects are more important. Globalisation’s major impact has been in the way it has promoted ideas and beliefs supportive of deregulation, while at the same time increasing the size of financial services providers, thereby potentially strengthening their position inside domestic policy struggles. Indeed, as this chapter illustrates, globalisation is really about the internationalizing of domestic policy debates. These involve the degree to which arguments about the development of global markets on the one hand, and the progress of ideologically-motivated trade negotiations on the other, affect political struggles over the direction of policy. If globalisation is to be understood as an independent variable driving policy outcomes, ultimately it is interpreted and struggled over at the domestic level.

II) Global Market Developments in the Financial Services Industry:

The globalisation of investment banking and the trading of securities and new financial instruments undoubtedly “tipped” the balance in domestic policymaking circles towards those interests arguing for deregulation. This prompted a worldwide impetus towards policy reform in the 1980s and 1990s. The globalisation of finance and the financial services industry, though historically stretching back decades, only became a serious challenge to domestic regulatory structures after the breakdown of the Bretton

Woods system of capital and exchange rate controls in 1972.⁸ Since then, governments in a variety of jurisdictions have removed capital controls, exchange rate controls, interest rate restrictions, and have removed barriers to foreign banking and securities dealing, while also sanctioning the trading of a variety of new financial instruments like derivatives. These policy changes by governments seeking to either attract new business as emerging deregulated “financial centres,” or to protect their existing status as important financial centres, combined with “. . . advances in computer technology allowed the exploitation of arbitrage opportunities on a world-wide scale. By the early 1980s, cross border flows of capital had reached enormous volumes, and issuance and trading of securities on international markets burgeoned.”⁹

Aided by supportive governments like the Thatcher Conservatives in Britain, who were eager to ensure London’s importance as a key financial marketplace, and by technological changes, these markets grew rapidly in scope, generating collective action problems for the regulation of financial industries. Indeed, the unregulated nature of these markets encouraged both a proliferation of new financial instruments and contributed to international banks’ penchant for increased lending relative to reserves and bank equity. Both of these phenomena created additional risks for global finance in the absence of improved international prudential regulation.

⁸ Arguably the “globalisation of finance” has a much older history, dating back to the emergence of capitalism and European imperialism. However, in common parlance the “globalisation of finance” is generally thought to have begun some time in the late 1960s as the system of capital and exchange controls established after WWII (ensuring that finance was a predominantly “national” game) began to break down. The establishment of “Euromarkets” for US dollars developed rapidly as international investors and firms sought increasingly creative ways to escape national regulation of finance. See, Porter, *Globalization and Finance*, p. 7. While it is true that the Bretton Woods system was leaking badly prior to 1972 and a number of jurisdictions had begun to situate themselves as deregulated financial centres where multinational financial services companies could escape domestic regulation and oversight, the rush to abandon exchange and capital controls after 1972 intensified this problem.

⁹ See, Susanne Lutz, “Convergence Within National Diversity: The Regulatory State in Finance”, *Journal of Public Policy*, 2004, 24, 2, p. 175.

These developments also meant that financial services firms increasingly had to compete globally for the more mobile aspects of the business. While basic banking services, for example, remained a largely domestic market, insurance, the issuance and promotion of securities, and investment banking became globalised. In turn, global competition made firms sensitive to the regulatory burdens they faced in the domestic marketplace:

Market actors may use their opportunities for broadening their sphere of activity to circumvent public policies that would impose regulatory costs on them. European banks for instance, used their exit-options in the early 1970s to evade the creation of expensive capital reserves as risk buffers by building credit pyramids in less regulated markets abroad. A pessimistic scenario suggests that states, while competing for the most mobile segments of capital, lower their standards of safety regulation and end up in 'regulatory races to the bottom'.¹⁰

This dynamic creates increased domestic pressure for deregulation from financial service firms facing new competition. This could result, as globalisation scholars have assumed, in policy change. At the very least, it increased domestic attention to demands for deregulation. Furthermore, it undoubtedly made the sector more complex for national regulators.

The Processes of Financial Services Globalisation:

While there are numerous schemes categorizing the changes occurring in the industry, Geoffrey Underhill argues that there were really three important market changes

¹⁰ Lutz. "Convergence Within National Diversity," p. 169.

occurring in the period; transnationalization, the increasingly international-orientation of firms; marketization, the increasing scale of firms; and market desegmentation.¹¹

Transnationalization:

In terms of transnationalization, one major observation about firms' behaviour over the last thirty years has been the migration of banking assets, as a percentage of the total assets, from leading industrialized countries to offshore financial centres.¹² Firms, seeking lower taxes, or the absence of regulation, took advantage of the opportunities provided by these centres to base their international banking activities outside the home country's jurisdiction. There can be little doubt, given the spectacular growth of such centres and the assets held there, that most major financial service providers were involved in this process.

Far from being a story about the unstoppable development of markets, however, it is important to recognize that the availability of these "exit options" was in part the result of states' international political efforts to remove barriers that had kept domestic financial services industries relatively isolated. As Tony Porter argues, transnationalization was potentially slowed by the risk of doing business in an unregulated environment where firms did not have ongoing relationships with other firms. These risks extended to the industry as a whole as new products were often poorly understood and the Less Developed Country (LDC) debt crises threatened the stability of some very large financial services firms. These risks had to be alleviated by international efforts to construct a more robust international banking regime that could deal with increased

¹¹ See the introduction to Geoffrey Underhill ed., The New World Order in International Finance, (London: MacMillan, 1997), pp. 1-13.

¹² See for a discussion, Tony Porter, States, Markets and Regimes in Global Finance, (St. Martin's Press, 1993), pp. 53-54.

transnationalization. The result was the Basle-based effort to develop new international standards for capital adequacy.

Marketization and Scale:

Marketization and the increased scale of firms, Underhill's second category of industry change, was a logical consequence of transnationalization. As firms increasingly competed for business internationally, differences in scale prompted a competitive "bigger is better" dynamic in international finance. Larger firms could make larger loans, or underwrite larger share offerings, and had economies of scale. Larger firms also had the ability to be active in many financial centres and markets, taking advantage of a wider array of permissive environments around the world.¹³

Problematically, in unregulated international financial markets there was no agency to prevent reckless conglomeration and industry concentration as there was in most domestic regulatory settings.

Desegmentation:

Perhaps more important was the process of desegmentation, sometimes referred to as "securitization" of banking, or "disintermediation." Banking was traditionally seen as a form of intermediated finance, in which the bank assumed the risk of lending to a borrower, without risking depositors savings. The bank "intermediated" between borrowers and lenders. Investment dealers or securities firms facilitate direct lending, in which investors supply capital directly to borrowers, through "disintermediated" finance. In this case the risk is borne by the investor.

¹³ Porter, in *States, Markets and Regimes in Global Finance*, p. 83, argues that the data suggest that since 1983 firms have gotten larger relative to the size of the total international market suggesting they had become more concentrated or oligopolistic.

In the 1980s, banks' major corporate customers, those seeking investment funds, found they could obtain lower cost capital through investment dealers and other kinds of financial service providers who were often located "offshore." This occurred at the same time that large depositors, also taking advantage of new kinds of financial instruments, found they could get higher rates of return by avoiding domestic banks.¹⁴ This was partly because those financial service providers, freed from regulatory restrictions, had competitive advantages over nationally regulated banks. Also, they were better placed to take advantage of interest rate differentials around the world.¹⁵ This dynamic brought domestically regulated banks into direct competition with such firms.

There is a "domestic markets" aspect to desegmentation as well. At the level of basic consumer banking and financial services, the 1970s and 1980s also ushered in a proliferation of the kinds of instruments FSPs offered to consumers. These also tended to desegment the domestic market, despite regulatory rules such as Canada's system of pillarization. For example, as insurance companies began to aggressively market their own mutual funds to ordinary consumers, these became a popular savings instrument, competing with and potentially supplanting bank savings deposits. Thus, although globalisation is often confusingly used interchangeably with all of the market changes occurring in this industry, some of the changes had little to do with globalisation *per se*.¹⁶

Banks responded to these pressures, not only by demanding domestic deregulation to improve their position against both domestic and international

¹⁴ See Theresa Morris, "Bank Mergers Under a Changing Regulatory Environment," Sociological Forum, Vol. 19, No. 3, September 2004, pp. 435-463.

¹⁵ Interest rate volatility and globalisation encouraged depositors to "shop around." Porter, States, Markets and Regimes in Global Finance, p. 95.

¹⁶ Coleman alludes to this when he suggests that "globalisation" has been rendered imprecise by the way all deregulatory market and policy changes are clustered with the concept by participants of this sector. See Coleman, "Federalism in Financial Services," in Bakvis and Skogstad eds., Canadian Federalism: Performance Effectiveness and Legitimacy, (Oxford University Press, 2002), p. 182.

competitors, but also by “going offshore” themselves, establishing subsidiaries where they to could offer a wider array of financial instruments at lower cost to these clients. Most importantly, banks “securitized” their lending, offering commercial clients the same types of investment instruments as other kinds of FSPs. Taking advantage of the lax regulatory structures of offshore financial centres, banks entered the securities business directly to try to maintain their market shares. In the 1980s international securities dealing began to dwarf the scale of lending in international markets.¹⁷

As a result it became increasingly hard to differentiate “international banking” from the “international securities” industry. This also meant that large multinational banks, like Canada’s federally-chartered banks, offered services outside of Canada that the system of pillarization prevented them from offering domestically. This made pillarizaion seem anachronistic to both industry participants and regulators. The process of international disintermediation, closely related to transnationalization and marketization, was perhaps the most important change occurring in the financial services industry.

Increased complexity:

Finally, it is important to note that these market changes also increased the technical complexities of banking. The nature of bank’s international operations, and the financial instruments they offered, not only stretched the knowledge basis of bankers themselves, but certainly created new challenges for national regulators trying to keep up with developments in the industry. Stephen Harris, a former Department of Finance official, argues that in practice financial services regulators “do only what is doable.”

¹⁷ Porter, States, Markets and Regimes in Global Finance, pp. 95-96.

Often aspects of international finance are beyond the technical capacity of government agencies to understand.¹⁸ Porter argues that “global finance” increasingly entailed a gap between “experts,” most often in the industry; and those affected by problems of global finance such as the world’s poor, or anyone whose relationship with finance is not necessarily “beneficial.” This “complexity gap” is also a major effect of the globalisation of finance, challenging state capacity to regulate the industry.

The dominant interpretation in domestic policy debates was that these trends required domestic deregulation and liberalization, particularly if a state wanted to promote its major financial centre. States that did not provide more permissive environments to global financial service firms would lose firms and sectoral employment as the industry abandoned that jurisdiction.

The Scope of Financial Services Globalisation:

Most data suggests that there has been some convergence in financial markets particularly since 1990, meaning that a globally integrated financial service market has emerged.¹⁹ Studies have suggested that internationally, industry concentration has been going up, and that “interest rate spreads” (the difference between the rate paid to depositors and that paid by borrowers) have been going down, which usually means a market is becoming more competitive, and that international bank profits have been declining as a measure of return on assets (at least in the 1980s and early 1990s). This suggests intensified competition. While skeptics of globalisation note that interest rate

¹⁸ See. “The Globalization of Finance and the Regulation of the Canadian Financial Services Industry,” in G. Bruce Doern et al., Changing the Rules: Canadian Regulatory Regimes and Institutions, (University of Toronto Press, 1999), p. 366.

¹⁹ See Porter. Globalization and Finance, p. 8. Or, Lothian, 2002, p. 710.

differentials persist such that the market is not “globally-integrated,” Porter argues that by the 1990s quantitative data demonstrated increased competition as a result of globalisation. Indeed, he argues that the data underplay the full scope of global competition faced by banks since they fail to consider the effect of securitization and competition from non-banks.²⁰ Porter argues that this evidence of globalisation helps to explain intensified international efforts to strengthen the global regulatory regime after the 1980s. States were losing the ability to regulate the international aspects of the industry without international cooperation. However, it does beg the question as to whether market trends associated with globalisation can be separated from international political processes that created the conditions by which this could occur in the first place.

III) Globalisation’s “Political Face” – Altering Policy Paradigms:

Globalisation involves active political struggles to change dominant policy paradigms. Scholars who move beyond economic accounts of globalisation note that the territorial expansion of economic activity, transmitted through domestic political institutions, has stimulated “. . . an increasingly dense network of interstate collaboration in matters of financial regulation.”²¹ In Europe the EU has undertaken many initiatives to coordinate the regulation of financial services. Internationally, the Bank of International Settlements, the Basle Committee for Banking Supervision and the Group of Ten have all attempted coordination of state policymaking and harmonization in the sector. These efforts have tended to focus on matters of prudential regulation as a response to the “exit options” which make it possible for banks to escape *needed* regulation. Analysts have

²⁰ Porter, *States, Markets and Regimes in Global Finance*, p. 92.

²¹ Lutz, “Convergence Within National Diversity,” p. 175.

often concluded that these processes have been driven by domestic regulators' interest in improving industry oversight as well as their own influence over domestic reform.

However, economic globalisation, by expanding the ability of firms in one country to provide financial services to clients around the world, has also generated opportunities for some governments to seek economic advantage by removing restrictions on that type of activity. International cooperation and coordination of financial services policymaking is not simply prudential. Rather, it has also, in the guise of trade policy, been aimed at liberalization by removing barriers to foreign service providers.

The "political" face of globalisation primarily manifests itself in two areas: cooperation amongst regulators to improve international prudential oversight, and the trade regime efforts to remove domestic barriers to foreign entry in the financial services sector. Indeed both supporters and opponents of deregulation and free markets see these efforts as part of a two pronged strategy to promote globalised finance.²²

a) State Efforts to Promote Globalised Finance:

Most accounts of globalisation in this industry focus on seemingly mysterious technological and market changes. Others have emphasized the political basis of these changes by emphasizing the degree to which ultimately states made this happen.

"Domestic governments retracted exchange controls, dissolved former price and interest rate cartels, lowered access barriers for foreigners to banking activities and stock exchange membership and allowed financial innovations to be traded."²³ Some leading

²² Proponents of globalization see both strategies as vital in "promoting a more efficient, and yet safe," financial system. Sydney J. Key, "Trade liberalization and prudential regulation: the international framework for financial services," *International Affairs*, 75, I, (1999) pp. 61-75.

²³ Lütz, "Convergence Within National Diversity," p. 175.

states pursued competitive deregulations out of national self interest, creating new competitive pressures for other states. Later, these same states, the United States and Britain in particular, used international trade liberalization processes to try to force recalcitrant states to open their financial services markets to global firms. The globalisation of finance has been closely intertwined with, and supported by the power of dominant states in the international system.

Indeed many influential works in IPE have emphasized the degree to which states, perhaps irrationally and perhaps struggling with collective action problems, promoted the globalisation of finance for what they perceived to be self interest. Susan Strange, Eric Helleiner, and Phil Cerny have all emphasized the degree to which globalised finance was driven by past state choices.²⁴ These studies argue that whatever pressures global finance places on domestic policymakers now, at some time in the past it was states that let this “genie out of the bottle.” They focus on the events that ultimately undermined the post war “embedded liberal” system of finance established by the Bretton Woods system and they tend to emphasize globalisation as a struggle between market forces and state authority. The question is whether state authority could now be sustained or recouped.²⁵ While these debates are well advanced elsewhere, and are important correctives to

²⁴ See, respectively, Susan Strange, Casino Capitalism, (New York: Blackwell, 1986), Eric Helleiner, “Explaining the Globalization of Financial Markets: Bringing the State Back In,” Review of International Political Economy, 2, no. 2, (Spring 1995), pp. 315-341. and. Phil Cerny, “Embedding Global Financial Markets: Securitization and the Emerging Web of Governance.” in K. Ronit and V. Schneider eds., Private Organizations in Global Politics, (London: Routledge, 2000). Such accounts invariably note the way in which powerful states, like the US and UK, have acted to advance global markets at key junctures, notably in the British creation of the Euromarket for US dollars which undermined the effectiveness of capital controls in other countries.

²⁵ While these studies argue that it was states that “let the “genie out of the bottle” and are thus to blame for their contemporary “powerlessness” to regulate financial services, some studies go further. Several studies argue that even now states are hardly powerless in the face of these changes and could chose to regulate banking and finance more thoroughly if they wished. See for example, Ethan Kapstein, Governing the Global Economy: International Finance and the State, (Cambridge University Press, 1994).

conventional emphasis on markets as the drivers of financial globalisation, it is less recognized that international political efforts to promote global market integration are ongoing. Powerful states, supported by influential multinational corporations, or vice versa, continue to use international political processes to remove barriers to global market integration and, as a side effect, promote domestic financial services deregulation around the world.

“Trade in Services” Liberalization and Financial Services Deregulation:

Since 1970 powerful transnational corporate interests allied with the United States Trade Representative (USTR) have succeeded in recasting financial services as a tradable commodity. Where once domestic financial services industries had been regulated with an eye towards purely domestic concerns such as the trade-off between ensuring sufficient capital versus the prudential security of depositors and investors, the growing acceptance of the application of trade theory to financial services meant that the industry was increasingly seen as a new locus of job creation and export potential. To governments and trade negotiators, the industry was seen as a dynamic creator of high paying jobs which could offset the loss of manufacturing employment. Domestic deregulation and conglomeration were seen as policies that would help foster large financial services as “national champions” creating jobs in the industry through servicing large global markets from what had been small domestic financial services centres.

These efforts to recast financial services and liberalize barriers to foreign service providers have been kept separate from international efforts to coordinate prudential

regulation.²⁶ Led primarily by the US, but seconded by many other countries, including Britain and Canada, a dense web of international trade agreements has emerged to promote the removal of investment barriers in industries like financial services. The Canada US Free Trade Agreement (CUSFTA), the North American Free Trade Agreement (NAFTA), The WTO, General Agreement on Trade In Services (GATS), the WTO Financial Services Agreement (FSA, 1997) and the abortive Multilateral Agreement on Investment (MAI) all have contained provisions aimed at reducing barriers to foreign financial services firms. These negotiations, and the ideas behind them, have also helped alter the dominant domestic policy paradigms governing the sector, such as the traditional system of pillarization in Canada. They have worked to support deregulation, either through international trade agreements or, more rapidly through voluntary, competitive deregulation and, more importantly, domestic conglomeration.

Background on Trade Negotiations:

In the 1980's, responding to what would later be called "globalisation," multinational corporations argued that services could be traded internationally like goods, and that barriers like domestic service sector regulation should be eliminated via multilateral negotiations. In the drawn out Uruguay Round of the WTO, advocates of services liberalization attempted to use GATT norms to force states to deregulate their service sectors. By including services in the GATT framework, the industry would be subject to the various non-discrimination standards, which would preclude states' rights to offer different treatment to domestically owned firms – something that is commonplace in financial services. While the GATS did not immediately produce

²⁶ Key, "Trade liberalization and prudential regulation."

massive liberalization, it did formally institutionalize services into the GATT framework. Arguably, it has redefined individual governments' powers to regulate their service economies as subsequent negotiations, and dispute resolution interpretations of the GATS have deepened the impact of the agreement.²⁷ It has also legitimated regional trade agreements' inclusion of services (and in particular, financial services) as both CUSFTA and NAFTA included financial services measures.

Conceptualizing international exchanges in services as "trade in services" represented a radical redefinition of these activities. Cross border service industries had been regulated internationally for decades. But the industries involved shipping, transportation, communications, banking, financial services, business services, insurance, and an array of consulting industries, which were not seen as "trade" or as a single economic sector. Instead, they had been regulated on an industry-specific basis through sectoral international regimes like the International Maritime Organization (IMO) and the International Telecommunications Union (ITU). Decidedly anti-liberal, these regimes sought to protect state control over important aspects of domestic economies. This was particularly the case in regards to financial services. States were:

. . . more concerned about maintaining control over entry of foreign services than they [were] with regard to entry of manufactured goods because market access for services generally involves the right of foreign firms to establish subsidiaries and to enter into open competition with national firms. This, of course, [was] anathema to states that want[ed] to assure certain market shares for national firms.²⁸

Redefining and then liberalizing trade in services also challenged existing material interests. By undermining states' ability to set autonomous regulatory policy goals, trade liberalization could force domestic service sector companies to compete with

²⁷ Weiss, *The Myth of the Powerless State*.

²⁸ Zacher and Sutton, *Governing global networks*, p. 214.

international firms for their domestic market shares. One might have expected that companies with protected national monopolies in the service sector, such as chartered banks, phone companies, and cable television services would have opposed this. States, ever-jealous of their ability to autonomously manage their economies could have refused to surrender control over critical service industries. One might have anticipated that trade negotiators, justifiably suspicious of a radical new discourse on “trade in services,” might want more time to assess national interests. However, none of this transpired. Instead, there was a high level of agreement on the perceived benefits of liberalization that reflected growing adoption of this paradigm at the domestic level.²⁹

The Trade in Services “Argument”:

Throughout the post-war period there was little interest in liberalizing services trade. Demands for liberalized rules of establishment and investment in foreign markets were largely ignored.³⁰ Geza Feketekuty, often given the title of “the father of trade in services” for his role within the United States Trade Representative's office in promoting the issue, argued that this was an increasingly problematic view as a revolution in communications and transportation technology was expanding the scope for transborder service exchange. This revolution had made international exchange in services analytically the same as merchandise trade and it should therefore be covered and

²⁹ The level of consensus supporting service trade liberalization is extremely difficult to explain from conventional IPE theories that assume actors pursue self interested policies. Indeed, it seems to provide evidence of the ideological or “hegemonic” face of globalization and modern capitalism, as support for projects like this seems simply derivative of omnibus commitments to global neo-liberalism. In the past I have suggest the utility of Gramscian approaches in explaining these kinds of developments. See, Russell Alan Williams, “Liberalizing “Trade in Services””: Ideas in International Political Economy” in Stephen McBride, Laurent Dobuzinskis, Marjorie Griffin Cohen and James Busumtwi-Sam eds. Global Instability: Uncertainty and New Visions in Political Economy, (Dordrecht, Netherlands: Kluwer Academic Publishers, 2002).

³⁰ Pascal Petit, Slow Growth and the Service Economy, (London: Frances Pinter, 1986), p. 107.

liberalized under the GATT and regional trade agreements.³¹ This basic "trade in services argument" or discourse played a crucial role in paving the way for a series of international trade agreements covering financial services and has also influenced policymakers' perceptions of the desirability of domestic deregulation.

It should be noted that from the outset, the "trade in services argument" was problematic. Most international exchanges in services were *not* analytically similar to trade in goods. There are also significant functional differences between types of service transactions which make a sectoral definition extremely difficult. Theoretically, technological change has made some types of international exchange in services more likely, but a revolution in the volume of such trade had not occurred prior to international efforts to promote liberalization.³² Generally the production and consumption of a service occur simultaneously and the producer and consumer must interact with one another.³³ Goods, on the other hand, can be produced, stored and transported across borders. Traditionally, international trade liberalization agreements have focused almost exclusively on removing barriers to this type of transaction, and it is to this type of exchange that trade theory has been applied. Trade in services is more complex.

While most service transactions require the physical proximity of producers and consumers, unlike trade in goods, some do not. Some services can be produced in one country, often can be stored and then transported to consumers without the need for the producer to have some sort of establishment in the foreign country. For example, a firm

³¹Geza Feketekuty, International Trade in Services - An Overview and Blueprint for Negotiations, (Cambridge: Ballinger, 1988).

³²Williams, "Liberalizing Trade in Services," pp. 65-88

³³Deepak Nayyar, "The Political Economy of International Trade in Services," Cambridge Journal of Economics, Vol. 12, June 1988, p. 280.

in one country could perform data processing or accounting for clients in another country.³⁴

It is this type of service, sometimes referred to in official trade accounts as "separated services," as "other," or as "specialized" business services which advocates of liberalization drew upon. These services were theoretically traded like goods. However, when international negotiations on services began at the GATT in 1986, it was on international service transactions as a whole rather than just these "traded" services. This is important because, when discussion of "trade in services" fails to make this distinction, trade issues are conflated with investment. Indeed much of the trade in services argument can be seen as thinly veiled effort by multinational corporations to promote the removal of investment barriers to domestic service sectors.³⁵ In fact one of the most important targets was domestic financial services industries that were protected through domestic ownership restrictions excluding foreign investors. For example, since the 1960s Canada's *Bank Act* has barred foreign investors from controlling a Schedule I bank.

Advocates of liberalization argued that a massive globalisation of service sectors was occurring.³⁶ However, between 1970 and the early 1980s, prior to global political efforts to remove barriers to services, trade in services actually shrank in proportion to

³⁴ The list of actual services that can be transacted in this way is quite long, it includes: accounting services, legal services, advertising and marketing, engineering, architectural design, data processing, software design, and, most importantly, an array of banking and financial services.

³⁵ Williams, "Liberalizing Trade in Services," pp. 65-88. Many have noted that the argument promoting "trade in services" liberalization that emerged in the 1980s conflated discussion of "separated" business services (services that were in a sense internationally tradable with the more dominant pattern of international exchange in services in which service multinationals simply provided services in either countries through investment in a local subsidiary. See for example Magnus Bloomstrom and Robert E. Lipsey, "US Multinationals in Latin American Service Industries," *World Development*, Vol. 17, No. 11, 1989, p. 1770.

³⁶ For an example see Joan Edelman Spero, "Trade in Services: Removing Barriers," *PS*, Winter 1983), p. 17.

trade in goods.³⁷ In the US, which was both the largest importer and exporter of services, trade in services declined substantially in proportion to US trade in merchandise.³⁸ These statistics were disappointing to services advocates because they were based on the official Balance of Payments categorization of "trade in services." Statistically most of this was comprised of investment in foreign service firms rather than actual "trade."³⁹ In fact, while examples of trade in services were invariably drawn from those services which analytically have qualities like trade in goods, in the US real trade in services, as opposed to investment, equaled less than two percent of manufacturing trade prior to political efforts to remove barriers.⁴⁰ The data for the European Union and Canada are similar.⁴¹ Even the WTO secretariat has conceded that "trade in services" was "modest" in comparison to trade in goods.⁴²

Aside from the degree to which this underlines the questionable and value-laden claims made by the proponents of liberalization, the statistics on trade in services emphasize a low level of globalisation in service industries in the 1980s. Most service industries and most service firms were still organized on a national rather than transnational basis. The scale of transnational services trade was still dwarfed by domestic service industries. Prior to GATS negotiations only eight percent of services

³⁷ Nayyar, p. 285.

³⁸ Extrapolated from, United States Department of Commerce, National Income and Product Accounts of the United States, Volume 2, 1959-88, (Washington: Economics and Statistics Administration, Bureau of Economic Analysis, 1992), Table 4.1.

³⁹ Indeed, it is not even limited to foreign direct investment in service companies, but rather includes all foreign direct investment as well as payments on external debt – hardly "trade in services."

⁴⁰ Jonathan D. Aaronson and Peter F. Cowhey, Trade in Services: A Case for Open Markets, (Washington: American Enterprise Institute, 1984), p. 7.

⁴¹ See, respectively, Petit (p. 84); and, Table 1, Statistics Canada, Volume Estimates of International Trade in Business Services (Ottawa: National Accounts and Environment Division, 1991), p. 15.

⁴² World Trade Organization, The Developmental Impact of Trade Liberalization Under GATS, Job No. 2748/Rev. 1, 1999, p. 2.

were being traded across borders even when investment in foreign service subsidiaries was considered “trade.”⁴³

However, where there was globalisation in the service industry, it was the preserve of a handful of multinationals. Multinational service firms had grown rapidly in conjunction with the revolutions in communications technology of the last four decades. By the early 1980s, of the top 200 multinational corporations, 82 were primarily service exporters (either through trade in services or investment in foreign affiliates in other countries).⁴⁴ In the US, many service companies were:

. . . among the largest companies in the country. These firms [had] become far more conscious . . . of the advantage of influencing government policies that affect their ability to deliver services worldwide, and their rapid growth . . . [had] given them the clout to get attention from the government. Both business executives and government officials [were] thus more inclined than in the past to look to barriers in services as key commercial issues.⁴⁵

These included firms like American Express, Citibank, Pan American, Sea Land, AIG, AT&T, and EDS, many of them financial services companies. The concentration of services trade within a few companies was paralleled by a second factor, the concentration of service exports from even fewer nations. The US and UK dominated the sector.⁴⁶ The concentration of huge positive service trade balances in only a few states is markedly different from the situation of trade in goods. Yet there has been an overwhelming consensus in favour of liberalization of services and including financial

⁴³ Murray Gibbs, “Continuing the International Debate on Services,” *Journal of World Trade Law*, May-June 1985, p. 204. Although sectorally, since WWII, international banking grew more quickly than trade and domestic economies. See Tony Porter, *States, Markets and Regimes in Global Finance*.

⁴⁴ Frederick F. Clairmonte and John H. Cavanaugh, “Transnational Corporations and Services: The Final Frontier,” *Trade and Development: An UNCTAD Journal*, No. 5, 1994, pp. 27-28.

⁴⁵ Feketekuty, p. 40.

⁴⁶ For discussion see, Williams, “Liberalizing Trade in Services.”

services in trade negotiations. This was because the ideas of the “trade in services argument” appealed to some segments of the economy, particularly financial services policy networks.

The Trade in Service Argument – The Dissemination of Neo-liberal Globalisation in the Services Sector:

A small number of individuals and organizations played an influential role in promoting the view that service industries should be liberalized in order to promote the logic of comparative advantage. In 1968, Hugh Corbett established a new corporate-funded think tank in London, the Trade Policy Research Centre, to promote free trade. Believing that services were playing an increasingly important role in the world economy, he commissioned a study of trade in services and restrictions on that trade. This study was the “. . . starting point for much of the subsequent work in the field of services and the Trade Policy Research Centre . . . [has] played a key role in the development of international thinking on trade and investment in services since that time.”⁴⁷

At the same time, the OECD sponsored a task force to help set the agenda for the GATT Tokyo Round (often referred to as the Rey Group). The Rey report contained a short chapter on “trade in services,” thereby coining the term. Influenced by the work of the Trade Policy Research Centre, the report framed all of the crucial arguments that would guide thinking about the issue for years to come. It suggested that services were being transacted across borders, that these transactions were the same as trade in goods and should be liberalized in a similar fashion.⁴⁸

⁴⁷ Feketekuty, p. 296.

⁴⁸ OECD, Report of the High Level Group on Trade and Related Problems, (Paris: OECD, 1973).

This logic was immediately accepted in the United States. Since world trade in services was dominated primarily by a small number of US-based multinationals, the appeal of this analysis in US circles was obvious. US firms had the most to gain from liberalization and, given the US' already more lax regulatory barriers to international investment, little to lose. The first US company to promote liberalization was Pan American which had run into problems with host countries placing restrictions on their right to bid for national mail services.⁴⁹ Concerns like these were crystallized into a full-blown campaign for including services in the GATT's Tokyo Round by Ron Shelp, the vice president of American International Group (AIG).

Shelp recognized that policymakers, negotiators and business leaders would more readily support the logic of liberalizing trade in services if the idea were dealt with in the discursive limitations of trade policy:

Internationally, the predominantly Anglo-American analysts who first posed the issues established the terms of discourse to which other members later had to respond. The very act of defining services transactions as "trade" established normative presumptions that "free" trade was the yardstick for good policy against which regulations redefined as non-tariff barriers, should be measured and justified only exceptionally.⁵⁰

During the Tokyo Round little was accomplished. Most GATT participants did not take the argument that services were traded very seriously: "Without a shared causal belief that services were indeed tradable, it was impossible to discuss the question coherently, much less negotiate."⁵¹ However, echoing Shelp's realization of the importance of placing services within the bounds of the trade policy community, US negotiator

⁴⁹ Feketekuty, p. 300.

⁵⁰ William J. Drake and Kalypso Nicolaidis, "Ideas, interests, and institutionalization: "trade in services" and the Uruguay Round," *International Organization*, 46. 1, Winter. 1992, p. 40.

⁵¹ Drake and Nicolaidis, p. 47.

Feketekuty noted that Tokyo was important because, “. . . the motivation for all multilateral trade negotiations has been to liberalize trade and the whole intellectual framework that supports trade negotiations is based on the proposition that the reduction of trade barriers will generate economic gains . . .”.⁵² However, in light of the Tokyo Round, the first step would be to confront domestic policy paradigms that rejected the “trade” logic.⁵³

In the late 1970s Hank Greenberg, the president of AIG, was appointed to the Presidential Advisory Committee for Trade Negotiations which provided US trade negotiators with private sector advice. Greenberg kept pushing the USTR to take services more seriously.⁵⁴ At the same time, Feketekuty promoted the issue both as the USTR's representative on the OECD's Trade Committee and as a special counselor to the USTR. Indeed, he served as the US's *defacto* "house intellectual" on services. The USTR, spurred on by these early converts, gradually threw its weight behind service trade liberalization. It began to circulate a newsletter to those interested in the issue.

Prompted by business, the US Department of Commerce conducted the first comprehensive study of the issue, entitled U.S. Service Industries in World Markets. Most studies that have followed have merely restated its conclusions.⁵⁵ It argued that the main problem confronting international service companies was investment barriers which prevented them from owning affiliates abroad. While this only emphasizes the degree to which this was an investment issue rather than a trade issue, these contradictions were

⁵² Feketekuty, p. 200.

⁵³ Feketekuty boldly claims that he was actually the first to perceive the need for an international "intellectual campaign" to spread the trade in services gospel and that the success in getting services on the GATT agenda was directly attributable to this intellectual campaign.

⁵⁴ Feketekuty, p. 305.

⁵⁵ Steven F. Benz, "Trade Liberalization and the Global Service Economy," Journal of World Trade Law, 19, March-April, 1985, p. 101.

never explored. This study was thought to be further proof of the need for liberalization of "trade in services."

Efforts inside the government were supported by advocates in the private sector. Ron Shelp persuaded the US Chamber of Commerce to organize a services committee which could monitor the Government's commitment to liberalization in the sector.⁵⁶ His most important contribution, however, may have been his influential book, Beyond Industrialization, a thorough synthesis of the trade in services argument.⁵⁷ The book was the first to call for a new round of GATT negotiations on the issue.

American Express executives Henry Freeman and Joan Edelman Spero also became active, participating in conferences, publishing articles and lobbying officials to promote service trade liberalization. Spero, Freeman, and Shelp used their influence in a variety of business organizations and public policy research institutes to persuade them to launch research studies on trade in services.⁵⁸

Given the structures of international exchange in services it is not surprising that US multinationals played the leading role in disseminating the idea; however, they consciously tried to "internationalize" the campaign, encouraging international organizations, most importantly, the OECD, to carry out similar research. "These various activities shared a common characteristic, service issues were invariably presented in a trade context, using terminology and concepts borrowed from GATT and other trade

⁵⁶ Feketekuty, p. 305.

⁵⁷ Ronald K. Shelp. Beyond Industrialization: The Ascendancy of the Global Service Economy. (New York: Praeger, 1981).

⁵⁸ Feketekuty, p. 309. The organizations included the US Council of Foreign Relations, the National Foreign Trade Council, the Committee for Economic Development, the Conference Board, the Center for Strategic and International Studies, and the American Enterprise Institute.

agreements.”⁵⁹ In London, the Trade Policy Research Centre continued to play a leading role in promoting trade in services, organizing conferences around the world, “Studies sponsored by the Trade Policy Research Centre . . . provided a growing body of literature on trade in services that could be used as background material by governments when preparing their position on issues discussed in the OECD and the GATT.”⁶⁰ The International Chamber of Commerce also played an important role in promoting the issue by creating a services trade working group that announced its support of liberalization in 1981.⁶¹ A range of other international organizations joined the liberalization ranks, including the World Bank, the Centre for the Study of International Negotiations in Geneva, the Center for Transnational Corporations in New York, the Atwater Institute in Montreal, *Prométhée* in Paris, and the Services World Forum, a private support group headquartered in Geneva.⁶² Essentially, the international business associational system organizing service firms became a leading site of pro-liberalization arguments.

As events moved towards the Uruguay Round of the GATT, arguments about the need to liberalize trade in services mixed with and supported domestic arguments for deregulation of service industries. Essentially the logic of the trade in services argument supported domestic service companies’ increasingly neo-liberal arguments that unregulated service markets would improve domestic efficiency and competitiveness in an increasingly global economy. This was particularly the case in financial services where extremely powerful domestic firms confronted with threats to their business from technological change and the emergence of offshore financial centres demanded that

⁵⁹ Gibbs, pp. 199-200.

⁶⁰ Feketekuty, p. 310.

⁶¹ Ibid, pp. 310-311.

⁶² Ibid, p. 311.

national governments remove barriers to their competitiveness with foreign firms. As will be illustrated in Chapter Four, this was certainly an argument advanced by Canada's big banks.

The GATT Uruguay Round

Under the Reagan administration, William Brock became the United States Trade Representative USTR (USTR) and proceeded to take services far more seriously. Brock was instrumental in getting trade in services included in the 1982 GATT Multilateral Meeting, the first step towards inclusion in the Uruguay Round.⁶³ Various research programs were conducted along analytical lines and assumptions identical to those used by the early "organic intellectuals" or "policy entrepreneurs" in the private sector:

These assessments indicated that services liberalization might well invigorate a sluggish world economy, offset declining competitiveness and protectionism in goods markets, and yield gains for countries other than the United States. Governments began to reassess the parameters of their reticent stances, and the OECD ministers declared in 1981 that GATT negotiations merited further consideration.⁶⁴

As a result, the OECD produced a document that laid out the key principles that *could* serve as the foundation for a future trade regime for services, Elements of a conceptual Framework for Trade in Services. The document was not published until 1987, although work had been completed as early as 1981-1982. The paper's biggest "... achievement [had] been developing a conceptual framework for service trade modeled on fundamental GATT principles such as national treatment, which required that imported merchandise

⁶³ The incoming Reagan Administration, committed to more explicitly neo-liberal policies, was eager to pursue the liberalization of trade in services (See Gibbs, p. 200). Brock also promoted the idea of a bilateral trade agreement covering services with Canada.

⁶⁴ Drake and Nicolaidis, p. 51.

receive regulatory and fiscal treatment equivalent to domestically produced products, and transparency of regulations and rules affecting trade.”⁶⁵

Despite the support of the OECD, many felt that the US proposal to negotiate a deal was premature. The European Commission had just launched its own study of the issue and members were uncertain about their competitiveness in a liberalized service market. Led by Brazil and India, the Group of Ten (G10) rejected the US’s “conceptual claims” and argued that the GATT regime had no jurisdiction over services.⁶⁶ However the GATT kept the possibility of services negotiations alive by delaying a decision, calling for national studies of the issue to be presented at the 1984 meeting.

Once the GATT called for a study, governments consulted with domestic industry to determine the “national interest” in negotiations on services liberalization.⁶⁷ The US study for presentation to the GATT suggested overwhelming benefits from liberalization. Fifteen other countries (including Canada) and the EC Commission completed studies that reached the same conclusions. Essentially, after negotiators met with industry representatives, their positions shifted rapidly. They began to believe that they also might *gain* from liberalization.

The case of Canada, an early supporter of the US position, is illustrative of the importance of the trade in services argument in reconfiguring government perceptions of the service economy. Canada consistently had one of the largest deficits in international exchange in services. Despite Canada's poor performance and the potential vulnerability of many Canadian service industries, such as banking and financial services, from larger, more competitive US service companies, the Canadian study ideologically supported the

⁶⁵ Ronald K. Shelp, “Trade in Services,” *Foreign Policy*, 65, Winter, 1986, p. 72.

⁶⁶ For a discussion of the response to the US proposals see, Drake and Nicolaidis, pp. 52-53.

⁶⁷ *Ibid.*, p. 54.

idea of GATT negotiations on services. Canada was in perhaps the weakest position in services trade due to its physical proximity to the US, its largely shared linguistic community, and the fact that US service companies already had a strong foothold in Canada. In fact, cultural content laws and investment restrictions were perhaps the only thing preventing a full integration of the Canadian services market into the web of US service multinationals. Nevertheless, the Canadian government supported the US initiative.⁶⁸ The new thinking in and out of government circles was that a trade liberalization regime could stimulate the growth of an export capability in countries like Canada.⁶⁹ As we shall see this was an argument that Canadian banks were fond of making in support of domestic deregulation. Canadian policymakers came to believe that deregulation of barriers to foreign entry in the services sector was a good idea, and given changes in technology, politically inevitable. Thus, by the mid 1980s they began to prepare their service firms to compete internationally. Countries like Canada began to pursue strategies of “pre-emptive” deregulation, not only to lure business to their service providers, but also to ensure that national service companies would be large enough to compete with American service multinationals when barriers were finally removed by trade agreements. This was the one of the major logics behind the “little bang” deregulation of the financial services industry in Canada in 1987 (the subject of Chapter’s Four and Five of this thesis).

⁶⁸ It is interesting to note how the closed network of trade policy experts may have influenced Canada's national study on services trade. The Canadian government hired Rodney de C. Grey, a veteran Canadian trade negotiator to study the issue. He consulted Feketekuty, Murray Gibbs, Harold Malmgren, and Gary Sampson, all strong advocates of the trade in services argument, and it is therefore not surprising that his study affirmed the trade in services argument in its entirety.

⁶⁹ Drake and Nicolaidis argue this while discussing Japan, p. 57.

When the contracting parties re-convened in Uruguay in September of 1986, the consensus Declaration argued that services should be included because liberalization could advance the economic growth of all countries. Ten years earlier such normative agreement on services would have been impossible:

Governments would not have confronted this choice if new ideas had not emerged. True, there were by the mid-1970's powerful U.S. based TNC's that wanted greater freedom to sell services abroad in what were heavily regulated markets. But states could have managed these pressures by adopting regulatory rules on an industry-by-industry basis. It was only when analysts showed that diverse cross-border, transactions . . . had the common property of constituting "trade" that comprehensive liberalization on a pan-industry basis became an issue on the global agenda.⁷⁰

When this idea first arose in the Tokyo Round, governments had no idea whether comprehensive liberalization would be positive. "If anything their existing intellectual frameworks and material interests pointed in exactly the opposite direction . . . state institutions and organized social constituencies opposed to open competition were embedded deeply in domestic politics."⁷¹

Policymakers came to believe that services were traded, that they were being exported on a scale previously unheard of, and that, if liberalized, countries could benefit as the "hosts" of transnational service industries, by becoming a financial centre, for example. It was this change in basic world view that paved the way for GATT negotiations on services, the Financial Services Agreement (1997), the abortive Multilateral Agreement on Investment (MAI), regional trade agreements that included service provisions, particularly on financial services, and preemptive deregulatory policies. Indeed, while the Uruguay Round dragged on, the United States entered the Canada/US Free Trade Agreement, which included services and investment provisions,

⁷⁰ Drake and Nicolaidis, p. 38.

⁷¹ Ibid.

as a way to increase the pressure on other states to make the same concessions in the WTO framework.⁷²

Canada and Financial Services Trade Agreements - Domestic versus International Policymaking:

Two points need to be made about Canada's position on the various trade initiatives relating to financial services. One is that government policymaking in the sector often occurred in somewhat separate streams, as decisions regarding domestic industry deregulation and concentration were dealt with through the normal policy review process of the *Bank Act*, while policies regulating foreign entry were influenced by Canada's participation in international trade negotiations. The other important point is that trade initiatives around the liberalization of entry were largely deployed by Canada's banks as evidence in domestic policy circles that domestic deregulation was *necessary*. In private, the banks sought to ensure that the agreements did not undermine rules that protected and privileged their position in the Canadian market. In short, trade negotiations often served as hypocritical justifications for demands for domestic deregulation to "ready" Canada's banks for the onslaught of competition from the US, even if the agreements ultimately did not open the door to that competition.

At several junctures over the last two decades, while the *Bank Act* was being revised to allow major Canadian financial services companies the latitude to reorganize themselves, barriers to foreign entry into the industry were also under review. In 1989, under the terms of the Canada/US Free Trade Agreement, size restrictions on US-based foreign banks were removed, potentially allowing US banks easier access to the Canadian financial services market. In 1994, under the terms of the North American Free Trade

⁷² In particular, CUSFTA removed some restrictions on US bank's activities in Canada.

Agreement (NAFTA), the same consideration was extended to Mexican banks. At a broader level, in 1994, in the wake of the establishment of the World Trade Organization and the General Agreement on Trade in Services (GATS), member states began sectoral negotiations designed to liberalize barriers to financial services for all WTO participants.

The Canadian government, parallel to its own policy reviews of the domestic regulation of the sector, also consulted widely with the industry as to what Canada's position should be in the negotiations. These consultations were kept separate from other policy review processes in the sector and major decisions were poorly coordinated. This will be illustrated in Chapter Four in regards to the Mulroney era "little bang." Trade policy decisions often were made in isolation from other concerns, largely to Canada's detriment.

In fact, from the 1980s onwards, it was widely believed that increased foreign competition was coming to Canada via trade liberalization. While there has often been no direct legislative link between international agreements removing barriers to foreign entry and changes in the domestic regulation of the Canadian banking industry, the fact that such moves were occurring provided an important political backdrop. According to Canada's banks, the threat of increased foreign competition created by global services trade liberalization was one of the single most important motivating factors for their rush towards conglomeration and their demands for the right to offer more and more services domestically. The banks felt that without a massive program of industry conglomeration within Canada, they would be in a poor position to compete with the size and economies of scale of larger banks in the United States.

Thus despite the Government's support for a deregulated and competitive financial services sector, a consensus had emerged amongst many industry participants that increased competition, particularly from larger foreign companies, would inevitably require domestic consolidation to ensure efficiency through economies of scale. In the 1990s, industry experts argued that "bigger was better."⁷³ Overall, Canada's participation in international trade negotiations that might bind the Canadian government into allowing increased foreign entry were creating political pressure within the sector to allow greater conglomeration and industry concentration.⁷⁴ This was the context in which the big banks and the government would engage over the 1998 merger proposals and the deregulatory recommendations of the *MacKay Task Force*. The banks felt that their "super mergers" were the logical culmination of more than a decade of policy reform.⁷⁵

⁷³ Charles Freedman and C. Goodlet. "The Financial Services Sector: Past Changes and Future Prospects". Background Paper for the *Ditchley Canada Conference*, Toronto ON, 3-5 October 1997, p. 18. The process of deregulation was dogged by a tension between the governments' desire for greater market competition against companies' desire to confront increased competition with greater conglomeration, economies of scale and industry concentration. While the government, in its public announcements, sought to enhance efficiency in the provision of financial services by increasing the number of market participants, individual companies inevitably responded to this competitive pressure through a "bigger is better" strategy to take advantage of economies of scale.

⁷⁴ In fact, it is fear of increased foreign competition which makes bank officials and their lobbyists so bitter about the policy setbacks of recent years. In interviews they complain about how other jurisdictions have set their banks free to expand domestically, which has made them potentially more threatening international competitors, while the Canadian government has been moving far more slowly. One bank official suggested that the real problem in Canada was that the banks had "bet" on domestic deregulation and conglomeration as they best way to respond to globalisation, but that the government was not delivering on the promises that it made in the 1980s and early 1990's. Source: Confidential Interview, 2006.

⁷⁵ Opponents of the mergers saw them as a potential turning point which could serve to undermine the drive to increased competition in the sector. Indeed, the bank mergers' most cynical critics throughout 1998 and the ensuing struggle over the proposals argued that the banks, taking advantage of their privileged position in the market, were seeking to head off any competition that might reduce their record-breaking profits and force them to be more responsive to consumer and business needs. Thus the new deregulatory policy paradigm was being strained by two different policy demands. The banks supported industry conglomeration as a logical consequence of the government's embrace of globalisation, while "anti-bank" groups argued that such rapid conglomeration was undermining the very logic of deregulation.

In practice, the Canadian banks' position on service trade negotiations in the 1980s was generally supportive, provided that negotiations did not touch on core Canadian market protections. For example, the position of the Canadian Bankers Association (CBA) on trade talks ideologically supported the notions of deregulation and liberalization. However the CBA, which is dominated by the big five banks, recognized that the "widely-held" ownership restrictions on Canadian Schedule I banks acted to protect their market from larger US competitors. To enter the Canadian market in a serious way, a US bank could only establish a Schedule II bank (with limited privileges) and would have to painstakingly build up its own branch structure. Had the US ever seriously pursued removal of the "widely held" rule, the CBA would have been in a difficult position. However, since the US has not done this, the big banks have been able to support service trade liberalization, enjoying benefits of the agreements without giving up their privileged position in the Canadian market.⁷⁶

For example, early in the CUSFTA negotiations, the banks were somewhat ambivalent about the deal. Their support for the final package was not the most "zealous" in the business community, since, for example, the Bank of Nova Scotia emerged as a critic. To facilitate industry consultations, the Canadian negotiating team formed Sectoral Advisor Groups on International Trade (SAGIT's) to consult with each sector regarding their demands for the talks. When the financial services SAGIT was formed and it included representatives of foreign owned Schedule II banks, the "big five"

⁷⁶ A long serving lobbyist for Canada's banks noted that the US has never vigorously pursued anything touching the core interests of the big banks. Source: Confidential Interview, 2006. This of course stands in marked contrast to the banks' constant public rhetoric that globalisation, and the threat posed by US banks to the Canadian market requires expansion in their powers and privileges.

worried that their protected market would be “traded” at the negotiating table for gains in other areas.⁷⁷

The banks opposed the notion of applying national treatment and GATT principles to financial services, since it would reduce the Canadian government’s long-term ability to give differential treatment to Canadian banks versus foreign subsidiaries. However, Canada’s negotiators liked the entire “trade in services argument.” In their view:

. . . the banks were strong Canadian-owned institutions, capable of competing in world markets. They would gain from the greater economic growth that would result from the FTA. [The negotiators also believed] that the US was already more open to foreign banking than Canada and Canadian banks would simply have to give up some of their protection.⁷⁸

The banks also worried that the Mulroney government was less sympathetic to their concerns than the previous government had been.⁷⁹

In the end the negotiations were less far reaching. The US was primarily interested in removing restrictions on foreign involvement in the Canadian securities industry, and in removing some of the restrictions on Schedule II banks, so that American banking subsidiaries in Canada would have more privileges. As will be discussed in Chapter Four, Canada’s unilateral move in 1987 to deregulate the securities industry, under pressure from the provinces and the big banks, effectively removed that item from the negotiating agenda. This was a move that reflected the isolation of trade from financial service policy decisions. On the US side, the Treasury Department insisted that banking was too complicated to be handled through traditional trade negotiations. In the end, financial services were formally separated from the other talks

⁷⁷ G. Bruce Doern and Brian W. Tomlin, *Faith and Fear*, (Toronto: Stoddart, 1991), pp. 116-117.

⁷⁸ *Ibid.*, p. 117.

⁷⁹ *Ibid.*, p. 118.

at the Treasury's request so that they could handle the talks directly.⁸⁰ Perhaps as a result of the involvement of prudential regulators, the US did not aggressively pursue financial services. While the FTA did loosen rules on US-owned Schedule II banks, it did not touch the major barrier to entry in the Canadian market: the widely held ownership restrictions on Schedule I banks. The banks could therefore be comfortable with the final package. They stood to gain from a general lessening of restrictions on cross border services trade, but their core domestic activities were largely unaffected: the FTA did not pave the way for a large expansion of US bank operations in Canada. However, the banks used the negotiations as a justification for their demands that they should be allowed more powers domestically to prepare for US competition.

The important point is that international trade negotiations on barriers to foreign entry in the sector have been institutionally separated from other policy concerns. Domestic policy debates were often "responsive" to the threats posed by international liberalization. This has generally resulted in an increase in policy support for deregulation and conglomeration, viewed as necessary prerequisites for meeting "inevitable" foreign competition. Interestingly, the degree to which these international agreements have failed to result in massive openings to foreign competition in domestic financial services markets may in part explain why policy commitments have subsequently shifted.

Trade Agreements and Financial Services – Direct Effects:

It was argued immediately after the final WTO deal that "significantly more was achieved than most observers - including optimists - would have thought feasible in

⁸⁰Ibid., p. 159.

1986.”⁸¹ The World Bank suggested that high income countries scheduled about 45 percent of their service sectors while low and middle income countries as a group scheduled about 12 percent.⁸² Subsequent negotiations have expanded the WTO’s coverage, particularly in financial services, and expansion of GATS provisions has been a major agenda item for the current round of WTO negotiations. More importantly, however, the institutionalization of the *laissez-faire* norms of liberalization and deregulation into the GATT’s coverage of services has meant that policymakers will have to respond to these principles. Liberalization is now the privileged goal. This is clear in the case of the various WTO Dispute Resolution Panel decisions which have aggressively interpreted the scope and meaning of the GATS to give it wider effect than negotiators may have intended.⁸³

Much was made of this in the 1990s and the potential it posed for states’ regulation of domestic service industries in the future. Indeed, states took pre-emptive action to get ready for the “forced liberalization” that seemed inevitable. However, current analysis suggests that more may have been made of these agreements than was warranted. Certainly that is the case for the financial services industry. Specific examination of the trade agreements’ direct impact suggests that financial services are still somewhat inured to trade liberalization effects.

⁸¹ Bernard Hoekman, “New Issues in the Uruguay Round and Beyond,” The Economic Journal, (103). November, 1993. p. 1533.

⁸² Bernard Hoekman. “Assessing the General Agreement on Trade in Services,” in Will Martin & L. Alan Winters eds., The Uruguay Round and the Developing Economies, World Bank Discussion Papers, 307, (Washington DC: The World Bank, 1995), p. 327.

⁸³ See, Weiss and Scott Sinclair, GATS, (Canadian Centre for Policy Alternatives, 2000).

WTO Financial Services Agreement (1997):

Following the completion of the Uruguay Round and the negotiation of the GATS, advocates of service sector liberalization expressed disappointment that the agreement did not go further in forcing states to open up their service sectors to foreign investment. They succeeded in launching negotiations on a sub-agreement on financial services,

The FSA was designed primarily to create easier cross border access for banks and other firms selling financial services. By making it easier for multinational financial firms to open offices in foreign jurisdictions it facilitates FDI in the financial sector itself, and to the degree that such FDI facilitates cross border investment in other industries, it facilitates FDI in general.⁸⁴

Specifically the Financial Services Agreement (FSA) required that states create opportunities for foreign financial service companies to establish subsidiaries. Under the original GATS Agreement, Canada agreed to remove size restrictions, contained in the *Bank Act*, on foreign owned Schedule II banks. Since 1980, foreign banks had been allowed into Canada but they were forced to establish a Schedule II bank subsidiary which did not have the same powers as one of the Schedule I (“big”) banks, and were also limited in the total size of their activities. In itself, the fact that Canada lifted the size restrictions was not overly significant since Canada had already promised to do this for American-based banks under the terms of the CUSFTA, and eventually, for Mexican banks under NAFTA. During the FSA negotiations Canada was asked by negotiators to go further. Canada eventually agreed to introduce legislation that would create additional options for those wishing to establish branches in Canada (see Chapter Eight).

⁸⁴ Porter, Globalization of Finance, p. 97.

Although these may seem like significant concessions, the FSA is a relatively weak agreement. Not all WTO members were required to sign the agreement, the agreement allowed “extensive” national limitations on commitments, and national obligations vary considerably.⁸⁵ Some argue, however, that while the specific depth of the provisions is not substantial for most states, the real importance of the agreement is that it prevents “backsliding.” States, once committed, cannot introduce new rules that violate GATT non-discrimination rules without facing challenges through the WTO Dispute Settlement Mechanism. However, this would not be the case if any new restrictions violating non-discrimination had prudential motivations. The GATS-FSA contains a prudential “carve out” which protects states’ unilateral right to implement new measures for explicitly prudential reasons. States may sacrifice liberalization in the face of concerns about market safety. While any new regulation should be drafted in a way that is as non-discriminatory as possible, ultimately it would be up to the dispute settlement process to decide whether or not a new set of prudential regulations violated the agreement. Observers have noted that there is little concern in the prudential community about this as it is believed that it is relatively easy to distinguish between a new prudential measure and attempted “protectionism.”⁸⁶

Interestingly, Canadian negotiators have defended the notion that financial services should never be fully subject to trade provisions. Along with other national banking regulators, Canada has consistently insisted on language that preserves the

⁸⁵ Key, p. 64.

⁸⁶ Ibid., pp. 67-68.

prudential carve out.⁸⁷ NAFTA non-discrimination provisions in financial services are also mitigated by a prudential carve out.⁸⁸

In March of 2001, the WTO agreed to negotiate guidelines for an expansion of the GATS which in theory will further restrict national governments' ability to regulate domestic economic activity.⁸⁹ However, the current round is mired in controversy and it is not clear what impact it will have on the financial services industry.

North American Free Trade Agreement:

In the Canadian financial service sector more attention has been paid to NAFTA than to the concurrently negotiated GATS. This is understandable, given the size of American financial services companies and the threat they may pose to Canada's market if barriers to foreign entry are fully relaxed. In theory, NAFTA:

. . . offers a framework to reduce barriers to trade in financial services across North America. A Financial Services Committee has been created as a result of the Agreement and is supposed to oversee liberalization of the finance industry across the continent. That being said, the exact power and impact of this committee are debatable. Although the NAFTA is supposed to lead to the liberalization of the finance sector throughout North America, the movement towards market and regulatory integration is slow in coming. In both Canada and the United States, there remains important legislative and structural impediments to integration. The NAFTA is not as institutionalized as the EU, yet its existence does imply new policymaking considerations for member states.⁹⁰

⁸⁷ In regards to Canada's position on the carve out in the current WTO negotiations see, see Canada, Department of Finance, Canadian Initial Sectoral Negotiation Proposal on Financial Services, March 2001, http://www.fin.gc.ca/activty/G20/fininst/gatsprop_e.html, or, Canada, Department of Finance, Consultation Paper for the World Trade Organization Negotiations on Financial Services, June 2000, http://www.fin.gc.ca/toce/2000/wto2000_e.html

⁸⁸ Key, pp. 67-68.

⁸⁹ Sinclair, GATS.

⁹⁰ Ian Roberge, The Internationalization of Public Policy and Multi-level Governance: A Comparison of Financial Services Sector Reform in Canada and France, (Doctoral Dissertation. McMaster University, 2004), p. 42.

Indeed, despite widespread belief that the conjunction between high levels of US FDI in Canada and Mexico and the arrangements entered into under NAFTA would ensure rapid integration of North American financial markets, “. . . a closer examination reveals a stunning lack of financial integration.”⁹¹ For example, FDI in the financial sector is quite low, far lower than other economic sectors, and US ownership and investment in Canadian financial services has remained relatively stable despite NAFTA provisions.⁹²

McKeen-Edwards, Porter and Roberge argue that this lack of economic integration mirrors the lower levels of political integration, “Looking overall at North America, it is clear that regulatory integration, like market integration, has been very modest. The impact of the NAFTA, the most ambitious effort, remains nebulous.”⁹³ Guy Gensey’s exhaustive examination of the impact of NAFTA rules on Canada financial services regulation is even more incisive.⁹⁴ Gensey illustrates that NAFTA was, by and large, a status quo agreement, falling far short of massive market openings to foreign financial services firms that was so often feared in the Canadian sector. The major effect of NAFTA was to extend the loosened size restrictions offered to US banks under the CUSFTA (1988) to Mexican banks as well.

More could be said here on the degree to which these global efforts have fallen somewhat short of breaking down remaining barriers to foreign entry in the financial

⁹¹ McKeen Edwards, Porter and Roberge, p. 329.

⁹² Ibid.

⁹³ Ibid., p. 332.

⁹⁴ Guy Gensey, The Liberalization of Trade in Financial Services: Exercising Domestic Regulatory Authority, (Doctoral Dissertation, Dalhousie University, 2003). See also, Guy Gensey, “Protecting the Public Good: Canada’s Standing Policy on Foreign Financial Institutions,” Canadian Political Science Association Annual Meeting, Dalhousie University, 2003.

services industry.⁹⁵ However, the point here is that despite globalisation, domestic financial service markets for consumers and small business remained relatively closed and trade agreements have done little to change that, at least in Canada.

In fact, even when restrictions are lifted on foreign operations, this does not mean that domestic financial service providers suddenly face direct competition from foreign firms. There is an argument to be made that the sheer cost of establishing the necessary branch infrastructure for a foreign bank to compete with existing Canadian banks, is itself a prohibitive barrier to entry.⁹⁶ Branches are expensive. While banks have sought to rationalize their branches as the arrival of ATM's, telephone and internet banking have reduced the daily branch requirements of their customers, deregulation and the widened array of services that banks are allowed to offer effectively make their branches an asset. Branches become a "storefront" from which they can offer insurance, leasing, mutual funds, retirement plans, and investment advice to potential consumers.⁹⁷ A foreign bank would have to make a very large initial investment to compete on an even footing with an alternative domestic supplier.

The degree to which the WTO/GATS/FSA and NAFTA have failed to impose onerous liberalization obligations is ironic. National policy networks spent a more than a

⁹⁵ Another pertinent example would be the OECD's Multilateral Agreement on Investment (MAI), which ended in failure. Following the failure of the GATS to comprehensively remove investment restrictions, the OECD members, still committed to the idea of liberalizing services trade, sought to advance the negotiations through an OECD treaty. The MAI draft treaty promised to comprehensively reduce barriers to international financial service firms. However, when the substance of the negotiations was leaked to anti-globalisation NGO's the process rapidly fell apart. Its failure was a major setback for proponents of liberalization.

⁹⁶ Adam Tickell, "Restructuring the British Financial Sector into the twenty-first Century," Capital and Class, Summer 1997, Issue 62, p. 14.

⁹⁷ Tickell argues that this is a major motivation for banks' demands for domestic desegmentation as it allows banks to "wring" more value out of their existing advantages, such as a national system of branches.

decade framing their positions on the negotiations while at the same time engaging in preemptive domestic deregulation, in anticipation of a relaxation of foreign restrictions.

b) Global Prudential Regulatory Cooperation – Building Trust for Globalised Finance:

In terms of international political efforts to promote the globalisation of finance, regulatory cooperation to ensure prudential oversight has often received more attention than trade liberalization. Many observers feel that in the absence of such cooperation, the internationalization of markets would have been greatly inhibited. Without intensified efforts to regulate global financial service providers in the 1980s, the system could have produced significant negative externalities (e.g. collapses of major financial service firms and declining levels of trust). In fact despite globalisation's "race to the bottom logic" in regards to financial services regulation, it has been suggested that the emergence of global financial markets actually stimulates interest in re-regulation to prevent firms from engaging in overly risky activities.⁹⁸

One of the major prudential concerns was that, internationally, bank capital was declining relative to assets. Worse still, much of international banking was "off balance sheet," meaning that assets carried could be much larger than official estimates or figures reported to regulators.⁹⁹ Arguably this was occurring because banks were facing increased competition from other financial instruments and needed to get around capital reserve requirements imposed by regulators. Securities firms, since they did not face

⁹⁸ Beth Simmons, "The International Politics of Harmonization: The Case of Capital Market Regulation," International Organization, Summer 2001, 55, 3, p. 590.

⁹⁹ What this meant was that the actual size of banks was decreasing in relation to the amount of capital they were handling – a worrying trend as it increased the likelihood of insolvencies if these banks made bad loans. The ratio dipped to 5% in the 1980s. See Porter, States, Markets and Regimes in Global Finance, p. 63.

reserve requirements, were at a significant advantage and banks were trying to close the gap. In short:

The internationalization of financial markets has not eliminated the need to regulate financial services firms. In fact, it has had the opposite effect; the internationalization of financial markets creates an evermore substantial need for governance. In that sense, the re-regulation of international finance has spawned systems of multi-level governance that stretch from the very local, to the national, to the regional and to the international.¹⁰⁰

The most significant effort to increase supervision of transnational banking came from the efforts of the Basle Committee on Banking Supervision. In the 1980s the Committee undertook the task of developing basic principles for banks' capital adequacy which, it was hoped, could be globally enforced. The committee, like other institutions in the international financial architecture, had weighted representation. It normally included a representative from the prudential banking regulator and the central bank of each G10 country (plus Luxembourg). The Committee also included representation from the Basle secretariat as well. Recommendations made by the committee were in no way enforceable, however the committee has proven to be very successful in gaining voluntary compliance from states.¹⁰¹ It has become a central agency in the international banking regime.

The most important work undertaken by the committee was the development of capital adequacy standards in 1988. The committee sought to create and harmonize a

¹⁰⁰ Roberge, p. 27.

¹⁰¹ Porter, States, Markets and Regimes in Global Finance, p. 57.

new system of adequacy which would supplant existing national reserve requirements.¹⁰²

The Basle Committee proposed a move away from conventional non-interest bearing reserve requirements to ensure a bank's soundness, to a market based system of capital adequacy which shifted the burden of compliance and the financing of bailouts to a bank's investors. Basically, the idea of capital adequacy standards was to give bank shareholders more compelling reasons to monitor the behavior of their banks, in lieu of what might be provided by national regulators.¹⁰³

The standards, which were to be implemented by 1992, required that a sound bank keep its capital above a certain ratio of its assets. This would ensure that a bank could cover bad loans and other losses. The rules set up two "tiers" of capital. Tier I "core" capital included the actual invested equity in the bank and any published reserves the bank might be holding. In addition, a bank may have Tier II supplementary capital which included things like loan loss reserves. Supplementary capital was broken into risk weighted categories. In addition, some kinds of loans were not counted as assets against bank capital. For example, loans to OECD governments were considered risk free and therefore should not be counted as a risk asset. The final result was that the total capital from both Tier I and Tier II had to exceed 8% of the value of risk weighted assets (or loans). Half of that capital had to be Tier I "core" capital.

Despite the lack of compliance mechanisms for the states which were to adopt this system and replace their own existing reserve requirements, the rules were widely embraced. Ethan Kapstein has argued that the Basle Accord was a crucial step, not only

¹⁰² Conventionally, banks in regulated environments were required to hold a portion of their deposits on reserve, to meet depositors' withdrawal needs and to ensure that the banks had a safety margin in the event of making too many non-recoverable loans. The fact that offshore financial centres allowed banks to evade these requirements was a major problem.

¹⁰³ Porter, States, Markets and Regimes in Global Finance, p. 63.

in the establishment of a new international regulatory order (or international “re-regulation” of finance), but also in ensuring confidence in the international banking industry and the viability of global market integration.¹⁰⁴ In a sense, much like trade liberalization efforts, the Basle efforts on capital adequacy sought to support globalisation, although there is considerable debate about the effectiveness of the standards.¹⁰⁵

Since the new rules did not involve a significant “rounding up” of regulation, they were popular with firms and most national governments. While there was some grumbling about the standards by banks, since securities firms were not subject to the requirement,¹⁰⁶ in the long run, the rules, “may unfairly favor large, sophisticated banks. . .”¹⁰⁷ This was certainly the case in Canada, where the new standards effectively reduced banks’ reserve requirements (this will be discussed in greater detail in Chapter Five). Indeed, aside from the US and Japan, most countries’ national regulatory requirements were inside of these ratios already.¹⁰⁸ In most cases the new system actually gave banks scope to increase their assets relative to capital. Even in the case of the US, the new standards were reflective of US interests. Indeed, some explanations for the standards emphasize US power in promoting the agreement. Once again this underscores the role of states, and states’ perceived national interest in driving the globalisation of finance.¹⁰⁹ Capital to asset ratios went up after 1988, suggesting that regulators were effective in

¹⁰⁴ Ethan Kapstein, “Between Power and Purpose: Central Bankers and the Politics of Regulatory Convergence,” *International Organization*, 46, no.1, (Winter 1992), pp. 265-287.

¹⁰⁵ For a discussion, see: Susan Strange, *Mad Money*, (Manchester: Manchester University Press, 1998), Chapter 9, pp. 158-178, or, Thomas Bernauer and Vally Koubi, “On the Interconnectedness of Regulatory Policy and Markets: Lessons from Banking,” *British Journal of Political Science*, (2006), 36, pp. 509-525.

¹⁰⁶ Porter, *States, Markets and Regimes in Global Finance*, p. 65.

¹⁰⁷ Porter, *Globalization of Finance*, p. 187.

¹⁰⁸ Porter, *States, Markets and Regimes in Global Finance*, p. 71

¹⁰⁹ Porter, *Globalization of Finance*, pp. 20-21.

implementing the standards. For some banks there was “real pain” in implementing the standards as they had to reduce their level of lending.¹¹⁰

The result is that the international banking regime has expanded the global political oversight of the industry.¹¹¹ International regulatory cooperation can “work” through states’ cooperative regulation of the industry, although until now it has primarily “worked” for the powerful: outcomes have tended to involve a reduction in domestic capital adequacy requirements for large international banks. However, Porter argues, “Considering global finance as a set of institutionalized rules provides opportunities to creatively challenge market orientated or state centric assertions that nothing can be done to control global finance because the forces involved are so powerful.”¹¹² Rules governing the system play a big role in outcomes. Such rules could be modified. Porter claims that the international institutional apparatus governing finance is far deeper today than it was in the 1970’s. One could say that the international pattern has really been for intensified “re-”regulation rather than simply the abandonment of regulation. Claims that globalised finance is unregulated seem politically loaded.

IV) Conclusions – Shifting Domestic Debate to Support Deregulation:

The globalisation of the financial services industry has been facilitated by the efforts of states. International prudential efforts have intensified and improved the

¹¹⁰ Porter illustrates that the standards did not simply serve bank interests, since some suffered. It might be safer to suggest that while the standards served the general interests of large international banks, some bore some costs to come into line with the rules. See, Porter, States, Markets and Regimes in Global Finance, pp. 76-77 and p. 88. Porter also notes that the standard affected market behaviour – banks were increasingly judged by their capital adequacy rather than asset size.

¹¹¹ Andreas Busch argues that Basle Standards were a major source of change in domestic regulatory practices and that it exemplifies the political face of globalisation, as regulatory convergence from “above.” See: Busch, p. 99.

¹¹² Porter, Globalization of Finance, p 30.

sustainability of globalised financial markets. International trade efforts have sought to further global integration by removing barriers to foreign entry, although with somewhat limited results. Globalisation's economic and political bases are closely intertwined and the process must therefore be understood in broader terms than "first wave" globalisation studies posit.

What can we hypothesize about the effect of globalisation in financial services on domestic policy? Regardless of the origins of global financial markets, it remains the case that the development of offshore, desegmented and more competitive markets should affect domestic policy outcomes. Certainly, the increasing internationalization and scale of firms will alter domestic policy networks. Other things being equal, bigger firms have more political influence and structural power in relation to the state.

Similarly, the increased complexity of the industry should strengthen the power of private market participants in relation to state agencies. International desegmentation and the securitization of bank activities created puzzles for domestic policymakers about the viability or continued relevance of existing domestic regulations. All of these factors would contribute to the wave of domestic deregulation that began in the 1980s.

International political efforts have promoted a narrow interpretation of the way states should respond to the emergence of global financial services markets:

Combined with efforts in the regulatory arena, the NAFTA and the GATS create an ideology of liberalism in the financial services sector. Although the effects of these agreements on states' domestic policies are not always evident, the ideology that underpins them is creating an environment where national governments and firms try to put in place policies that make domestic institutions more competitive on the global stage.¹¹³

¹¹³ Roberge, p. 110.

The trade talks themselves have created “policy windows” for domestic actors to pursue new policies. Facing the prospects of increased liberalization via trade negotiations, domestic groups demand new privileges and powers to prepare for the new environment.

However, states have not reacted in uniform and consistent ways to globalisation. There has not been a clear pattern of regulatory convergence and downward harmonization.¹¹⁴ Since Canada’s “new politics” of financial services appears to be moving in the opposite direction, globalisation alone cannot explain policy outcomes. This should not be surprising. Most of the effects described in this chapter are not direct in that they do not create a necessary set of policy responses. Instead most are what Howlett and Ramesh referred to as “indirect” and “opportunity” effects. They create new domestic opportunities for policy change and may ideologically privilege deregulation as the favoured response, but they in no way create predictable pre-determined paths of policy change. “It is not possible to specify the direction of instrument choices resulting from the opportunity effects of globalization because of their contingent nature. What is important is that globalization offers greater opportunities for policymakers to refer to international developments to advance their position.”¹¹⁵ This suggests that models of policymaking are needed that incorporate the possible indirect and opportunity effects of globalisation on public policy and focus on how these effects work their way through domestic institutional structures.

Policy networks analysis allows the integration of the indirect and opportunity effects of globalisation into models of domestic policymaking. Networks analysis allows us to think about how these factors may shift the balance of power underlying existing

¹¹⁴ Simmons, pp. 589-620.

¹¹⁵ Howlett and Ramesh, p. 10.

policy paradigms. Indeed, market integration, the WTO, the Canada/US Free Trade Agreement and North American Free Trade Agreement, the abortive MAI, and sectoral regulatory cooperation through the BIS have all contributed to the shift in the dominant policy paradigm in Canada. Policymakers were obsessed with the global competitiveness of Canada's financial services industry given the likelihood of intensified foreign competition in the Canadian market.¹¹⁶

Globalisation's most significant effect might well be that it redefined the perceived "tasks" of state policymakers seeking to achieve traditional policy goals. Ensuring a stable, national, banking community was once thought to be possible by protecting domestic firms. Post-"globalisation," it is thought that this goal can only be achieved by facilitating the positive adjustment of the domestic industry to the impending challenges of international competition. Domestic policymakers saw the need to move preemptively to support the growth of domestic firms.¹¹⁷

Within the policy network, the new policy paradigm supporting deregulation and conglomeration has been rife with conflict over its interpretation. On the one hand, the banks, arguing that liberalization has increased competition from huge foreign service providers, have demanded that they be allowed to pursue aggressive strategies of domestic conglomeration. They claim that this will make Canada an important financial services centre. On the other hand, "anti-bank" constituencies, strengthened by the banks' success in constantly turning the process of deregulation to their advantage, have

¹¹⁶ Roberge, p. 4.

¹¹⁷ This is a point made in both William Coleman, and Tony Porter, "'Playin' Along: Canada and Global Finance," In Wallace Clement and Leah Vosko, eds., Changing Canada: Political Economy as Transformation, (Montreal and Kingston: McGill-Queen's University Press, 2003), pp. 241-264; and, James Darroch "Global Competitiveness and Public Policy: The Case of the Canadian Multinational Banks," Business History, 34:3 (July 1992), pp. 153-175.

emphasized the need to increase domestic levels of competition. Debates about globalisation have been central to these struggles since the 1980s and the dominant neo-liberal understanding of the challenges of globalisation, propagated by the trade in services argument, has consistently strengthened the hands of the banks. Policy outcomes were heavily influenced by the government's desire to protect Canada's status as a global financial services centre. However, the subsequent erosion in support for deregulation and conglomeration suggests that globalisation, or that particular understanding of the requirements of globalisation, does not explain policy outcomes in this sector. More attention must be given to domestic politics.

**CHAPTER 3: “THEORIZING THE “NEW” DOMESTIC
POLITICS OF FINANCIAL SERVICES”**

“Banking establishments are more dangerous than standing armies.”

Thomas Jefferson

I) Introduction – The Power of Banks:

It is commonly assumed by social scientists and observers of domestic politics that banks and large financial services companies wield a great deal of political power in capitalist societies. Many different interpretations, both theoretical and commonsensical have been offered. Indeed studying the power of modern banks is difficult in part because of the variety of explanations on offer as to why they exert such a pervasive role in policymaking.

For example, Marxist approaches to political economy in particular highlight the role of large corporations in modern politics. Instrumental Marxists stress the way in which capital directly determines state policy commensurate with its own immediate interests. Banks and the other large FSPs in Canada, aside from being among the largest Canadian corporations, are also the largest donors to political parties, potentially buying themselves a great deal of influence.¹ Similarly many of the industry regulators, senior government officials, ministers and members of the House of Commons and Senate that develop legislation regulating the sector are drawn from financial services corporations.² Some are shareholders; some have close ties from their days in private sector

¹ For an example of the size of these donations, see Table 7.2, Chapter Seven.

² One early study illustrating this is Colin Campbell's examination of the Canadian Senate, which dealt at length with what we now call "conflicts of interest" of Senate members of the Banking Committee who were also board members of leading financial services companies. See, Colin Campbell, The Canadian Senate: A Lobby From Within, (Toronto: MacMillan, 1978). During the interviews for this study, a number of parliamentarians and federal officials revealed past work in the private sector for such firms. These included Senators, Members of Parliament and a number of prominent cabinet ministers.

management at banks or securities firms.³ All of these factors lend credence to such instrumental notions that banks and large FSP's can directly demand that the state implement policies consistent with their narrow interests to the detriment of other segments of society.

Structural Marxist and regulation theory approaches to corporate power stress the structural relationship that capitalist states have with the organizers of production. The role of large financial services companies in creating money, circulation, supplying new investment to expand production, and in recycling the profits of production are all crucial to the regime of accumulation.⁴ Scholars in this tradition stress that over the long term, regardless of the ebb and flow of daily political struggles, the state will accommodate the wishes of such corporate interests because to do otherwise will undermine the conditions of growth.

Regardless of the mechanisms by which the state is dominated, Marxist approaches often assume that globalisation, by increasing the "exit options" available to capital, will expand the power of capital to dictate public policy.⁵ Many simply assume that large financial service providers will dominate the politics of the sector in a way that leaves little room for other societal influences.

³ Stephen Harris notes that there is a close relationship between industry and state elites. There is an array of close bureaucratic and political contacts. Indeed, just by way of example, the head of the Ontario Securities Commission is often a direct cross over from firms involved in the industry. Stephen Harris, "The Globalization of Finance and the Regulation of the Canadian Financial Services Industry", in G. Bruce Doern et al., Changing the Rules: Canadian Regulatory Regimes and Institutions, (University of Toronto Press, 1999), p. 367.

⁴ Alain Lipietz, Towards a New Economic Order, (Cambridge: Polity Press, 1992). Finance Ministries are often seen as agents or allies of transnational elites. For example, see Robert Cox, Production, Power and World Order, Social Forces in the Making of History, (New York: Columbia University Press, 1987).

⁵ Teple's Globalization and the Decline of Social Reform, is a good example.

Other academic, non-Marxist studies have traditionally said much the same thing.⁶ William Coleman notes that many studies suggest that the size of banks and other large financial service providers “. . . affords them undue influence and political power.”⁷ This tendency is also manifest in more “common sense” or “journalistic” analyses of the role of banks in democratic societies. For example, a host of journalists in Canada have published “tell all” histories of the sector in recent years, suggesting that, in the end, the banks simply tell the government what to do.⁸ Little space is left for other influences in policymaking and little attempt is made to document the actual mechanisms of bank “domination.” Taking the grand assumptions of both of these kinds of approaches and translating them into “on the ground” explanations for the politics of the financial services sector is extremely difficult. The claims are too general and the arguments underspecified. What is needed is a model for understanding the politics of the sector.

This chapter, drawing on public policy frameworks, argues that the “policy networks” approach offers a superior way to understand the politics of this sector relative to the underspecified hypotheses offered by many studies of globalisation. The chapter develops a policy networks based model which attempts to integrate macro level theories about the impact of globalisation and national institutional settings. This model can provide more accurate predictions about how states will respond to globalisation in specific policy sectors. In particular, the chapter, rejecting early networks analyses that overestimate the importance of globalisation, argues that the particular institutional setting of financial services policymaking in Canada was radically altered by the *ad hoc*

⁶ See for example, Charles Lindblom, Politics and Markets, The World's Political and Economic Systems, (New York: Basic Books, 1977).

⁷ William Coleman, Financial Services, Globalization and Domestic Policy Change, (London: Macmillan, 1996, p. 19.

⁸ See for example, Walter Stewart's work on Canada's banks.

and poorly organized process of deregulation in the 1980s. This has led to an opening of the policy network to new organized interests and new policy goals, ultimately undermining the deregulatory policy paradigm that had dominated the sector for the previous twenty years. The policy networks approach helps to clarify how globalisation affects domestic policy outcomes. Indeed, the approach offers a nuanced way to bring IPE scholarship's recent interest in domestic institutional factors more closely in line with traditional concerns in comparative public policy, and in particular with Canadian public policy's interest in the *internationalization* of domestic policymaking. As scholars of public policy have recognized, understanding contemporary policymaking requires that we "blur" the boundary between international politics and the domestic study of policy.⁹

II) Comparative Historical Institutionalism and Policy Networks:

Scholars in international political economy, studying the impact of globalisation on policy change, recognize that globalisation's effects are mediated through domestic institutions. In sectors like the regulation of financial services, different national institutional legacies tend to produce different kinds of policy responses to the challenges

⁹See William Coleman and Anthony Perl, "Internationalized Policy Environments and Policy Network Analysis," *Political Studies*, September 1999, Vol. 47, Issue 4. "Globalisation" and the study of globalisation are not new in Canadian policy studies, ". . . the country's political economy has long made Canadians highly vulnerable to developments beyond their borders. Dependent on foreign trade and investment, Canada's economy has become deeply integrated into the American economy and, for selected primary commodities, the international economy." Grace Skogstad, "Globalization and Public Policy: Situating Canadian Analyses," *Canadian Journal of Political Science*, XXXIII:4, (December, 2000), p. 805. Students of policy in Canada have traditionally been primarily concerned with the implications of Canada's international economic dependencies for Canadian sovereignty and policy autonomy. However, in conjunction with increased international interest in the political challenges posed by economic globalisation, scholars are increasingly interested in how globalisation may directly implicate itself in domestic policy processes and decisions.

of globalisation.¹⁰ However, the conceptual tools of IPE that could account for such factors are poorly developed.

Globalisation requires us to think about both global factors and domestic politics when studying the politics of financial services. Comparative historical institutionalists' studies of states' adaptation to globalisation, while assuming that global economic and political changes create pressure for policy change, "... emphasize the institutional embeddedness of domestic political economies."¹¹ Existing state structures, political institutions, systems of associational and interest intermediation and the existing market distributions of power create path dependency by "... providing actors with restrictions and opportunity structures . . . create certain historical paths which are never easy to leave. . . . In this view, it seems highly unlikely that countries will ever converge on a singular model of financial regulation."¹² Descriptive evidence of the "disparate" policy effects of globalisation across countries and across policy sectors, while invalidating the hyper globalisation/first wave globalisation hypothesis, have increased interest in the role of domestic institutions in mediating the impact of globalisation. This is certainly the case in both contemporary IPE scholarship and Canadian public policy research.¹³

In the case of financial services reform, many studies have suggested that there are significant differences in national policy responses to globalisation. For example, institutional accounts have illustrated how domestic responses to globalisation have varied based on the access that reform opponents have had to policymaking. In Britain,

¹⁰ See for example, Daniel Verdier, "State and Finance in the OECD: Previous Trends and Current Change," *Politics and Society*, Vol 28. No. 1, March 2000, pp. 35-65.

¹¹ Lutz, "Convergence Within National Diversity," p. 170. For discussion, see K. Thelen and S. Steinmo, "Historical Institutionalism in Comparative Politics, in S. Steinmo et al. eds, *Structuring Politics: Historical Institutionalism in Comparative Analysis*, (Cambridge University Press, 1992, pp. 1-32.

¹² Lutz, "Convergence Within National Diversity," p. 170.

¹³ Skogstad, p. 818.

where authority is highly centralized and interests have few opportunities to influence policy, reform occurred quite quickly. Suzanne Lutz argues that in the “fragmented” federalism of the United States, attempts to harmonize and deregulate rules governing the financial services industry went much more slowly despite the same external motivations. In the US, opponents to federal reforms were able to ally with some state governments to resist some aspects of regulatory reform.¹⁴

Comparative analysis of policy change has been buttressed by cross-national evaluations of the relationship between capital market structures and the nature of the state. Despite the assumed pressures of globalisation which push the same “bigger is better” logic everywhere, federal states in which local or state governments regulate some FSP’s have produced less centralized capital markets. Such studies suggest that:

The findings . . . build a strong case for the institutional hypothesis. The changes in capital markets . . . are not evenly distributed across OECD countries but follow a clear institutional logic. The countries that are the most responsive to internationalization and deregulation are the countries that are the most centralized politically.¹⁵

In more centralized states, globalisation and politically-driven deregulation have increased the market shares of “centre banks” (big, national FSP’s). In decentralized states, Daniel Verdier has argued that the “exchange relations” built up over the years between local governments and second tier “banks” (credit unions, savings and loans, etc.) has tended to entrench their position in the marketplace. Decentralized states create opportunities for smaller financial service providers to get political help in resisting internationalization and deregulation, which favour big banks.¹⁶ Indeed Verdier, like

¹⁴ See Lutz, “Convergence Within National Diversity,” p. 188.

¹⁵ Verdier, p. 57.

¹⁶ Ibid., pp. 35-65.

Lutz, also notes that what seems to be at issue is the level of access that opposing groups have to policymakers. He assumes that the existence of either split jurisdiction over financial services or a powerful legislative role in setting policy create better conditions for groups and firms that are normally less influential to influence policy.¹⁷

Comparative historical institutionalism suggests that domestic political institutions matter, and that they exert “stickiness” over the trajectory of policy change and create path dependent outcomes. Federalism, or other domestic institutional settings which afford smaller players an opportunity to resist reform, slow states’ adaptation to globalisation.

While hypotheses such as these certainly add to our understanding of states’ varying responses to globalisation, more importantly they draw our attention to mid level processes in explaining *why institutional settings matter*. Studies that argue that a more decentralized state or a state with a more active legislative branch will be slow in adapting to globalisation, because these states afford other groups a chance to resist programs of deregulation and conglomeration inimical to their interests. It is not, therefore, centralization or decentralization *per se* that affects outcomes, but access or influence. Sometimes, as in the Canadian case, centralization may actually increase the access of dissident groups to policymakers. What really needs our attention is how the combination of globalisation and national institutional settings affect a particular “policy network” and the access that different members of the network have to political influence.

¹⁷ Indeed Verdier argues that what globalisation and deregulation have really engendered is not so much a new algebra of states versus markets, with the latter winning on all fronts, but rather in more “open” institutional national settings an emerging geographic fault line between centre and periphery. See Verdier, p. 58.

Policy Networks:

A popular strategy in Canada for thinking about internationalization of the policy process has been to use the “policy networks” or policy subsystems family of concepts.¹⁸ This approach does not simply view domestic institutions as a mediating variable which measures how resistant to change a state’s existing policy environment is to global economic and political pressure. Instead it explores how factors such as these affect the policymaking environment, structuring actors’ access and capacity to influence. Policy networks analysis offers IPE and comparative public policy scholars a “middle level” theory to more accurately model and predict the way in which a state may respond to globalisation *in a particular policy sector*. The approach, while drawing on the macro level insights of both globalisation theory and the new institutionalism, assumes that domestic political struggle will continue to drive policy, albeit in a context in which factors like globalisation may alter the policymaking environment, favouring some interests over others.

Networks analysis seeks to understand the proliferation of governance structures where a discernible group of public and private actors “. . . negotiate [public policy outcomes] in a horizontal, coordinating manner . . .”¹⁹ The approach is analytically “open,” and includes a wide array of considerations which challenge researchers’ ability to generate parsimonious, testable hypotheses. However, it draws our attention to a range of macro social, economic, and institutional considerations which may contribute to how open or closed a particular network is to new actors and new policy demands. From this

¹⁸ See for example, Skogstad, pp. 805-828. or Steven Bernstein and Benjamin Cashore, “Globalization, Four Paths of Internationalization and Domestic Policy Change: The Case of Eco Forestry in British Columbia,” *Canadian Journal of Political Science*, 33, (2000), pp. 67-99, or the extensive work of William Coleman already cited.

¹⁹ Coleman and Perl, p. 691.

we may attempt to deduce how different policy network “structures” or “shapes” may ultimately contribute to different policy outcomes. It is a narrower specification of the insights of historical institutionalism, moving us beyond broad institutional factors (like federal versus unitary state structures) to more nuanced understandings of the institutional settings within a specific sector.

The approach offers a model of intermediation between leading interest groups and government. It suggests that the existence, membership and characteristics of a “network” influence policy outcomes. The approach begins from the premise that in many policy sectors, broad social constituencies have very little access to policymaking. Rather, government agencies tend to deal with key actors with well-developed power bases, focusing on actors that matter in a sector. Indeed it has been noted in the past that networks analysis resembles a disaggregated approach to more general Marxist and elite theories of the state in which state agencies afford a privileged role in policymaking to dominant economic interests.²⁰ Similarly, “. . . the policy networks approach draws our attention to the importance of the institutional context for the issue of governance. If policy processes take place within a certain institutional context (i.e. a stable relation pattern between organizations), it becomes important to understand that context.”²¹

The policy networks/policy subsystems form of analysis has traditionally suffered from a number of theoretical problems, and indeed much of the literature has focused on defining the meaning of the “network” and operationalizing the theory rather than testing

²⁰ This is a point illustrated by Carsten Daubjerg and David Marsh, “Explaining policy outcomes: integrating the policy network approach with macro-level and micro-level analysis,” in D. Marsh ed., Comparing Policy Networks, (Philadelphia: Open University Press, 1998), pp. 51-71.

²¹ Erik-Hans Klinjn, “Analyzing and Managing Policy Processes in Complex Networks: A Theoretical Examination of the Concept Policy Network and its Problems,” Administration and Society, (1996) 28, 1.

the hypothesis it generates regarding policymaking. Three major theoretical concerns have been raised.

Problem - What is the “network”?

In the early stages of networks analysis, Keith Dowding argues that the notion of a “policy network” is at best a metaphor which lacks its own intrinsic explanatory power.²² He suggests that relations “inside” the network and conflict amongst actors in a policy area is what really explains policy outcomes. Observing a network is not central to inquiry; what is important is mapping rationally self-interested conflict amongst the myriad of groups in a policy sector.

Understandably, most networks scholars reject this argument, suggesting that the network is a heuristic device that helps explain actors’ strategies and, ultimately, policy outcomes in a sector. Indeed, Coleman and Perl reject Dowding’s criticism, arguing that the networks concept actually benefits from the fact that it can apply various theories (rational actor based assumptions, theories of institutional possibilities and cultural problem solving assumptions) to relations inside the network.²³

Problem - What does it mean to observe the network?

A related problem is the question of what it means to observe and categorize a policy network. We can “see” networks in almost any policy area, “The problem is that after those networks are described it is not clear that the knowledge of their existence enhances our ability to predict policy outcomes. Is there sufficient information about the

²² K. Dowding, “Model or Metaphor? A Critical Review of the Policy Networks Approach,” Political Studies, 43 (1995), pp. 136-158.

²³ Coleman and Perl.

effects of different structures of networks on policy to make predictions?”²⁴ The study and observation of policy networks is only relevant if it is tied to causal claims about how different types of networks affect policy making and policy outcomes. Networks analysis must carefully tie the empirical observation of a network to a hypothesis about how its structures will affect policy outcomes.

Problem - What motivates actors – interests or ideas?

Finally, networks analysis is collectively ambivalent about the ontological basis of actors’ interests and strategies. Much networks analysis reflects rational choice in its ontological commitments. David Marsh refers to this popular strain as being an “actor-centered institutionalism” approach which combines institutionalist theory with rational choice. It assumes that actors seek to maximize their self-interested preferences, albeit in an institutional structure which constrains or facilitates different strategies.²⁵

Empirically then, we need to know not only about the structure of relations amongst network participants, but also about what those participants’ policy-related interests might be. Others suggest that the lines of ideological contention in a policy sector define the network’s structure. Networks have competing “advocacy coalitions” struggling for influence.²⁶ In this case the key empirical problem is to document different actors’ ideational orientations towards policy. This provides the basis for hypothesizing about a

²⁴ Guy Peters, “Policy Networks: myth, metaphor and reality,” in D. Marsh ed., Comparing Policy Networks, (Philadelphia: Open University Press, 1998), p. 22.

²⁵ See David Marsh, “The Development of the Policy Networks Approach”, in D. Marsh ed., Comparing Policy Networks, (Philadelphia: Open University Press, 1998), p. 10.

²⁶ The “advocacy coalition framework” is one approach to the policy subsystem family of methods. It suggests that struggle inside a policy sector is ideational – that the structure of conflict is defined by the ideas different actors espouse. See Paul A. Sabatier and Hank C. Jenkins, “The Advocacy Coalition Framework – An Assessment,” in Paul A. Sabatier, ed., Theories of the Policy Process, (Boulder: Westview Press, 1999), pp. 117-166.

network's structure and its likely impact on policy outcomes.²⁷ Thus as network analysis developed there seemed to be a great deal of ambivalence about what the meso level "network" helped to generalize.

The Structural Approach to Networks:

In response to these kinds of problems, Marsh and Rhodes, and later Marsh, attempt to specify a particular "structural approach" to policy networks. Their approach does help to overcome the confusion generated by the problems above. Firstly, the concept of the "network," and the categorization of different kinds of networks, is seen as a heuristic device simplifying and generalizing the relations we observe inside that network. It suggests a basic continuum of network structures, each with a particular kind of politics. Second, the structural approach specifies a causal relationship between network structure and policy change. Finally, it deliberately embraces some ambivalence about the relationship between actors' interests and ideas, seeming to suggest that both matter in policymaking. Marsh clearly sees networks as primarily involving "exchange relationships" and power dependence, rather than simply ideological conflict over policy goals.²⁸ However, others who deploy the structural approach argue for the inclusion of "ideas" in explaining policy network change and policy change.²⁹

Most usefully the structural approach moves beyond a simple metaphorical conception of networks, suggesting that there are distinct causal claims that can be made

²⁷ Peters, pp. 20-31, sees this as the best way to link the structure of networks and their internal conflict to hypotheses about policy change.

²⁸ For example, see, Daubjerg and Marsh, pp. 51-71.

²⁹ Coleman and Perl. Often, this simply makes sense. While struggles over material interest may dominate the politics of a policy sector, there is no doubt that new ideas, and new ways of seeing policy problems can also influence outcomes. This dissertation shares this ambivalence. While it understands the Canadian financial services policy network in primarily "actor-centred institutionalist" terms, it nonetheless suggests that ideas about globalisation play a role in explaining policy outcomes.

about the nature, or “shape,” of a meso level network and the likely policy outcomes it would produce. In particular Marsh and Rhodes make three important overarching claims:

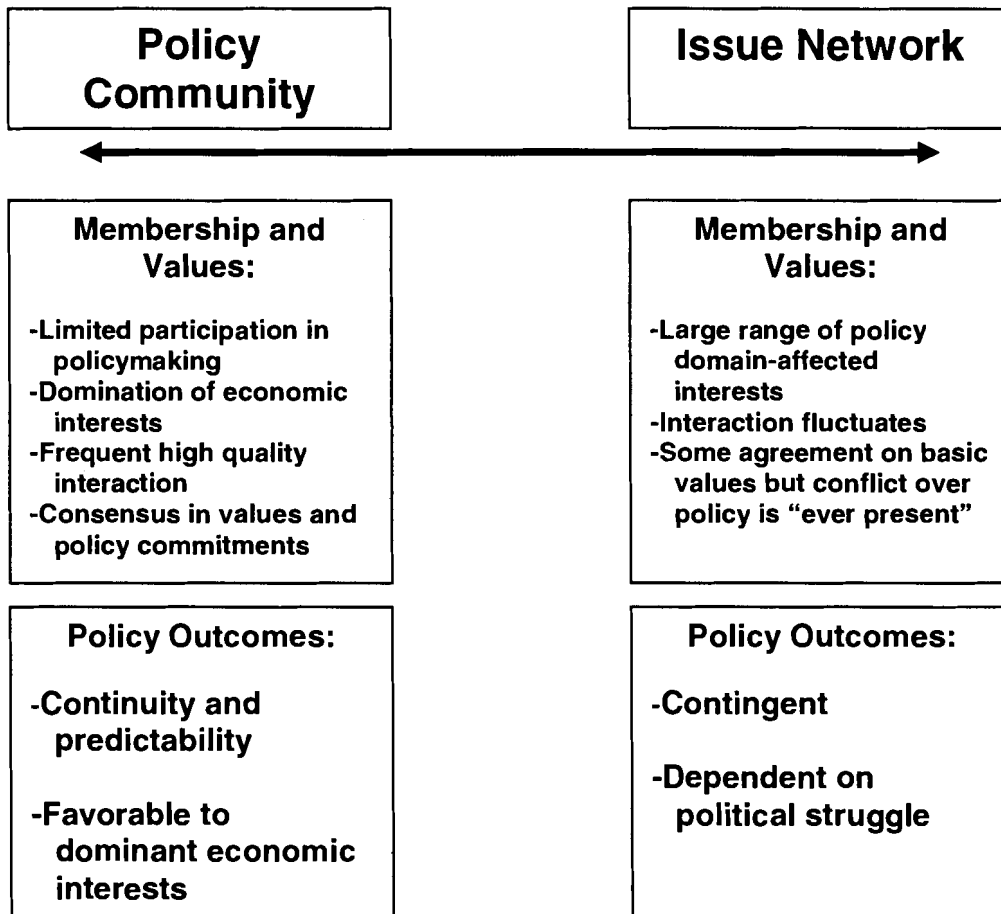
- 1) That changes in network shape or structure correlate with changes in policy
- 2) That a “tight” or “closed” network will tend to constrain policy change and promote continuity, whereas more diverse policy outcomes are more likely in a “weaker” network, and;
- 3) That change in network shape is due in large part to factors exogenous to the network.³⁰

Given these broad claims, the empirical challenge for networks scholars has been to classify network types so that patterns of policy change can be predicted. The structural approach suggests a basic continuum of network types with, at one extreme, “tight” or “closed” *policy communities*, and at the other looser *issue networks* (See Figure 3.1). All policy subsystems may fall somewhere along this continuum, the point being that in the real world networks closer to the policy community end of the continuum will exhibit a different kind of politics than those at the issue network end of the spectrum.³¹

³⁰ See Marsh and Rhodes, 1992, p. 257 and David Marsh, “The Development of the Policy Networks Approach,” in D. Marsh ed., Comparing Policy Networks, (Philadelphia: Open University Press, 1998), pp. 3-20. The last factor is interesting as Dowding essentially argues that the drivers of policy change are endogenous to the network (internal power relations and bargaining); thus the network only metaphorically captures those relations. Most other network scholars suggest network change is driven by external factors.

³¹ Basically network shape (open or closed) is the political opportunity structure in which actors must attempt to influence policy. It is interesting to note the similarities between these assumptions and the analysis offered by the “political opportunities structure” literature on new social movements, which similarly suggests the importance of such factors in contributing to the likelihood that actors or interests will be able to influence events in a policy area. See for example, Gary Marks and Doug McAdam, “Political Opportunities and Collective Action: The Case of the European Union,” in D. della porta, He. Kriesi and D. Rucht eds., Social Movements in a Globalizing World, (Great Britain: Macmillan Press Ltd., 1999).

Figure 3.1: Policy Networks/Subsystem Continuum - Network Shape and Policy Outcomes³²



From this basic typology a number of hypotheses are offered about the effect of network shape on policy making.

1) "Policy Communities" create predictable outcomes:

In a "tight" or more "closed" policy community, access to policymaking is limited to key actors, dominant economic interests (or producer groups) and relevant state agencies. This kind of network tends to exhibit a high level of ideological consensus on policy goals:

³² This table is an illustration of the arguments of Marsh, Marsh and Rhodes and Peters.

As a policy paradigm becomes institutionalized, the policy domain settles down into a period of normal politics. Policy communities stabilize in the given policy domain, levels of integration rise and state actors may see fit to share power directly by creating corporatist policy networks. Often a single policy community comes to dominate all phases of the policy process: agenda setting, evaluation of alternatives, policy formulation, policy implementation and policy evaluation. Most likely the groups or advocacy coalitions granted most legitimacy by the policy paradigm become the core civil society actors who participate in the sub government or actor constellation of the policy community.³³

Marsh and others argue that tight networks with clear resource exchanges between state agencies and economic interests produce more stable and predictable policy outcomes:

. . . the outcome of a tight policy network, in terms of their policy community, is likely to be policy continuity, some would say inertia, because participants share a common ideology and thus policy preferences and all participants acknowledge it is a positive-sum game. Similarly a policy network dominated by professional or business interests is likely to forward policies favoring that interest.³⁴

Policy communities produce stable policies supportive of leading economic interests in a sector.

At the issue end of the continuum, “issue networks” are more open. Membership includes a wider area of policy domain-affected interests. Access to policymaking fluctuates, and there is more conflict over policy goals. In this type of network, policy is less predictable as it is contingent on political struggles inside the network.

2) Changes in network shape will correlate with changes in policy

If a network opens, perhaps due to some sort of exogenous factor like domestic institutional reform, it is likely to create greater opportunities for groups which had previously been excluded from the policy community to influence events. Furthermore,

³³ Coleman and Perl.

³⁴ Daubjerg and Marsh, p. 54.

change in network shape in a policy subsystem will likely associate with policy change. For example, if a closed policy community “opens” to new participants with new policy goals resulting in the emergence of an issue network, it will likely produce policy change.

The crucial question becomes what kind of factors produce change in network shape? Most networks scholars (Dowding is a notable exception) emphasize exogenous macro level factors; either in the form of macro social, economic and ideological change, or, more interestingly, in the role of national institutional arrangements.³⁵

Macro Considerations, Network Change and Policy Change:

Policy communities and issue networks produce different politics. However, “. . . policy outcomes are not just a function of what occurs in the network; they are also strongly influenced by the economic, political and ideological context within which the network operates.”³⁶ In order to explain network membership, formation, and structure, we need to be aware of external contexts. Policy networks are best treated as a meso level approach that, if it is to have “explanatory utility,” needs to be integrated with macro level theories. The two most common “macro level” considerations are those that concern broad social and economic changes not isolated to the policy network, like the changes associated with “globalisation,” and broader institutional factors somewhat outside of the immediate policy network, such as federalism.

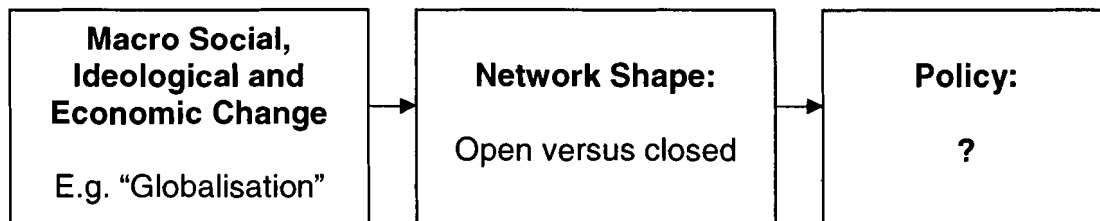
³⁵ Marsh and Rhodes, p. 257, suggest that “. . . most network change is explained in terms of factors exogenous to the network, although the extent and speed of the change is clearly influenced by the network’s capacity to minimize the effect of such change.”

³⁶ Daubjerg and Marsh, p. 54.

Globalisation and network shape:

From the networks perspective, globalisation can engender direct policy change at the domestic level either by altering the power or exchange relations amongst actors in a policy network or by altering policy relevant ideas in a subsystem.³⁷ In either instance this may affect both network shape and the likelihood of policy changes (see Figure 3.2).

Figure 3.2: Macro-level Social/Economic Factors and Network Change:



Generally, across policy sectors there is reason to suspect that globalisation will either close a network, producing a policy community, or entrench an already existing policy community as it is thought that globalisation strengthens the hand of dominant economic interests. This tends to promote neo-liberalism in many policy sectors.

Drawing on discussion in Chapter Two, there are a number of globalisation-related-effects in this sector which may influence network shape. As noted, “globalisation” includes an array of technological, economic political and ideological processes:

1) Increased internationalization and scale of firms: To the extent that globalisation and the development of international financial markets facilitates increases

³⁷ This is an argument developed at some length in Coleman and Perl, pp. 691-709.

in both the scale and international activities of financial service providers, this in turn may increase the power of those firms in domestic policy networks. Not only do the “exit options” of globalisation strengthen the hand of multinational corporations relative to state institutions, but they also strengthen their hand in relation to other groups inside the policy network.

2) Market desegmentation (both domestic and international): The proliferation of new kinds of financial instruments and the intensified competition between previously segmented market sectors severely challenges the existing policy paradigm of pillarization. This strengthens the resources and arguments available to those demanding deregulation.

3) Ideational changes in regulatory purposes: The re-conceptualization of the industry as “trade” and a site of growth and domestic job creation has also posed a challenge to traditional conceptions about the purposes of regulation. International political cooperation in liberalizing trade in services and internationalizing prudential oversight have promoted liberalization and deregulation at the domestic level, again perhaps altering the balance in domestic policy struggles.

4) Increased technical complexity: One major effect of globalisation is that it increases the complexity of the industry, making it more difficult for public authorities to play a leading role in policy. Globalisation increases the state’s reliance on the industry for advice and technical expertise which also may affect network structure.

Questions of scale, disintermediation and technical complexity have all been associated with globalisation in the financial services sector.³⁸ Logically they all tend to “close” the network in favour of dominant economic actors.

Macro Institutional factors and network shape:

Networks analysis also places a great deal of emphasis on the broader national institutional setting in which a policy-specific network is situated, “. . . if the researcher is concerned to explain policy outcomes, particularly variation in outcomes across sectors or countries s/he can hardly neglect the influence of broader state institutions.”³⁹ Indeed, careful attention to the institutional context is seen as a corrective to early networks analysis which tended to ignore the role of state institutions in contributing to network structure.⁴⁰ The broader political processes in which the network is situated, such as state-society relations, will contribute to the pattern of inclusion or exclusion in the policy network. Networks analysis tends to focus on the same factors identified by comparative historical institutionalism: whether a state is unitary or federal, the constitutional division of powers (and whether the jurisdiction in a sector is held by one level of government or shared), and the relative power of executives and legislatures. These may all affect how open or closed the policy process will be at the meso level in the specific policy sector.

In combination, these considerations generate predictive capacity as to where networks are likely to be closed or open and thus some insight into the likely continuity of policy outcomes and domination of leading producer interests. We need to integrate this into our analyses as well, because macro institutional factors could, in effect, mitigate

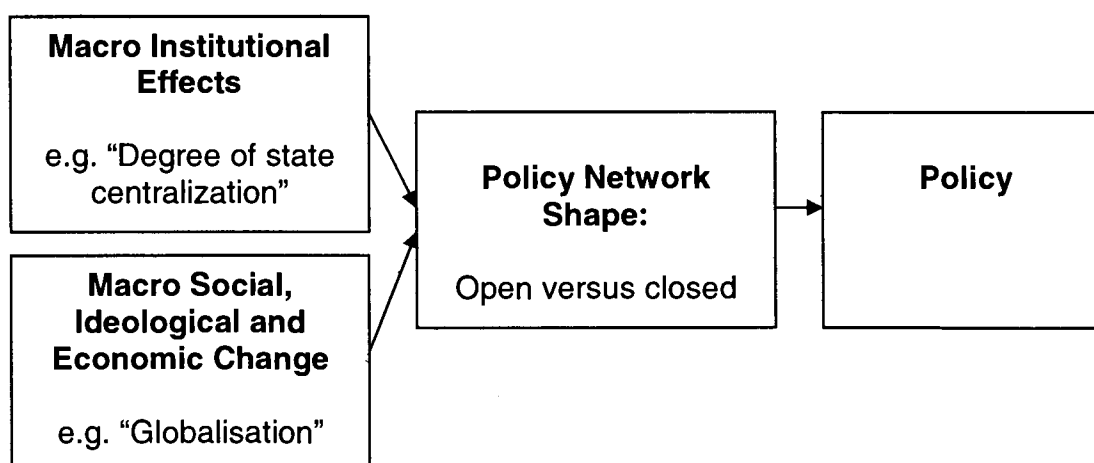
³⁸ See Chapter Two for a discussion.

³⁹ Daubjerg and Marsh, p. 54.

⁴⁰ Coleman and Atkinson, p. 163.

the impact of globalisation on network structure in some settings. The relationships between these factors, and their effects, can be modeled, as illustrated in Figure 3.3.

Figure 3.3: Model - Macro-level Factors and Network Shape



There are really two sets of independent variables that impact network shape and lead to hypotheses about how open or closed a policy network might be. In this sector, these are globalisation and macro institutional effects. In between those variables and policy outcomes are the meso level considerations of the actual policy network, its shape, and the internal struggles over policy that occur there. How does this model work in the Canadian financial services case?

The Canadian Financial Services Policy Network – “Esoteric Politics” and Policy Change:

Financial services policy networks have traditionally been seen as closed policy communities isolated from broader constituencies. Drawing together assumptions of comparative historical institutionalism, policy networks analyses and, arguably, Marxist

analyses of state-society relations, politics in this sector have been viewed as “esoteric.” Policymaking is thought to be dominated by an informal but close relationship between leading state agencies and leading firms, to the exclusion of broader constituencies. In the Canadian case, this consists of the close and cooperative relationship between Canada’s big banks and the Federal Department of Finance. Most see this relationship as being grounded in a mutually beneficial exchange relationship.

The banks, on the one hand, have received government support over the last century for their economic interests. The banks have been allowed to reduce the number of industry participants to five large firms, foreign competition and new market entrants have been excluded through complex ownership rules, and the banks have received new powers and privileges “virtually for the asking” as circumstances required.⁴¹ Federal support has ensured the stable profitability of the banking sector.

In return, the benefits to the federal government are more complex. At the very least, the banks supply “stability.” Several observers have argued that the one overriding policy goal of the federal government has always been stability.⁴² Stephen Harris notes, somewhat obviously, that in sectors like this political elites rarely choose economic policies that, by dampening economic performance, may ultimately hurt the standing of the government.⁴³ A stable banking industry also provides the Department of Finance with vital conditions for Canadian economic development: the secure inward flow of

⁴¹ James Darroch, “Global Competitiveness and Public Policy: The Case of the Canadian Multinational Banks,” *Business History*, 34:3 (July 1992), p. 155.

⁴² Ibid p. 154. Ian Roberge also suggests that the major policy goal in this sector was stability. See, Ian Roberge, *The Internationalization of Public Policy and Multi-level Governance: A Comparison of Financial Services Sector Reform in Canada and France*, (Doctoral Dissertation, McMaster University, 2004).

⁴³ Stephen Harris, “The Globalization of Finance and the Regulation of the Canadian Financial Services Industry,” in G. Bruce Doern et al., *Changing the Rules: Canadian Regulatory Regimes and Institutions*, (University of Toronto Press, 1999), p. 367.

capital, the facilitation of international trade and the infrastructure necessary for government finances.

In addition, the federal government is able to reinforce its own role by ensuring that federally chartered banks dominate the Canadian system: “Unlike provincially regulated investment dealers and some trust companies, chartered banks come under federal regulation. If the federal government wished to exert its power over financial markets the chartered banks offered a better vehicle.”⁴⁴ The banks act as “carriers” of the federal jurisdiction. Expanding their role expands the oversight of the federal government in relation to the provinces.

The outcome of this relationship has been a policymaking style that isolates other private actors and state agencies from influence. Observers note that Canadian policymaking has been quite transparent as the government has openly sought the advice and expertise of the banks. However:

. . . one major shortcoming of the process is that it can give rise to regulatory capture and/or indecision. The regulatory capture arises as a consequence of the asymmetrical distribution of information between the financial services industry and the state. Historically, the state has had to rely on the financial services industry for suggestions for policy change and for the evaluation of the impact of a potential policy change. The financial services industry recognizes its comparative advantage and attempts to maximize its usefulness.⁴⁵

Indeed, Harris suggests that in the past it was not unusual for the Department of Finance to simply call directly on officials from one of the banks to “second” their own analysis in the development of new policies. He notes that this was not “conducive” to an independent policy process.⁴⁶ The contrast with other participants in the policy process

⁴⁴ Darroch, “Global Competitiveness and Public Policy,” p. 154.

⁴⁵ Harris, “The Globalization of Finance,” p. 366.

⁴⁶ *Ibid.*, p. 367.

was striking, since “Consumers’ associations, on the other hand, wait in the background for formal consultations from the state to present their briefs. There is clearly unequal access of ‘ordinary’ citizens, compared to the financial services industry representatives, to state decision makers.”⁴⁷

Coleman argued that Canada’s “esoteric politics” in financial services ensured that policymaking was often a private, informal affair that focused on developing consensus around technical matters between government officials and large financial services companies: “Policy communities were exclusive, often dominated by financial services firms themselves, and highly informal. Understandings rather than agreements were reached, customs were favoured over statutes, and most matters were considered to be ill-suited for discussion in cabinet or in the legislature.”⁴⁸

III) The Coleman Model – Globalisation and Esoteric Politics:

William Coleman’s earlier work, Financial Services, Globalisation and Domestic Policy Change, illustrating the benefits of networks analysis, sought to explore how globalisation might affect financial services policy subsystems and thereby influence likely policy outcomes. Coleman suggests that globalisation would mean that other societal groups and the public, through their elected representatives, would continue to have little access to the policymaking process. Globalisation would foster a “new esoteric politics” in which policymaking might be more transparent and institutionalized, but

⁴⁷ Ibid., p. 367.

⁴⁸ Coleman, Financial Services, Globalisation and Domestic Policy Change, p. 4. Coleman’s work was comparative. It attempted to study the development of the new esoteric politics in the United States, the United Kingdom, France, Germany and Canada. Since institutions vary from one national context to another, Coleman developed a model for mapping the power relations of the sector, as a preparatory analysis to thinking about how the politics of the sector were likely to develop.

outcomes would still largely be the preserve of a privileged inner circle of large industry players. Thus while Coleman argues that states have responded to globalisation differently, given different domestic institutions and existing policy frameworks, he suggests that globalisation has contributed to entrenching the “limited democracy” in the sector.⁴⁹

Coleman’s model suggests that banks’ and other large FSPs’ abilities to exercise power over policy is influenced by three considerations:

1) The structure of the financial services system – the potential economic basis of firms’ power

Coleman argues that the existing regulatory and business structure of the financial services industry influences the power of FSPs. Obviously, if the market is highly competitive, with many small companies, then the potential power of individual firms will be reduced. If the market is an oligopoly, where only a few firms dominate across the full range of products and services, then the potential power of those firms will be much higher. Coleman concludes that both globalisation and the transition to universal banking, by increasing the scale and breadth of Canada’s big banks, would further increase their economic muscle in relation to other actors. Globalisation has made Canadian banks bigger; perhaps not in comparison to foreign banks, but certainly in relation to other domestic firms and industries. At the same time the banks have faced little domestic competition from large foreign FSPs which might have challenged their economic power.

2) The political organization of economic interests – the associational system of dominant economic interests in the sector and its effectiveness in actualizing economic power.

⁴⁹ Ibid., p. 10.

While the economic power of large FSPs “. . . provides these firms with a considerable potential to shape what become matters for political consideration and to influence the outcomes of the public policy process,” this is *potential* power only, because there is nothing “automatic” about the translation of economic power into political power.⁵⁰ Associational systems have become more important as the complexity of modern economies and modern politics have increased. To be effective an associational system must be cohesive and integrated. Otherwise, competition between different groups seeking to represent a business sector could undermine the translation of economic power into political power. In Canada, Coleman found that competition amongst associations was very low.⁵¹

Coleman also argues that an association achieves a special level of legitimacy, a “public status,” when one or more of these four conditions is present:

. . . the state supplies its resources, defines its domain of representation, regulates its internal organization, or gives it an official role in the policy process, whether in formulating or implementing policy. A public status may become a resource in its own right. It may provide an association with a special, privileged access to the policy process and, hence, with a stronger opportunity to exercise power.⁵²

The Canadian Bankers Association (CBA) meets these criteria. Thus, Canada’s industry associations, at least those that represent the chartered banks, have considerable internal resources and are well placed to translate their economic power into political influence.

⁵⁰ Ibid., p. 47.

⁵¹ Coleman’s comparative research found that in the five countries he studied, competition for members amongst associations in financial services was lowest in Canada. There was little if any competition by associations to represent leading financial services companies. See Coleman, Financial Services, Globalization and Domestic Policy Change, p. 52.

⁵² Ibid., p. 53.

However, their power is potentially limited by the legacy of “pillarization” because it resulted in a vertically-fragmented associational system. Here the problem is straightforward. To the extent that industry associations are divided by historical legally-divided market segments (i.e. the CBA represents federally chartered banks, the Investment Dealers Association (IDA) represents securities dealers, and the Trust Company Association of Canada (TCAC) represented trust companies), there is considerable potential for political divisions that will limit the *collective* influence of FSPs over the state. In the process of deregulation, for example, banks and trust companies may fight for policies to gain advantage over one another. Often their associations could find themselves on opposite sides of regulatory questions.

This is an important systemic cleavage and perhaps the only important one in Canada. However, it is only significant as long as markets remain segmented, or before the full effects of globalisation and deregulation set in. Prior to deregulation, the various industry associations counterbalanced one another as there was little vertical integration of the industry associations. In the wake of deregulation, as banks increasingly dominated all sectors economically, they also came to dominate, directly or indirectly, the other industry associations. One could say that either the banks’ own association (the CBA) became proportionately more powerful in relation to the other associations or that the other associations became further manifestations of the banks’ political interests. In practice, the former seems to have been the case. This case illustrates that the “problem” of vertical integration should become less apparent once the industry itself is vertically integrated.

Indeed, one can see this clearly by comparing the Investment Dealer's Association, (IDA) and the associations representing insurance companies. As a result of deregulation and the banks' takeover of all leading securities companies in Canada, the IDA now represents bank-owned investment dealers' concerns:

. . . in Canada, the Canadian Bankers' Association stands out as a strong association: its staff complement far exceeds that of other groups. In addition chartered banks must, by law, belong to the association giving it maximum density of representation and a limited public status. The Investment Dealers Association representing the securities sector also has a strong position, particularly given the self-regulating function delegated to it by the state. Since the securities affiliates of the chartered banks dominate these markets [since 1987] and have a strong position in the IDA, this association's capacity becomes a second source of strength for the commercial banks.⁵³

The insurance industry, protected from bank competition and takeovers, still has an insurance industry association representing powerful, non bank-controlled players and thus struggles against the banks on a range of issues.

Coleman concludes that with the lack of an integrative mechanism to overcome vertical integration, associational politics in Canada was "pluralist." However it is undoubtedly the case that when it comes to transmitting economic power potentials into political power, the commercial banks, represented by various organizations, ". . . have a clear upper hand in this more pluralist game."⁵⁴

3) The structure of policy networks – state structures and their relations with powerful economic interests – the final "filter" through which FSPs economic power must pass if they wish to dominate policy.

Examination of the economic structure of the financial services sector, in order to reveal the power potential of FSPs and the associational interest intermediation system, is

⁵³ Ibid., p. 54.

⁵⁴ Ibid., p. 66.

not sufficient to capture the political power of banks and other financial companies. These factors alone tell us only how potentially politically powerful they might be. According to Coleman we also need to examine the structure of the state – the institutions within which FSPs seek to command or constrain policy outcomes. Even if economic interests are powerful and politically well organized, a strong state, closed to their demands, will be able to pursue independent policies. We need to know how the state is organized and how that organization may affect the ability of FSPs to determine events.

Coleman categorizes the relevant state agencies in the sector as being; finance ministries, central banks, and the regulatory agencies. Crucially, Coleman does not include the policymaking institutions of legislatures in his overview of public agencies in the sector. Parliament, its committees and its role in drafting and passing legislation is ignored. This is an important point to which we will return.

Coleman suggests that states have more capacity to engage in anticipatory policymaking when the finance ministry, the central bank, and all other state agencies are involved in the process and share perspectives. Arguably this decreases the power of FSPs when their perspectives are at odds with the government agencies. Coordination and consensus between public institutions is also enhanced when there are fewer agencies. In the Canadian case, Coleman argues that state capacity is lower than in many other countries. Firstly, the Bank of Canada does not have a major role in regulating FSPs.⁵⁵ The Bank of Canada is a “pure” central bank, “Hence its relations with the sound finance community are less systematic and its perspective highly focused on the

⁵⁵ This was clear from interviews with Bank of Canada officials who had little interest in regulatory concerns in the sector outside of those that related directly to questions of monetary policy. Source: Confidential Interviews, 2005.

monetary policy implications of banking and securities policy.”⁵⁶ This means that the Department of Finance must act without the supportive expertise and legitimacy of the Bank of Canada. Second, there are a large number of key agencies in the Canadian policy community, each charged with its own limited responsibilities. Not only do we have to consider the Department of Finance, but there are other functional federal regulators, like the Office of the Superintendent of Financial Institutions (OSFI) and the Canadian Deposit Insurance Corporation (CDIC). On top of that there are provincial regulators. In the case of Quebec and Ontario there are ambitious provincial regulators, who do not always share the goals of federal agencies. In short, Canada has a weak central bank, in terms of its oversight and connection with the industry, and a Department of Finance that, despite being at the centre of federal policy (the CDIC and OSFI nominally report to the ministry), has little control over, or coordination with, provincial agencies. Coleman concludes that at least in theory, Canada has less state capacity than is the case in some other jurisdictions.⁵⁷

Nevertheless, Coleman does argue that there has been a strong consensus within federal agencies about policy goals for the sector. The Department of Finance has a coordinating influence. Its view is broad and all-encompassing, balancing the efficiency of market concerns of the Department of Finance with the soundness of institutional perspectives that are taken more seriously by the regulators at the OSFI and CDIC. It also takes a leading role in promoting the industry as an engine of economic growth and

⁵⁶ Coleman, *Financial Services, Globalization and Domestic Policy Change*, p. 73.

⁵⁷ *Ibid.*, pp. 76-77.

tries to manage the federal-provincial relationship in the sector.⁵⁸ One suspects that had the constitutional division of powers been slightly different, had the federal government been given more jurisdiction over all of financial services, or had they historically sought to maximize what jurisdiction they had, then state capacity in Canada might have been quite high with the Department of Finance playing the lead role in overseeing the sector. Coleman notes that structures would have been in place for the government to “devise and implement an anticipatory strategy of action.”⁵⁹ However, the provinces are outside of this system of coordination.

Coleman argues that:

The degree of state capacity affects the options available to policy-makers when faced with the kind of rapid change associated with globalization. As state capacity increases, policy-makers are provided with more latitude to choose whether to follow an anticipatory or a reactive approach to policymaking.⁶⁰

In the Canadian case, Coleman argues that attention to these factors illustrates a basic problem: Canadian policymakers would find it difficult to manage the process of policy change in an anticipatory way that strategically responds to the challenges of globalisation, because, “Domestic political institutions inhibited formulation of a common anticipatory strategy of action.”⁶¹ Canadian policymakers were confronted by well organized, powerful private sector interests in an environment of weak state capacity, meaning that policy was likely to be largely reactive to events and the demands of leading FSPs. Furthermore, Coleman argues that globalisation and the host of changes

⁵⁸ Ibid., p. 210. Coleman notes that in his research, “All agreed that the finance ministry had the responsibility for designing policy and that the other agencies were advisers to the ministry.” Coleman, Financial Services, Globalization and Domestic Policy Change, p. 211.

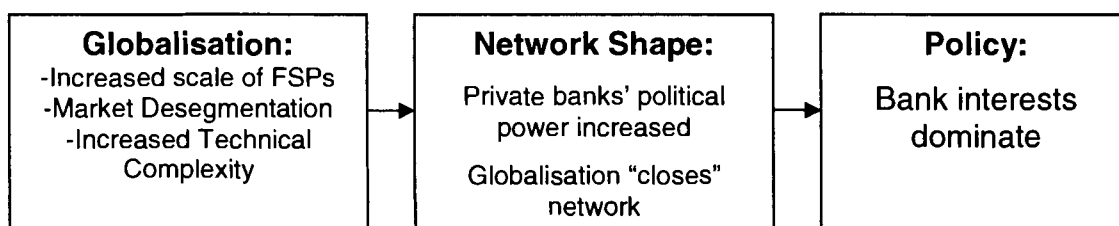
⁵⁹ Ibid., p. 211.

⁶⁰ Ibid., p. 79.

⁶¹ Ibid., p. 202.

associated with market desegmentation would act to expand the powers of Canada's big banks in relation to other actors and that this would entrench their pervasive control over policy outcomes.

Figure 3.4: Coleman's Hypothesis – Globalisation and “Esoteric Politics” in Canada



To simplify, Coleman's argument is expressed in Figure 3.4. Essentially, Coleman's account emphasizes how changes associated with globalisation and market desegmentation and the process of deregulation all tend to increase the power of the banks in relation to other network participants. This ensures that, at the very least, the policy network remains a closed "policy community," and that the traditional "esoteric politics" pattern, in which the federal government can be relied upon to support the interests and political demands of the banks, should be entrenched.

IV) Macro Institutional Factors and the Legacy of Deregulation:

Interestingly, although Coleman's analysis attempts to consider the role of macro institutional factors, he does not synthetically consider how the initial *ad hoc* lurch

towards deregulation itself altered the institutional context of this policy network.⁶² Deregulation altered the effective federal division of powers in this sector, collapsing several policy networks into one. It also unintentionally increased the role of the House of Commons in guiding policy. More recent networks analysis, in particular the proposals for a clearer “structural” approach to networks, by Carsten Daugbjerg and David Marsh, has suggested the need for more attention to precisely these kinds of institutional considerations, since they, much like globalisation, will also affect the shape of a policy network, and thereby contribute to policy outcomes.⁶³ Attention to these considerations in the Canadian context suggests there was good reason to think that the financial service policy network would “open” in the wake of deregulation, producing a more conflictual issue network than had existed in the past.

Daugbjerg and Marsh highlight a number of institutional factors that may affect network shape:

a) State Strength: They suggest that network analysis needs to disaggregate “state strength” and ask more specifically how strong the state is in the policy-specific domain. They argue that, normally, greater centralization makes a state stronger in relation to the organized interests with which it deals inside the network. Federal states or those with strong parliamentary checks on the power of the executive tend to have weaker agencies at the sectoral level.⁶⁴ Importantly, in sectors where state capacity and state agencies are weak, closed policy communities are actually less likely to emerge. In

⁶² His work does explore the question of weak state capacity in policymaking and its role in the relative power of the banks *visa vis* Government agencies.

⁶³ It is interesting to note that Coleman and Atkinson, p. 163, made a similar point as they were concerned that consideration of the role of broader state institutions was not being adequately integrated into the networks approach.

⁶⁴ Daugbjerg and Marsh, p. 64.

part this is because the state will be too weak to exclude groups negatively affected by policy outcomes from entering the policy network. Indeed, where there are weak state actors operating in networks with powerful *competing* interests, an open “issue network” with constant conflict over basic policy goals is likely to emerge (see Figure 3.3).⁶⁵ Similarly, one of the principle threats to an existing policy community is that in a weak state, actors outside of the network may be able to enter it as evidence grows that the “costs” of policy outcomes are being imposed on actors excluded from the policy process. In sum, weak states with poor coordination are more likely to be sites where policy communities will degenerate into issue networks.⁶⁶

In the Canadian setting, as the discussion of Coleman’s work has just illustrated, it is widely argued that state capacity in financial services is weak.⁶⁷ Harris notes that the complexity of keeping up with industry changes has stretched the expertise of state policymakers, leaving them ever more reliant on the private sector.⁶⁸

This weakness was arguably exacerbated in the era of deregulation by the federal government’s failure to establish an industry-wide regulator charged with responsibility for prudential concerns, the oversight of business practices, and industry competition. Instead, questions about how the industry would be regulated went unresolved. Although

⁶⁵ Ibid., p. 66.

⁶⁶ Ibid. They argue that policy networks approaches could benefit from a Marxist theory of the state, which would suggest the likelihood of many closed policy communities dominated by producer groups. However, this analysis would have to integrate consideration of parliaments and political institutions since they are likely to be sources of sectoral variation in the power of business elites. In sectors where state agencies are weak or are poorly coordinated, or in which parliament is an active and effective check on executive power, issue networks may emerge making domestic politics and partisan struggle more important than Marxists might predict.

⁶⁷ Coleman, in *Financial Services, Globalization and Domestic Policy Change*, made this point. See more recently, Harris, “The Globalization of Finance,” pp. 361-388

⁶⁸ Harris “The Globalization of Finance,” says that, “fortunately” everyone understands this and there is reliance on both the industry for information and on international regulators.

deregulation strengthened the jurisdictional authority of the federal government, it did little to improve the strength and effectiveness of federal regulatory institutions.⁶⁹

b) Policy Networks and Parliaments - Networks analysis justifiably often plays down the role of legislatures and parliaments in influencing policy outcomes. Outside the US, executive branches of government tend to dominate the legislature, reducing their importance as generators of policy. Certainly this has been the case in Canada and Britain.⁷⁰ However, Daubjerg and Marsh suggest that in environments where there is weak state capacity, such as the absence of a powerful sectoral regulator, or where there are divided levels of authority, parliaments may play an important role, irrespective of executive dominance. In terms of parliaments' legislative role, they argue:

. . . it does not make sense to argue that parliaments are excluded from influence because we cannot observe their direct effects upon the policy outcome. Parliaments do, however, rarely change policy proposals agreed on in sectoral policy networks, but this does not mean that they are too weak politically to oppose such proposals, rather it suggests that their views are taken in to account in advance.⁷¹

The tendency to ignore the role of parliaments is partially based on poor empirics in networks analyses. Networks analysis is frequently biased toward observable exhibitions of power and thereby ignores the implicit structural power of parliaments.⁷² It may be

⁶⁹ This was particularly notable in regards the government's commitment that "big shall not buy big," a general principle that banks would not be allowed to merge following deregulation, thus ensuring basic levels of competition. No federal agency has responsibility for ensuring this provision. As a result, when in 1998 Parliament and parliamentary committees asserted a role in defending this principle, the government found itself in a very difficult position. MPs provided anti-bank groups with a platform to attack the merger proposals. Had decisions like these been under the purview of powerful industry-wide regulator, events might have moved differently.

⁷⁰ Networks analysis has tended to view policymaking as "non-parliamentary," instead focusing on the relationship between agencies of the executive and private actors. See Daubjerg and Marsh, p. 62.

⁷¹ Ibid.

⁷² Non-legislation can also be evidence of Parliaments' power. Networks only propose policies that can pass and rarely produce proposals they know will be blocked by Parliament.

that parliaments play a role in the policy process often by choosing not to act; thereby blocking new policy initiatives in the policy subsystem.

Beyond the legislative role, parliaments and political parties also play a role in providing access to groups that are not positively predisposed towards existing policy orthodoxies. On the one hand, closed policy communities are likely to emerge only if producer groups enjoy support from a dominant state agency which reduces the role of the legislature. More open issue networks tend to occur when a large number of interest groups with stakes in a policy issue have some support in Parliament. Elected officials are more apt to invite dissident groups into policy debates than are state agencies.⁷³ Thus, the relative importance of Parliament can have a determinant effect on network shape.

In Canada, traditionally there has been little role for the House of Commons in this sector. Prior to the deregulatory period, the Senate, and the Senate Standing Committee on Banking, played the most direct role in reviewing policy in this area. Colin Campbell argues that the ample representation of the banking community and members of bank boards of directors on the Senate Committee meant that it was little more than a “lobby” for bank interests in Ottawa, often “dragging its feet” on any legislation that would act to disadvantage the Canadian banking industry.⁷⁴

However, since the 1980s the House of Commons has become a much more important site for politics in this sector, albeit one that is curiously overlooked. The failure to develop a strong national regulator during the deregulatory period has meant that any serious complaints about developments in the financial services industry are

⁷³ Daubjerg and Marsh, p. 63.

⁷⁴ Campbell, p. 12.

directed towards elected officials, rather than being handled by regulatory officials who might be sympathetic to major industry participants..

The process of deregulation, rushed and ahead of schedule, left a number of important regulatory concerns unresolved. For example, in the process of deregulation the government promised an informal rule that would bar mergers between large financial service providers: the “big shall not buy big” rule. This was intended to ensure domestic levels of competition. However, no regulator was charged with the responsibility and criteria for enforcing this rule. As a result, the House of Commons has informally re-asserted its role in reviewing large bank mergers, a role that it had surrendered in the 1910 *Bank Act*.

This is just one example, but the point should be clear: the lack of strong central agencies, combined with the *ad hoc* nature of deregulation, has created ideal conditions for ordinary MPs to assert a larger role in the sector than has been the case in the past. In turn, groups traditionally excluded from the tight relationship between the Department of Finance and the “big banks,” such as small business associations, consumer groups and other large FSPs threatened by the banks’ increasing intrusion into their markets, often find MPs to be allies in their attacks on the privileges of the banks. MPs seek to both gain support from dissident groups, as well as benefit from the political unpopularity of the banks. Thus, other sectoral interests find Parliament to be a useful “entry point” into policy.⁷⁵

There are now three parliamentary committees that “matter” in the sector. The House of Commons Finance Committee, as one of its major responsibilities, oversees the

⁷⁵ Since Coleman argues that policymaking in this sector tends to be dominated by financial services firms and the Department of Finance, he pays little attention the role of Parliament and parliamentary committees. This seems a problematic oversight given subsequent events.

regulation of the financial services industry. The House of Commons Industry Committee has also taken an interest in the sector, particularly as it pertains to the interests of the financial service industry's commercial clients. The Senate Banking Committee, probably the most important committee in the Senate, also oversees the sector.

Since deregulation a "rivalry" has emerged between the Senate Banking Committee and the Commons Finance Committee as deep divisions of opinion have emerged, particularly over mergers between banks. While the Senate Committee has taken a supportive view of the banks' position, the Commons has not. Members of the Senate committee view the perspective of the members of the Commons committee as being "too political" or "motivated by headlines" rather than the needs of the industry. Indeed, one Senator interviewed for this study extolled the benefits of not being elected since it freed him from the kinds of partisan concerns that undermined, in his view, the work of the Commons Finance Committee.⁷⁶

While these committees can theoretically "kill" government legislation, most view that as unlikely given that solid government majorities usually dominate committee business.⁷⁷ However, these committees can propose changes to government legislation, can have a prominent role in investigating the sector, and can make policy recommendations prior to any actual drafting of legislation by the Department of Finance. In fact, one of the most significant changes to the Canadian policymaking environment has been the expansion of the review role of these committees. Rather than responding to government papers as they did in the 1980s during deregulation,

⁷⁶ Source: Confidential Interviews, 2005.

⁷⁷ See Guy Christopher, "Capital gains: A banker's guide to Ottawa," *Canadian Banker*, March-April 1998, Vol. 105, Issue 2, pp. 27-34.

parliamentary committees since 1997 have been allowed to express their opinion on policy prior to the government's formulation of its position.

From a networks perspective, the expanded role of Parliament in the wake of deregulation, in combination with weak state capacity, should theoretically lead to the expansion of the policy network and erode the basis for the closed esoteric politics of the past. Thus a networks analysis that takes institutions and institutional change more seriously as determinants of network shape can lead to a very different hypothesis than the globalisation and esoteric politics argument offered by Coleman. This study argues that in the Canadian case there were reasons to suspect that deregulation would "open" the policy network, at least for a time.

c) Federalism, the Division of Powers and the Boundaries of the Policy

Subsystem: Finally, deregulation of the financial services industry implicitly collapsed several, somewhat separate, policy subsystems into one. Where provinces had traditionally regulated the trust, securities and insurance sectors and the federal government the banking industry, now all industry sub-sectors, including the influential insurance industry, have a more direct stake in the decisions made by the federal government regarding the powers banks should or should not have. Deregulation, by eroding pillarization, has redefined the basic "policy domain" - the range of domain-affected interests that may wish to influence events. We have gone from having a federal "banking policy network" to a national "financial services policy network" bringing together a wider array of economic interests. This factor and its likely impact on the policy network has been strangely ignored.

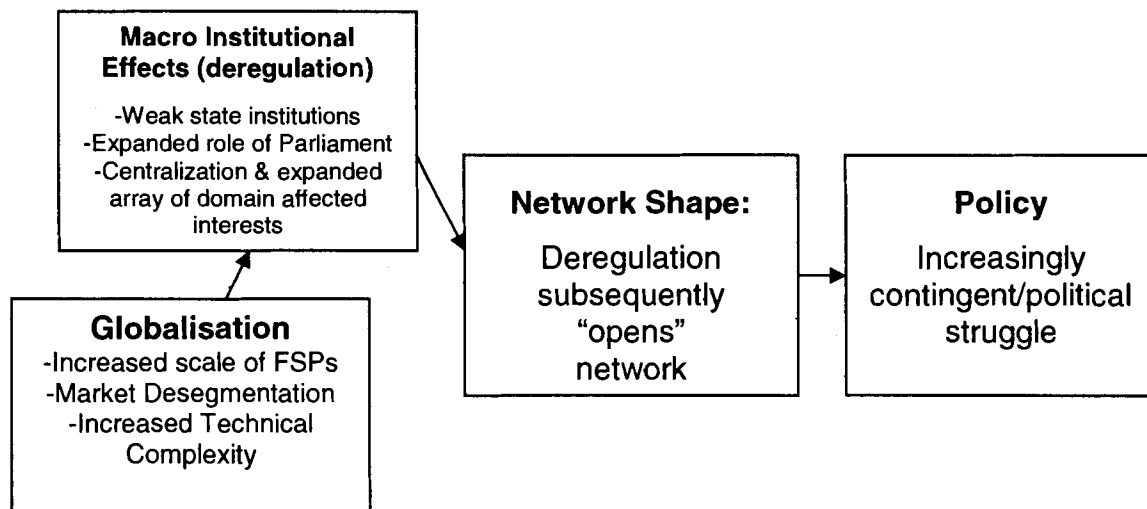
For networks analyses this is crucial to network shape as these types of macro institutional rules effectively determine the boundaries of a network.⁷⁸ Deregulation would, at least in the short term, expand the range of affected economic interests that may wish to become more directly involved in the federal government's policy deliberations. Thus deregulation itself increased the likelihood of a more open network, with a wider array of participants, including many which might oppose the banks' policy agenda. As noted previously, since the 1980s this sector has gone through extensive *centralization*, in which the federal government has vastly expanded its powers. This is also likely to draw a wider array of actors into the sector.⁷⁹

Attention to these three institutional considerations identified by networks scholarship, the degree of "state strength," the role of Parliament and the effect of centralization on the network's boundaries, leads to a different hypothesis about developments than that provided by the globalisation/esoteric politics argument (see Figure 3.5).

⁷⁸ Coleman and Perl.

⁷⁹ Harris "The Globalization of Finance," argues that deregulation was driven by the banks' interests, but events were subsequently complicated by the legacy of pillarization which ensured that industry often did not speak with one voice. Each component sub-sector of the industry has fought to protect its turf while trying to gain access to other sectors.

Figure 3.5: Hypothesis - Deregulation and the “Issue Network”



While networks analysis focusing on globalisation as a macro causal explanation for policy change suggests a simple entrenchment of the tight relationship between the banks and the federal agencies, institutional change may offset those trends and have unforeseen long-term effects on network shape. Daugbjerg and Marsh’s more institutionally-sensitive approach to networks analysis draws our attention to such factors. In the Canadian financial services sector there was good reason to suspect that following deregulation, the collapsing of federal and provincial jurisdictions, the increased role of Parliament in overseeing the sector, and the continued weakness of state agencies all provided conditions for network expansion. Thus, the initial response to globalisation, in the form of deregulation, created conditions for the closed financial services policy community described by Coleman to degenerate into a looser issue network.

This change in network shape would lead us to expect that the struggle between different interests would become more pronounced, changes in the general trajectory of

policy more likely, and that policy outcomes are likely to be less predictable and more contingent on domestic political struggles.

Canadian Financial Services and Globalisation: A Closed Policy Community or an Open Issue Network?

In the subsequent sections of this dissertation, it will be argued that both sets of hypotheses advance our understanding of policymaking in this sector. Coleman's arguments that globalisation would strengthen the hands of Canada's big banks, entrenching esoteric politics, does seem to fit the politics of the deregulatory period in Canada (events from 1980 to 1996/1997). As will be illustrated below, throughout that period Canada's banks enjoyed a privileged and informal dominance over policymaking outcomes. However, since the mid 1990s, esoteric politics has broken down. The institutional legacy of deregulation has ultimately encouraged an opening of the policy network, which in turn has altered the direction of policy, undermining support for further deregulation and conglomeration. The institutional factors identified by Daugbjerg and Marsh have counteracted the impact of globalisation and stimulated a re-politicisation of this sector. Policy outcomes are now more clearly contingent on domestic political struggles than was historically the case.

V) Conclusions:

Coleman's study ended long before the policy crises of 1998 and thus may have overestimated the robustness of "esoteric politics." In light of subsequent evidence of widespread anti-bank backlash in the wake of the 1998 merger proposals and the sustained epistemic uncertainty in the sector, we need to reevaluate the interaction of

globalisation and esoteric politics. In this case, globalisation may have stimulated a “re-politicisation” of the sector and a breakdown in esoteric politics.

Drawing on the esoteric politics argument and the state of policymaking at that time, Coleman assumed that the network included only the Department of Finance, its subordinate regulators, and the most powerful financial service providers. By failing to include the parliamentary committees charged with the oversight of legislation in the sector, Coleman may have underestimated the size of the network.⁸⁰

Coleman makes an important overarching claim about financial services policymaking in different countries. He says, “. . . it is important to note one similarity: the policy network tends to be limited to financial firms and their representational associations only.”⁸¹ This is the logical consequence of the esoteric politics argument, because this sector is notably isolated from other societal interests. However the question is, has Coleman correctly identified the impact of globalisation and deregulation on the Canadian policy network? Crucially, if parliamentary committees became active institutions in the policy network, then the range of societal organizations involved in policymaking might have become larger than expected.

Empirically, this is undoubtedly the case. Coleman’s model, intricately elaborate for a cross-national comparison of financial services policymaking, leaves out a number of considerations that must be included if we are to understand the current politics of the sector. Indeed, Coleman identifies a range of other “interested” actors in the sector:

In addition to financial services firms, individual citizens depositing or investing their savings, non-financial firms looking for credit and investment capital, and governments all have an interest in financial

⁸⁰ Although, it might also be reasonable to say that Coleman’s analysis was correct, and that subsequent events simply increased the role of Parliament.

⁸¹ Coleman, Financial Services, Globalization and Domestic Policy Change, p. 87.

services policy. The representation of these interests in the policy process was not common under the older, informal esoteric politics. Nor is their representation automatic in the present era.⁸²

However, in Canada, Parliament has become an important state agency in the network. For example, it has been argued that one of the principal reasons that the insurance industry has not been exposed to direct bank competition by deregulation, as occurred with the securities industry, is politics. The mutualized insurance companies and their thousands of local dealers are politically influential with MPs and have successfully lobbied for continued restrictions on bank insurance sales.⁸³ The insurance industry may not have the same close relationship with the Department of Finance and their associational representatives do not have the same access to the Finance Minister that the banks have; yet they have fought a successful delaying action against the banks. Without including the parliamentary committees in the policy network we cannot capture this influence.

What is true of smaller industry groups is also true of other associations representing wider social constituencies not explicitly part of the financial services industry. For example, small business associations are also influential with individual MPs. Consumer groups have become more active participants in the sector. Consumers are using more financial services than ever, but getting almost all of them from their bank. These consumers have good reasons to want closer regulation of bank service fees, credit card interest rates, and bank business practices. Many consumer associations,

⁸² Ibid., p. 93.

⁸³ See, Michael Babad and Catherine Mulroney, Pillars: The Coming Crisis in Canada's Financial Industry, (Toronto: Stoddart, 1993), p. 25, or Walter Stewart, Bank Heist: How Our Financial Giants Are Costing You Money, (Harpers Collins, 1997), p. 207. Moves to allow banks into insurance provision challenged the livelihoods of insurance salespeople who were notable for their political activism. Said one MP, “. . . you don't just take 10,000 people and destroy their livelihood overnight. That's not what government's supposed to do.” See, Babad and Mulroney, p. 25.

benefiting from the widespread public antipathy to the banks, have become regular participants in financial services policymaking.

Networks analysis must therefore move beyond an isolated consideration of globalisation, and recognize that Parliament is also part of the policy network. Thus other groups, or “advocacy coalitions” with “anti-bank” policy goals, may be important actors in the network. Indeed, to the extent to which globalisation exposes ordinary Canadians and small business to increasing financial insecurity, by privatizing responsibility for social security and pensions, and making Canadians more reliant on their own savings and investments, it may act as a generator of public demands for closer regulation of the banks. Working through a more “open” policy network, globalisation might theoretically entrench the esoteric politics of the sector; but it also could unleash powerful domestic interests for closer, public, political oversight of the sector, something Coleman admitted as a possibility.⁸⁴

Closer attention to macro institutional factors and changes in the institutional setting of the financial services policy network gives us reason to expect the unexpected in the Canadian case. The initial handling of deregulation in Canada was likely to undermine the closed policy community. Adam Tickell has argued that the struggle over mergers in 1998 illustrates clearly that “politics matters” in the regulation of financial services in Canada.⁸⁵ Tickell suggests that the merger proposals were ultimately rejected because the banks’ political strategies were poor, particularly given the growing domestic

⁸⁴ Coleman refers to this phenomenon as a kind of “Trojan Horse,” increasing public interest in the sector’s policymaking processes. See Coleman, *Financial Services, Globalization and Domestic Policy Change*, p. 4 and 19. However, given the impact of globalisation and the particular path of deregulation and desegmentation in Canada, Coleman was sceptical that that would be the case.

⁸⁵ Adam Tickell, “Global Rhetorics, National Politics: Pursuing Bank Mergers in Canada,” *Antipode*, 32:2, 2000, pp. 152-175.

political opposition to the increasing dominance of Canada's biggest banks. Indeed, Tickell suggests that this was a major setback for the contemporary neo-liberal "hegemonic project" in financial services. The struggles of 1998 opened a rift between the Canadian state and Canadian financial capital over how the industry should be regulated in the 21st century. While domestic politics and domestic political structures seem to have played a crucial role in affecting policy outcomes in the sector, little effort has been made to explore the current domestic politics of financial services regulation. This is because most analysis has tended to focus on the role of globalisation in policy change rather than the role of the Canadian domestic institutional setting.

**SECTION TWO: “CANADIAN FINANCIAL SERVICES
REFORM IN AN ERA OF GLOBALISATION – ESOTERIC
POLITICS”**

**CHAPTER 4: “THE ‘ESOTERIC POLITICS’ OF
DEREGULATION – UNDERSTANDING
CANADA’S ‘LITTLE BANG’ (1984-1987)”**

“People of the same trade seldom meet together, even for merriment or diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.”

Adam Smith, The Wealth of Nations

I) Introduction:

On the weekend of October 19, 1986, Canada’s Finance Minister, Michael Wilson, held private negotiations with the chairmen of all five of Canada’s biggest banks at the Chateau Montebello resort in Quebec. The “Montebello” meeting included only the most powerful figures in Canada’s financial services industry: the bank chairmen, the head of the Canadian Bankers Association (CBA), the Deputy Minister of Finance, and Wilson himself; an “extraordinary summit.” Industry observers claim that it was the first time the bank CEOs formally met like this with the Finance Minister.¹ The bankers wanted to convince Wilson of the need for industry deregulation. They wanted to remove the traditional barriers that prevented them from offering services in the other “pillars” of the industry. In particular, given signs that Ontario and Quebec were going to deregulate ownership restrictions in the provincially regulated securities industry, they asked the government to immediately amend Federal *Bank Act* provisions that prevented them from owning securities firms. They argued that the rest of the world was abandoning market segmentation and that Canada’s banks were being left at a global disadvantage.² Robert MacIntosh, the head of the CBA, argued that disintermediation and

¹ The Montebello meeting has been well documented, thanks in part to the number of journalists who covered the event, but also because Robert MacIntosh, then head of the Canadian Bankers Association, related the events in some detail in his biography. See Robert MacIntosh, Different Drummers: Banking and Politics in Canada, (Toronto: MacMillan Canada, 1991) pp. 275-277.

² Ibid.

securitization, in which securities were becoming a more popular (and cheaper) way for large corporations to raise money, was hurting the industry. As a result the banks wanted the government to accelerate already-announced plans for industry deregulation and allow them rights that “universal banks” had in other jurisdictions.

Wilson, who had recently become Minister of Finance, was ideologically committed to deregulation and free markets and knew the banking and securities industries very well. Wilson was a former Vice President of Dominion Securities.³ The new Mulroney Government was politically-imitative of the Reagan and Thatcher administrations which had already began financial services deregulation. Within only a year of being in office, Wilson’s Finance Department had issued a discussion paper which proposed a gradual program of de-pillarization to be initiated by the *Bank Act* revisions scheduled sometime before 1990. Mulroney’s Conservatives, while supportive of deregulation across the board, saw deregulation in financial services as a way to increase competition which would in turn improve efficiency and provide additional financing opportunities to Canadian businesses looking to expand. While Wilson promised nothing at the meeting, behind the scenes, policymakers in Ottawa had already agreed to accelerate the process of deregulation and allow the banks to enter the securities industry.⁴

The banks’ push for deregulation came at a good time. Not only was the Government friendly to their proposals, but international negotiations (GATT and the

³ Michael Babad and Catherine Mulroney, Pillars: The Coming Crisis in Canada’s Financial Industry, (Toronto: Stoddart, 1993), p. 4.

⁴ Stephen Harris alleges that MacIntosh makes too much of the Montebello meeting in his biography (along with others). The Department of Finance already had agreed that the government had to make the move. See Stephen Harris, The Political Economy of the Liberalization of Entry and Ownership in the Canadian Investment Dealer Industry, Ph.D. Dissertation, Carleton University, 1995, p. 361, citation 72.

Canada-US Free Trade talks) were already underway, promoting liberalization and deregulation by removing domestic barriers to foreign banks. This was all a response to the changing nature of international financial markets (what would later be called globalisation). Furthermore, Canadian federalism and the division of powers in this sector, which gave provinces a role in promoting their own financial services industries, was also generating domestic pressure on the government to act.

Given these factors, events moved quickly after Montebello. Rather than having to wait several more years for the formal policy process of deregulation to unfold, legislation was hurriedly introduced, allowing the banks to operate securities subsidiaries (the legislation took effect only six months after the meeting, in June of 1987). As a result virtually all of Canada's biggest securities dealers were bought-out by Canada's big banks. This "little bang" as it has come to be called, was only a first *ad hoc* step toward the 1992 *Bank Act* revisions which would formally bring pillarization to an end. The banks and their "near bank" competitors would all be allowed to operate subsidiaries in each other's "turf."⁵ The Montebello meeting put in motion a process by which Canada would move from the system of pillarization to the universal bank model of financial supermarkets offering a full array of services. As Michael Babad and Catherine Mulroney argued at the time, "Canada may now be on the path to financial supermarkets and increased competition," or, on the other hand, the government may have simply set the stage for a crisis in which the industry would be dominated by a few banks, and "If competition dwindles, we are all affected."⁶

⁵ The only notable exception was the insurance industry which continues to be protected to this day – other FSPs cannot sell a full array of insurance products "in branch."

⁶ Babad and Mulroney, p. 7.

This chapter will illustrate that these changes were motivated by the interaction between globalisation, the opportunities it afforded network participants to pursue deregulation, and the Canadian institutional setting, which through the division of powers in this sector, enabled provinces to precipitously promote deregulation. The federal banking policymaking environment at the time illustrated the “closed” esoteric politics style identified by Coleman in the preceding chapter. A closed policy community, dominated by the federally-regulated big banks and the Department of Finance, informally “negotiated” policy outcomes: “In fact, only the large banks could claim a certain level of access to governmental authority during this period. This access, in part, is the result of the fact that they were the only completely federally-regulated industry in the financial services sector.”⁷ Little federal attention was paid to other pillars of the industry. Finance, the dominant state agency, alone oversaw the development of government policy proposals (through a series of coloured discussion papers), which preceded legislation.

Finally, as Coleman has suggested would be the case given weak state capacity in this sector, policy was “reactive” rather than anticipatory. Government officials responded to the demands of leading FSPs rather than mapping out an organized program of reform. While the Department of Finance initially proposed a gradual, phased process of desegmentation that would also ensure some level of domestic competition to the big banks, the policymaking process soon degenerated into a series of reactive initiatives to respond to crises beyond the government’s control. When it became apparent that the provinces were moving more quickly, the government abandoned its own proposal for

⁷ Ian Roberge, The Internationalization of Public Policy and Multi-level Governance: A Comparison of Financial Services Sector Reform in Canada and France, (Doctoral Dissertation: McMaster University, 2004), p. 102.

the gradual deregulation of the industry and in an “*ad-hoc*” manner, simply allowed banks to take over the securities industry. When two banks failed in the midst of the policy debate over deregulation, the government suddenly decided that de-pillarization would have to be accompanied by some sort of “re-regulation” and the formation of a new regulator to ensure the soundness of Canada’s financial institutions. Observers worried that de-pillarization would spark a race towards excessive industry concentration, leading the government to commit itself to an informal rule that would bar large banks from merging to reduce competition – the “big shall not buy big” rule. As a result, deregulation left many basic questions about the regulation of the industry unresolved. Who was going to regulate the industry to protect consumers from improper practices? The risk of “self dealing” and “non arms length” transactions became more probable in a de-pillarized environment. Also, who was going to regulate the competitiveness of the industry - who was to ensure that “big shall not buy big”? The government’s reactive, *ad hoc* capitulation to the banks meant that there were no clear plans in place to deal with these remaining regulatory questions. The nature of Canada’s “little bang” has had profound long term implications and has played a role in the subsequent “breakdown” of esoteric politics.

II) The State of the Industry 1984:

The “four pillars” of Canada’s financial services industry were still broadly in place when the Conservatives came to office in 1984, although some desegmentation of the market had already occurred. Traditionally, different types of companies could not offer a full range of services to customers, but had to specialize and compete only within their sub-sector (or “pillar”) of the financial services community. Banks could offer basic

banking services to individuals and corporate clients, but they could not manage trusts, manage their clients' stock portfolios or sell them insurance. Ownership restrictions reduced competition within these sub-sectors by limiting the potential for new market participants to emerge. Generally, the purposes of pillarization were threefold:

- 1) Prevent industry-wide conglomeration
- 2) Prevent problematic conflicts of interest (like tied selling or self dealing etc)
- 3) Prevent risky behaviour – lending or stock promotion of/to affiliated companies⁸

In practical terms, one major benefit of pillarization was that by preventing conglomerated FSPs from emerging and providing a wide array of services, it inherently reduced the likelihood of improper business practices without the need for close government supervision. For example, by preventing banks from selling securities to their clients the government did not need to worry about the expansion of potential “self dealing” conflicts of interest. Self dealing was risky to consumers. For examples, a bank could theoretically sell to its own customers stock in a company which was in trouble, and significantly indebted to the bank, without disclosing the company's problems to the customer. By doing so the bank could reduce its own exposure to that company's collapse by transferring it to its own customers. Cross-sector conglomeration created potential conflicts of interest which require closer regulation and supervision.

Arguably, pillarization also ensured that consumers had multiple choices in institutions (depositors could place their savings in a trust, bank or credit union, for example) albeit in an environment where the service providers were not fully

⁸ See Walter Stewart, Bank Heist: How Our Financial Giants Are Costing You Money, (HarpersCollins, 1997), p. 54.

commensurate with one another and therefore perhaps not fully competitive with one another.⁹

Prior to deregulation, federal oversight of the pillar system focused almost exclusively on the banking policy sector which was the only sector for which Ottawa had sole jurisdiction.¹⁰ The regulation of the banking industry was conducted via the *Bank Act*, the principle government legislation overseeing the industry. The *Bank Act*, prior to 1987, was subject to review and revision every ten years. After 1987, the Act was changed, requiring that the government review and make any necessary changes to the act every five years as the pace of industry reform accelerated due to globalisation and technological change. Prior to deregulation, under the *Bank Act*, there were two federal regulatory agencies:

- 1) The *Inspector General of Banks* was the main regulatory agency, monitoring the banks business practices for prudential reasons. The Inspector's purpose was to prevent bank failures.
- 2) The *Canadian Deposit Insurance Corporation* (CDIC) The CDIC provided insurance to depositors in federally regulated institutions.¹¹

⁹ The system of pillarization was not watertight, and indeed firms had been allowed outside of their core activities. William Kennett, the Inspector General of Banks in the 1980s argued that the existing policy framework allowed this to occur to ensure some basic "controlled competition" in what was otherwise a potentially oligopolistic market: "... the policy ... permits these institutions to offer supplementary services which compete to some extent in the core area of other groups. For example, trust companies do some commercial lending; banks do some dealing in securities ...". See William Kennett, "Submission of the Inspector General of Banks," in Ontario, Ontario Securities Commission, Report to the Minister of Consumer and Commercial Relations, December 31, 1982, p. 10. Thus pillarization did not prohibit inter-pillar competition, it simply prohibited inter-pillar ownership structures which confused what a firms "core" activity was.

¹⁰ Prior to the 1990s the federal financial services policy sector was a banking policy sector. For example, insurance issues were ignored. The federal *Insurance Act* went unreformed for almost 50 years prior to Canada's "little bang." See, Roberge, p. 102.

¹¹ Perhaps the most important regulatory change in the 1960s was the creation of a national deposit insurance system, The Canadian Deposit Insurance Corporation (CDIC). The CDIC meant that a "run" on a Canadian bank became much less likely as depositors money was insured (to a specified amount) even if a bank failed. In theory, it was thought that the formation of the CDIC should have helped small banks survive as they were inherently riskier places to keep money than a big bank. See, Stewart, Bank Heist, pp. 56-58.

After the 1980 revisions to the *Bank Act*, which had taken the better part of a decade to work out, banks were divided into two categories. Schedule I banks make up the “first tier.” Schedule I banks had to be “widely held,” meaning that no individual shareholder could control more than 10 percent of the shares of the bank. Also foreign ownership was limited. In fact, the original reason for the “widely held” restriction was to limit the possibility of foreign takeovers of Canadian banks. However, over the last half century the rule has acted to prevent the emergence of large new banks to compete with the existing Schedule I banks as it makes the financing of a new bank extremely difficult.¹² All five of Canada’s “big banks” (as they are commonly referred to) are Schedule I banks.

Schedule II banks might be “closely held” by eligible Canadian financial institutions or eligible foreign institutions (after 1981). Schedule II banks did not enjoy all of the privileges of Schedule I banks and were limited from offering a full array of services. Although there are far more Schedule II banks in Canada, most are simply small subsidiaries of foreign banks offering limited services to commercial clients.¹³

The rules governing the business activities of Schedule I and II banks and the competition between the two categories of banks have been one of the crucial questions that the government has investigated since the 1960s. Governments, at least superficially, have shown a consistent interest in exploring how they might increase the

¹² As in all industries, new entrants are usually “closely held” by a small number of investors until they are well established and can attract a wide array of shareholders to their stock.

¹³ For more information on Canada’s banking regulations and the activities of Canadian banks see: <http://www.fin.gc.ca>

level of competition faced by the Schedule I banks. Indeed it was major topic of inquiry for the *MacKay Task Force* in the late 1990s.¹⁴

As discussed in Chapter One, the other pillars of the industry, including the securities industry, were traditionally regulated by provincial governments. In fact, the rules governing the securities industry were “set” by the province of Ontario where most of Canada’s securities dealers were based. However, the federal government also chartered trust companies that operated across provincial boundaries. Furthermore, by being the exclusive regulator of the big banks, by far the biggest players in the financial services industry, the federal government inherently exercised some influence over all of the other segments. For example, provincial governments could try to deregulate the securities industry by removing ownership restrictions on securities firms, but if the federal government did not allow chartered banks into that industry then deregulation would only be partial. Pillarization was still the dominant policy paradigm in the country in the 1980s and the federal government had considerable influence and control over that complex regulatory system beyond its own banking policy network. This carefully-designed regulatory environment changed markedly as the divisions between the different types of financial services companies were lifted.

The 1981 *Bank Act* changes, the first of significance since the 1960s, established the Schedule II bank structure, which allowed foreign banks a small presence in the Canadian market. It also reduced reserve requirements, and removed the remaining

¹⁴ The 1980 *Bank Act* revisions created the Schedule II category ostensibly to encourage the establishment of new banks; reflecting the widespread concern that the big banks were “oligopolistic.” The results have never been very impressive, as little has changed in terms of the big banks’ market shares. In 1997, the Government asked the *MacKay Task Force* to investigate how to improve the competition for banking services from these kinds of second tier industry participants. This became even more important as the government has confronted the possibility of mergers between Canada’s small number of Schedule I banks.

restrictions on banks' rights to offer mortgages. More interestingly, under the changes, banks were also permitted to own and operate provincially regulated mortgage and loan companies for the first time.¹⁵ This was a small precursor of the pattern that de-pillarization would follow over the subsequent two decades. As the federal government expanded bank powers by allowing them to own other kinds of FSPs under provincial jurisdiction, it effectively expanded its own oversight, but also brought those types of firms into the federal banking policy network. Stephen Harris argues that in this period, the government failed to consider the spillovers of this kind of deregulation: how would this affect the provincially regulated bank competitors? Since the 1981 revisions focused on banks (as the federal government inevitably did), the result was that bank powers were being increased without the similar benefits for other FSPs. Provincial "near banks" began to lose customers and market share, the start of a steady decline in their fortunes.¹⁶ Harris argues that this imbalance needed to be redressed in a more synthetic way during the next round of revisions to the *Bank Act*. Provincial regulators, more closely concerned with provincially-tied firms, also began to think about how to improve their competitive position.

The 1981 *Bank Act* revisions began an era of sustained reform. Rather than waiting until 1991 for another round of policy change, the federal government launched a review of financial services policy almost immediately after the 1981 changes. This accelerated pace of reform was the government's response to the rapidly changing

¹⁵ Roberge, p. 117.

¹⁶ Stephen Harris, "The Globalization of Finance and the Regulation of the Canadian Financial Services Industry," in G. Bruce Doern et al., Changing the Rules: Canadian Regulatory Regimes and Institutions, (University of Toronto Press, 1999), p. 373.

technology of the financial services sector *and to growing industry demands for deregulation and freer markets.*¹⁷

III) Pressure for Deregulation:

Observers frequently suggest that the increased interest in deregulation had something to do with “globalisation,” although these observations are often made without clearly specifying what it means. However, the domestic institutional setting also created pressure for deregulation in the 1980s.

In terms of globalisation, observers argue (both then and now) that effectively, the process of disintermediation (or, securitization) undermined the pillar system leaving the government with little choice but to embrace the universal bank model of industry regulation.¹⁸ As was noted in Chapter Two, this made it increasingly difficult for the Canadian government to protect Canada’s banks from global competition, particularly for the international financial services needs of the banks’ multinational commercial clients. It also increased the structural power of Canadian banks to demand more favourable rules domestically, or some financial services activities could simply be relocated.

Furthermore, if partisan international efforts to include financial services in the global trade regime were successful, these challenges for the Canadian industry would be more serious. Trade liberalization of financial services would intensify this problem by bringing international competition to more sectors of the domestic financial services industry. For example, removing barriers to foreign firms’ right to establish branches in Canada could bring globalisation to the consumer basic banking services segment. By

¹⁷ See Charles Freedman, “The Canadian Banking System,” Bank of Canada, March 1997, or Freedman and Goodlet, 1997.

¹⁸ Harris, “The Globalization of Finance,” p. 375.

the mid 1980s, as part of the efforts to avoid US protectionism, Canada supported both US demands for the inclusion of service industries in the GATT as well as bilateral negotiations for a Canada-US Free Trade Agreement, in which it was expected that the US would seek improved access to the closed Canadian financial services market. The success of Canadian banks in the more open US market raised the stakes. Since the 1980s there has been a consistent industry fear that if Canada did not open the door to US financial service providers, the US would eventually retaliate by tightening their markets to Canadian firms.¹⁹ While these worries may now seem somewhat unfounded they were all part of the mix of new ideas affecting how Canadian policymakers responded to globalisation. They also highlight the degree to which deregulation was not simply economically-driven.

In fact, there had long been advocates of deregulation and desegmentation in Canada. The banks frequently demanded more powers and privileges from the federal government, but radical deregulation was outside of the existing policy paradigm and did not receive serious consideration. “Globalisation” and the interpretation of what it required changed this: “Similar to other countries, the competitive pressures engendered by rising globalization of financial services helped intensify an interest in market deregulation in Canada.”²⁰ Globalisation not only shifted power relations within the policy network by increasing the structural power of Canada’s multinational banks, it also shifted how policymakers saw the purposes of regulation in the sector. Once obsessed with prudential concerns, policymakers increasingly worried that the industry

¹⁹Ibid., p. 372. Harris worried that “economic nationalism” in financial services would undermine Canadian interests in the US.

²⁰William Coleman, Financial Services, Globalization and Domestic Policy Change, (London: Macmillan, 1996), p. 201.

and the employment it created might be lost to other, more permissive, jurisdictions. These concerns lent credibility to banks' demands for deregulation. The new universal bank policy paradigm in the sector which supported both deregulation and cross pillar conglomeration was a "necessary" response to the threats of globalisation.²¹

In practical terms, Canada has had a large, well developed banking and securities industry. Based in Toronto, it emerged as an important second tier international financial centre, providing considerable employment. Globalisation, in the minds of many, potentially challenged that situation. When the government began to consider deregulating the industry, the banks would argue that failure to allow them into the securities industry would undermine that sector's global competitiveness. The resonance of these arguments undoubtedly strengthened the banks' campaign for deregulation and conglomeration. As such, this ideological "face" of globalisation and the way it was deployed inside this policy network is an important part of the politics of the sector.²²

International developments and their interpretation promoted deregulation as the correct policy response to globalisation. However, these factors do not tell us a great deal

²¹ As noted in Chapter One, deregulation in Canada involved a massive change in policy paradigms. The system of pillarization was replaced with a universal bank deregulatory paradigm. Under this system the banks have pursued aggressive programs of conglomeration. In response to "anti-bank" opponents, worried by these developments, the banks have argued that this is a necessary response to "globalisation." The effectiveness of these arguments, in particular the constant reference to the threat posed by larger American banks, has consistently strengthened the banks hand in dealing with the government.

²² While networks analysis largely focuses on the power of actors, and the relations of exchange which tie dominant groups to state agencies, Coleman and Perl have recently argued that ideological considerations are also crucial to understanding state responses to globalisation in a policy network. They see ideological change, shifts in the level of support for different policy paradigms, as one of the crucial ways in which globalisation affects public policy. They argue that there is a process of ideological mediation at the international level involving the transnational dissemination of policy paradigms. This spillover can influence changes in policy paradigms at the domestic level. Thus, where institutionally-derived network analysis often explains the path dependent "persistence" of political outcomes in a policy sector, globally shifting ideologically-based understandings of a policy area are a major impetus towards policy change at the domestic level. See William Coleman and Anthony Perl, "Internationalized Policy Environments and Policy Network Analysis," *Political Studies*, September 1999, Vol. 47, Issue 4, p. 701.

about the politics of how this occurred. Understanding the process also requires that we pay attention to the Canadian institutional context.

Federalism, the division of powers, and the confusing allocation of responsibilities over financial services, provide an important context for politics in this sector. In fact, pressures for deregulation were intensified by the behaviour of the provinces. Quebec and Ontario were both considering their own deregulation in the areas of financial services within provincial jurisdiction. The division of powers over the sector provided proponents of deregulation with multiple opportunities to push forward their agenda. Likewise, provinces were even more exposed to the regulatory “race to the bottom,” problems normally associated with globalisation, as they found themselves in competition with one another to attract the industry. “Indeed there was an important competitive element at the international level for liberalization of financial services, there was the same pressure to stay one step ahead in the Canadian market. Quebec was always one step ahead of Ontario.”²³

Much of the divide between the different policy sectors (e.g. The federal banking sector versus provincial trust and mortgage sectors), was jurisdictional rather than functional. The *Constitution Act* (1867), section 91(15) allocates responsibility for “banking” to the federal government. Coleman notes that historically the federal government chose an “institutional approach” to defining its powers under the constitution: “It saved the term ‘bank’ for the commercial banks, deemed ‘chartered banks’, that it chose to charter. ‘Banking’ then became what the federal government permitted these firms to do.”²⁴ In the absence of a legal definition of the functions of

²³ Harris, “The Globalization of Finance,” p. 374.

²⁴ Coleman, *Financial Services, Globalization and Domestic Policy Change*, p. 206.

banking, the federal government could assert a wider control over financial services by simply expanding the powers of the chartered banks. Thus, federal government authority could extend well beyond any neat demarcation of what its actual powers were.²⁵

The situation at the provincial level was similar. Most trust companies (the major deposit-taking competitors to the banks) were incorporated under provincial jurisdiction under Section 92(13) of the Constitution. However; their functions looked a lot like banking (deposit-taking and lending) and when they wished to cross provincial boundaries, they could receive a federal charter for their banking activities. However, they were still under provincial jurisdiction for their “core” activities, trusts and estate management. This meant that nationally-active trust companies faced the problem of double regulation, which their bank competitors avoided, resulting in a competitive imbalance that needed attention. In the case of financial cooperatives and credit unions, which also offered basic banking services, the federal government simply refused to regulate them at their inception, relegating them to provincial jurisdiction and “near bank” status:

In short, even though provinces do not have constitutional jurisdiction over “banking” strictly speaking, they are now engaged in regulating and supervising trust companies and financial cooperatives, so called “near banks”, which are banks in all but name. As trust companies and financial cooperatives grew to become competitors with each other and with the chartered banks, the issue of regulatory harmonization became a more pressing concern on the political agenda.²⁶

²⁵ The 1964 *Royal Commission on Banking and Finance*, the “Porter Commission,” argued that the government should create a legal definition of “banking” since the absence of one created jurisdictional confusion over which level of government was responsible for regulating different sectors of the industry. The *Commission* saw this as a way to keep the federally-regulated banks out of the other provincially-regulated market segments. The federal government did not respond to the recommendation. A legal definition of banking might have prevented some of the troubles encountered in managing deregulation in the 1980s.

²⁶ Coleman, *Financial Services, Globalization and Domestic Policy Change*, p. 207.

The regulation of the trust and banking sectors was in need of revision, and as the federal government was expanding the powers of banks, near banks demanded similar privileges from the provinces.

The securities sector was similar. While provinces had claimed jurisdiction over the industry, the national and international nature of the transactions seemingly gave the federal government a strong claim to jurisdiction under section 91(2) of the *Constitution Act* (1867) – the federal “trade and commerce power.”²⁷ The federal government left it to the provinces to informally co-regulate the industry; however, once the federally-regulated banks became interested in becoming securities dealers, pressure soon emerged for this to change.²⁸ Thus, both the federal and provincial governments could conceivably claim more jurisdiction over financial services.

This jurisdictional confusion was a problem only if the two levels of government, instead of coordinating their policies, sought to push policy in different directions or to unilaterally assert their power over the industry. Problematically, in the 1980s provincial governments began to do just that. Both Quebec and Ontario were increasingly concerned with nurturing the development of Montreal and Toronto respectively as major financial centres. This radically affected their attitude towards the existing “pillar” regulation of the securities sector. In particular, “Adding to the complexity were the political ambitions of the Quebec government which increasingly targeted financial services as crucial to its nationalist economic agenda.”²⁹ Inside Quebec, the *Mouvement*

²⁷ Ibid.

²⁸ Jurisdiction over the securities industry has still not been resolved.

²⁹ Coleman, *Financial Services, Globalization and Domestic Policy Change*, p. 202. Where federal approaches to deregulation had invariably focused on the expanding bank power and privileges in a policy sector that excluded other industry participants (and the provinces, which were not part of the mechanisms of policy coordination at the federal level), Quebec was similarly concerned about provincially regulated firms.

Desjardins was an extremely large industry player (arguably, the sixth largest “banking” institution in Canada), an extensive and well used *caisses populaires* system (which led in all financial services sectors in the province except commercial lending), and Quebec was also home to *Banque Nationale du Canada*. “Given these indigenous institutions, plus the jurisdiction in financial services available to provincial governments under Canadian federalism, Quebec’s political leaders have been well-placed to promote a distinct set of nationalist policies on financial services during the past two decades.”³⁰ Quebec’s initiatives, however, threatened to challenge Toronto’s position as the most attractive financial services market in Canada, a fact which has ultimately played the key role in driving the pace of deregulation in the country as a whole.

Deregulation may have been encouraged by “globalisation,” but it was also domestically encouraged and facilitated by the jurisdictional vagaries of Canadian federalism. To many, deregulating barriers that prevented provincially and federally regulated firms from competing with one another was a logical recognition of the fact that, for example, trust companies and banks were functionally the same type of business. These various background factors all came together over a three year period in the 1980s. In the end, the nature of Canadian regulation was dramatically altered and the universal bank policy paradigm was solidly entrenched.

³⁰ *Ibid.*, p. 210.

IV) The Politics of Deregulation:

In April of 1985, the new Mulroney government's Junior Minister of Finance,³¹ Barbara McDougall, released a Department of Finance study, *The Regulation of Canadian Financial Institutions: Proposals for Discussion*, commonly referred to as the "Green Paper," as a precursor to another round of *Bank Act* revisions.³² The Green Paper was the result of two years of private consultations with the various sectors of industry.³³ The government argued that there were two motivations for the Green Paper. Firstly, they wanted to evaluate the state of the industry in light of rapid industry changes; including both the "international" changes (what would later be called globalisation) and the general trend towards desegmentation around the world. Secondly, the paper was intended as a response to growing demands from the provincial trust, mortgage and loan, and insurance companies for attention to their regulatory problems. These industries were not subject to the mandatory ten year review as were the banks.³⁴ Strangely, the Green Paper made no mention of the government's need to evaluate its position regarding the inclusion of financial services as an item for negotiation in the various trade agreements. The government treated this policy review process as a purely domestic concern.

³¹ Over the last 20 years, the Junior Minister has been referred to as the "minister of financial institutions," the "secretary of state for financial institutions," and sometimes just the "junior finance minister;" regardless of the title, the Minister's responsibility has always been the financial services industry.

³² Canada, Department of Finance, The Regulation of Canadian Financial Institutions: Proposals for Discussion, (Minister of Supply and Services Canada, 1985).

³³ In December of 1983 the Liberal Government had set up a new consultative mechanism, an interagency committee that worked with the CEO's of major FSPs to develop proposals for sectoral reform. Coleman says this eventually worked its way through the incoming Conservative government, influencing its first major discussion paper on policy change in the sector. (Coleman, Financial Services, Globalization and Domestic Policy Change, p. 214.) As such, the consultations to prepare the green paper launched by the soon to be outgoing Liberal government were "inherited" by the Mulroney government in the formulation of its "Green Paper."

³⁴ Canada, Department of Finance, The Regulation of Canadian Financial Institutions, Executive Summary, p. 1.

Written before any parliamentary study of the issue, the Green Paper laid out a set of proposals for de-pillarization that fit well with the new government's pro-market pro-deregulation ideological commitments. First, challenging decades of orthodoxy in the sector, it questioned the basic scheme of pillarization, suggesting that because markets were less functionally segmented than in the past, that this raised questions "... about the government's long-standing practice of formulating policy for each segment of the financial industry separately, rather than for all segments at the same time."³⁵ What the government envisioned was the beginning of a comprehensive overhaul of policies for the financial services sector as a whole which would be coordinated with the provinces. The Paper proposed that in the future there should be an industry-wide regulatory review every 10 years rather than simply a review of the *Bank Act*. Indeed, the Green Paper started the process by which all segments of the financial services industry came to be seen as a single policy sector.³⁶

Second, the Green Paper focused on the deregulation of pillar ownership restrictions, the barriers that kept firms in different pillars from affiliating with each other. While its stated "principles and directions" for regulatory reform included concerns like "promoting the soundness of financial institutions," "improving consumer protection," and guarding against self dealing and other conflicts of interest, the real thrust was aimed at the global competitiveness of the industry and to ensure that there was "competitive equity" amongst the different players in the industry (to ensure that the members of the different pillars were given fair treatment by the government).³⁷ In

³⁵ Ibid.

³⁶ The Green Paper also proposed merging the Office of the Inspector General of Banks with the Federal Superintendent of Insurance companies to form a more comprehensive regulator with expanded powers.

³⁷ Canada, Department of Finance, The Regulation of Canadian Financial Institutions, p. 3.

practice, much of the Green Paper can be read as a plan to increase internal consumer and business choice for banking services and as a way to improve competition and efficiency in the industry as a whole, which would then improve the international competitiveness of Canada' financial services industry.³⁸

While arguing that this was not a proposal for “deregulation,” since tightened standards were required to deal with potential conflicts of interest in the industry, the paper essentially argued for programmatic de-pillarization. It suggested that the government allow the formation of “financial holding companies” which could own and operate subsidiaries in each market sector. The individual firms operating under the financial holding company would be able to take advantage of the efficiencies of distribution and marketing offered by the sectoral crossovers. For example, a trust company owned by the same financial holding company as a securities firm had an existing customer base that might also purchase securities. Through their affiliation, the securities firm could gain privileged access to that customer base. While not as cost efficient as the “one stop shopping” model of universal banking, where all services can be offered within the branch of single firm, the holding company model would offer firms the chance to expand their operations through affiliates into the other pillars achieving new economies of scale.

The Green Paper envisaged this as a way to increase competition for banking services and securities. The paper argued that competition for the big banks in basic banking services, deposit-taking and commercial lending, needed to be increased. It

³⁸ Financial sector observers at the time saw the Green Paper in this light. For them, the entire motivation for deregulation was the efficiency and global competitiveness of the Canadian financial services industry. See Gordon Borcham, “Three Years After Canada's ‘Little Bang,’” Canadian Banker, September/October, 1990, Vol. 97, Issue 5, p. 2.

suggested that this be done by either directly giving trust and other “non-bank” institutions (insurance companies, for example) wider commercial lending powers (essentially, letting them act as banks); or, through the new financial holding companies model to allow trust and insurance companies to set up a new category of subsidiary “schedule c” banks, which would have the same powers as the existing banks. The government supported the second option since it ensured uniform standards of regulation for all institutions offering services within a pillar.³⁹ Indeed, the paper argued that through the holding company model, trust, insurance, and financial cooperative companies would all be able to more directly compete with the existing banks for banking services.

In regards to the securities industry, the Green Paper noted that the industry was provincially regulated, and that the provinces were beginning to move towards allowing financial institutions like banks and trust companies to own securities companies. As such, it suggested that federally regulated financial holding companies should also be allowed to own and operate securities firms.

The Green Paper also suggested that there would have to be some sort of regulatory framework to closely monitor “self dealing” and other “non-arms length” transactions. Indeed the government noted in the Green Paper that there were existing holes in the prohibitions against self dealing and that the best way to address the problem was a comprehensive industry-wide ban on such practices. Such a ban should be

³⁹ Canada, Department of Finance, The Regulation of Canadian Financial Institutions, Executive Summary, p. 4.

implemented at the same time that the new holding company model was adopted by the federal government.⁴⁰

Most importantly, the Green Paper proposed that the financial holding company model should be implemented in phases in such a way as to ensure that the big banks would not emerge as the only survivors of deregulation of the pillar ownership restrictions. The model would not immediately apply to the Schedule I banks, as further changes to the *Bank Act* were due in 1990.⁴¹ Trust companies, securities dealers, credit unions and insurance companies would all be given a head start. Thus while the 1981 *Bank Act* changes had allowed the banks to encroach on other segments of the market, the Green Paper proposed a new regime for the industry which, through the financial holding company model, would have allowed significant de-pillarization as trust, insurance companies, and smaller banks and credit unions would all potentially be allowed to move into the banking and securities industry.

At the broadest level, the Green Paper proposed a move towards a universal bank model, though it specifically distanced itself from full “one stop shopping,” in a series of planned stages. This approach would ensure that competition for the big banks was increased, rather than beginning a deregulatory process in which the banks would simply have been turned loose to enter the other pillars and potentially use their superior size and resources to put their competitors out of business. This approach might have resulted in a number of large financial holding companies which could eventually become universal banks if the government subsequently allowed them to offer all of their affiliates’

⁴⁰ Canada, Department of Finance, The Regulation of Canadian Financial Institutions, p. 6.

⁴¹ Canada, Department of Finance, The Regulation of Canadian Financial Institutions, Executive Summary, p. 5.

services “in branch.” Some of these potential “universal banks” might have originally been provincially regulated trust, insurance or securities firms.

Given the fact that the proposals would have created a new ownership structure encouraging inter-pillar ownership links, the Green Paper also directly addressed the issue of competition. What was to prevent a massive wave of conglomeration that would ultimately reduce competition in the financial services industry? Noting that in industry consultations, the main argument against any de-pillarization was that over the long term, through mergers and acquisitions, it would lead to increased industry concentration and therefore reduce competition, the Paper argued that the combination of the 1980 *Bank Act* changes which allowed foreign banks limited access to Canada as well as the new holding company proposals made it more likely that new entrants would emerge.⁴²

More interestingly, the Green Paper was consistent with the way globalisation was being interpreted at the time, and argued that there was no longer a straightforward trade off between concentration and competition, since increased domestic concentration could also increase the ability of Canadian firms to compete internationally.⁴³ Domestic concentration could result in a number of huge, globally competitive universal banks.

The Green Paper concluded that concentration was not yet a problem, thus it did not seriously probe what would happen if industry concentration occurred across pillars as a result of desegmentation, either through the holding company model, or through wholesale desegmentation. The only real concern expressed was in regards to how an insolvency would be dealt with. “Should financial institutions become very large, a failure of a single institution then would be very damaging to the financial system and the

⁴² Canada, Department of Finance, The Regulation of Canadian Financial Institutions, p. 22.

⁴³ *Ibid.*, p. 23.

economy as a whole.”⁴⁴ However, the paper concluded that there were adequate safeguards to prevent reckless conglomeration in the future, such as:

. . . the current legislative provision that requires Ministerial approval of mergers involving any federally-incorporated banks, trust companies, mortgage and loan companies and insurance companies. Thus the federal government has the power to stop any mergers of such federally-incorporated companies that would have an undesirable effect on market concentration and the competitive environment for financial services.⁴⁵

The Green Paper was understandably unpopular with the banks, in large part because of the slow pace it proposed for reform. While other FSPs might get some new powers in the not-too-distant future, the banks would have to wait until the regular revision of the *Bank Act* in 1990.⁴⁶ The banks argued that they should be allowed into the other pillars at the same time. Other financial services companies thought that the proposals were too complicated, and that they might not be able to take advantage of the new opportunities. Instead they argued that they should simply be allowed to offer more services “in branch” rather than through the formation of a holding company and a schedule c bank subsidiary.⁴⁷ In the subsequent House of Commons Finance Committee hearings which were intended as the precursor to formal legislation, only 4 of the 137 submissions supported the Government’s favoured “Schedule C” option. The Commons Committee Report thus suggested alternative ways of accomplishing the same result.⁴⁸

In fact, both the House of Commons Standing Committee on Finance and the Senate Standing Committee on Banking held hearings in response to the proposals. Both

⁴⁴ Ibid., p. 25.

⁴⁵ Ibid.

⁴⁶ Babad and Mulroney, p. 21. Although at the time, some questioned whether the banks would get the same powers even in 1990. See Harris, “The Globalization of Finance,” p. 376.

⁴⁷ Harris, “The Globalization of Finance,” p. 377.

⁴⁸ Canada. House of Commons, Standing Committee on Finance, Trade and Economic Affairs. Canadian Financial Institutions: Report of the Standing Committee on Finance, Trade and Economic Affairs, (Ottawa: Queen’s Printer, 1985).

revealed dissatisfaction with the Green Paper framework, albeit dissatisfaction that was confusing and contradictory. The Committees were both concerned that the framework needed to be more flexible, while at the same time they expressed concerns over how to prevent self dealing and other non-arms-length conflicts of interest in a deregulated environment.⁴⁹ However, the entire legislative process was subsequently undermined by external events, including several bank failures in Alberta and sudden pressure from Ontario for wholesale deregulation of the securities industry; both of which generated rushed, *ad hoc* responses from the federal government.

V) 1985 Bank Collapses:

In the fall of 1985, Canadian Commercial Bank (CCB) of Edmonton and Northland Bank of Calgary failed. While the banks were small (combined, they constituted less than 1% of the industry), their failures prompted a parliamentary investigation of the activities of government regulators as well as Willard Estey's influential inquiry into the Canadian regulatory framework.⁵⁰ Policy debate soon focused on the crisis as elected officials in Ottawa were more concerned about the risks of further collapses in the industry and the ensuing political and economic fall out than the more abstract questions posed by the Green Paper. The failures were the first since the collapse of the Home Bank in 1923 and the "... events became matters of intense public discussion, owing in part to reforms in Parliament that permitted committees freer rein."⁵¹

⁴⁹ Babad and Mulroney, pp. 21-23.

⁵⁰ A respected former judge who had conducted several federal government industry investigations in the past, Estey was asked by the government to conduct a solo investigation of the failures and propose changes to Canada's regulatory institutions that could prevent similar failures in the future. See, Willard Estey, Report of the inquiry into the collapse of the CCB and Northland Bank, (Ottawa, Canada: Minister of Supply and Services Canada, 1986).

⁵¹ Coleman, Financial Services, Globalization and Domestic Policy Change, p. 214.

The result, once the dealings of the firms in question became public knowledge, would be rapidly-produced Government proposals for new regulatory institutions.

The Canadian Commercial Bank (CCB) had been shaky for some time. A combination of illegal dealings, a series of bad loans, and overextended involvement in the Alberta Oil patch boom which bottomed out in the early 1980s, had undermined the bank's soundness.⁵² Faced with mounting unrecoverable loans, CCB had also engaged in "irregular" accounting practices to hide the severity of its problems. The bank's accountants listed existing loan collateral at the value of what it would be worth in the future if the economy improved. Remaining real estate collateral, which was worth a fraction of what it once had been, by being valued at what might be recovered when real estate prices went up again, offset the red ink in the loan portfolio. The bank also continued to compute interest against loans that would never be recovered and added that interest to the principal of the bad loan. These attempts to cover up the bank's problems failed as the economy recovered too slowly.

More important for the subsequent parliamentary evaluation of these events was the fact that the existing federal Inspector General of Banks, William Kennett, knew that CCB was doing this, but had hoped that the bank would survive.⁵³

When the problem was no longer recoverable, Finance Minister Michael Wilson, Kennett, and the CEOs of the big banks secretly tried to orchestrate a bailout in which other FSPs would freeze interest and principal payments owed by the bank. However, CCBs books were worse than expected, and once news spread that a bailout was required, depositors started a run on the bank (\$1.6 billion was withdrawn). Ironically the biggest

⁵² For the details of their dealings, see, Babad and Mulrone, pp. 34-36.

⁵³ Ibid., p. 36.

withdrawals were from the big banks and the federal government who were all trying to limit their exposure to the collapse, despite their efforts at a bailout.⁵⁴ Northland Bank, also exposed to bad oil patch loans found itself in similar trouble. Despite private warnings from regulators that its portfolio was a “time bomb,” nothing was done about the Northlands situation until it too collapsed in the midst of the CCB controversy.⁵⁵

Because Kennett and Wilson had reassured depositors and creditors throughout 1985 that the bank was sound and deposits were insured, when the banks ultimately failed the Government felt bound to insure all deposits, beyond the normal deposit insurance levels, meaning that the collapse of CCB cost the Department of Finance, and Canada’s taxpayers, over \$1.2 billion.⁵⁶

Both the resulting hearings in Parliament (in which the players were brought before the Commons Finance Committee for questioning) and Estey’s investigation generated considerable controversy and demand for change, by revealing the weakness of Canada’s banking regulators. In his report, Estey placed a great deal of the blame on Kennett and the Office of the Inspector General of Banks (OIGB). In parliamentary hearings, Kennett weakly defended his office by saying that he had limited resources to monitor a bank the way he needed to in order to prevent these kinds of accounting manipulations.⁵⁷ Indeed, Kennett’s OIGB was poorly suited to the growing complexity in the sector. In 1978 the OIGB had a total staff of only thirteen. The Inspector could do little more than rely on a bank’s own auditors to oversee their activities.⁵⁸

⁵⁴ Ibid., p. 41.

⁵⁵ MacIntosh, *Different Drummers*, p. 222. Northland, like other small banks, was hit by a “perceptual contamination” given the public run on CCB. This led to depositor withdrawals at precisely the moment the bank could least afford it.

⁵⁶ Babad and Mulroney, p. 43.

⁵⁷ Ibid., p. 42.

⁵⁸ Coleman, *Financial Services, Globalization and Domestic Policy Change*, p. 218.

Estey's report suggested that the functions of the Canadian Deposit Insurance Corporation should be merged with the functions of the OIGB, to create a new super regulator with the ability to catch banks engaged in inappropriately risky behaviour. Estey also saw this regulator as having more than just a prudential mandate. It could also monitor the industry's consumer practices and level of competition. Estey's call for an overhaul of the regulatory structure was popular. Not only were all involved embarrassed by CCB's accounting practices and the behaviour of the OIGB, but the failures suggested that the regulatory structure itself was inadequate to the task. The bank failures illustrated that the "lenders of last resort," the CDIC, the Bank of Canada and the Department of Finance, had neither the inspection nor analysis capacity to make up for the deficiencies of the OIGB.⁵⁹

Changes to Canada's Regulators:

When the Government subsequently developed its legislative response to the collapses, in conjunction with its rapid industry deregulation at the end of 1986, the outcome was somewhat different from what Estey had suggested.⁶⁰ Rather than merge the CDIC with the OIGB, the government opted to simply replace the OIGB with a new regulator, the Office of the Superintendent of Financial Institutions (OSFI). Established by the *Office of the Superintendent of Financial Institutions Act* (1987), the OSFI has a slightly wider mandate than the old OIGB. It is responsible for the supervision of all "federally regulated financial institutions." This includes all banks, all federally-

⁵⁹ Ibid., p. 219.

⁶⁰ Estey's report and the Government response to it took place at the end of 1986. By that time, attention had shifted to Ontario's proposed deregulation of the securities industry. Both events prompted a rapid response from the government without further study or consideration of how the two sets of concerns (deregulation and the structure of the existing regulators) might relate to one another.

incorporated or registered insurance, trust and loan companies, and cooperative credit associations. The OSFI is also responsible for monitoring federally regulated pension plans.⁶¹ However, the OSFI's primary function remains the same as the OIGB: to reduce the risk of "undue losses" for depositors and policy holders. While the Canadian Deposit Insurance Corporation helps to maintain the stability of the industry by actually insuring some deposits against loss, the OSFI tries to prevent such losses from occurring in the first place by trying to prevent banks and financial services companies from collapsing, or in the event that they do, by minimizing the risk of losses to depositors should such a collapse occur. To do so, the OSFI, much like its predecessor, oversees the enforcement of *Bank Act* provisions, ensuring that banks and other financial services companies are in ongoing compliance with industry regulation. The OSFI also monitors companies' activities to ensure that they do not engage in inappropriately risky behaviour which may lead to the collapse of a bank. The new office was given considerable autonomy as the Superintendent was appointed for ten years and had control over all internal staff. The OSFI also had considerably expanded staff levels.⁶²

In the same legislation that created the OSFI, the CDIC was reformed. The old CDIC had been a "shell" organization. It had virtually no staff and had not even been invited to participate in government discussions as to what should be done about the failing banks, despite the fact it was the insurer.⁶³ After 1986, private sector representatives were appointed to the board and it was charged with the responsibility of overseeing the soundness of all insured firms whether they were federally regulated or not. This required increased staff resources. Most importantly, as Coleman noted, it

⁶¹ For more information on the OSFI and its activities see <http://www.osfi-bsif.gc.ca>

⁶² Coleman, *Financial Services, Globalization and Domestic Policy Change*, p. 219.

⁶³ Ibid.

meant that the CDIC had overlapping responsibilities with the OSFI. The government also increased CDIC premiums, expanding the pool of funds available to bailout failing institutions.

These changes fell short of what Estey had envisioned. Instead they were reflective of the banks' view that the collapses did not require any fundamental changes to banking regulation.⁶⁴ The reforms were reactive and *ad hoc* rather than anticipatory and synthetic. This was particularly unfortunate given that these reforms occurred simultaneously to the controversy surrounding demands for more rapid industry-wide deregulation at the end of 1986. The reforms had two notable shortcomings.

First, both agencies were solely prudential regulators. Neither was charged with a wider array of responsibilities. The OSFI, for example, could also have been charged with consumer protection responsibilities, monitoring the industry for improper practices like tied selling or for excessive hidden service fees. Estey had suggested the regulator should be given these kinds of responsibilities. The OSFI could also have been given a special mandate to monitor industry competitiveness, or at least to prepare reports on mergers for the Minister of Finance. Indeed, given the OSFI's role in monitoring Canadian banks and the security of depositors' savings, the OSFI has periodically been asked to analyze large merger proposals. The proposed 1998 mergers between Canada's largest banks resulted in just such an investigation. The OSFI was asked to analyze whether the mergers increased the risk of a bankruptcy or failure of one of the major banks, and whether or not such a failure would be more difficult to manage in the post

⁶⁴ Royal Bank CEO, Allan Taylor, speaking to the Canadian Club in Toronto, days after the Estey Report was released, suggested the banks agreed with what he claimed were the report's suggestion that no major changes were needed. The Government obviously sided with the banks' interpretation of the Report. See, Allan Taylor, "What's Good for Canada? Strategic Change in the National Financial System," *Vital Speeches of the Day*, EBSCO Publishing 2003, pp. 133-136.

merger environment. However, the OSFI was asked to only evaluate the prudential aspects of merger proposals. It was not asked to evaluate whether such mergers undermined competition and the range of available lenders. In the final analysis, the OSFI's mandate was narrow and arguably duplicated much of what the reformed CDIC was being asked to do. Neither of these regulators could meet demands for other kinds of public regulatory concerns as the government moved towards deregulation.

Second, the government's reforms did little to overcome the problems posed by federalism. Provincial institutions were still not covered by the OSFI. Canadian regulatory arrangements remained, in Coleman's view, less integrated than that of the EU.⁶⁵

Changes in the industry:

The collapse of CCB and Northlands also undermined the standing of smaller regional banks in the minds of Canadian consumers and businesses. Several other small banks were taken over.⁶⁶ In combination with the continuing instability in the trust industry, this reduced the scope of competition from the smaller competitors of the big banks. This also drew the attention of the government. While still in the process of formulating a legislative response to the Green Paper, the government made it clear that it wanted to increase competition by expanding the powers of smaller institutions to compete with the big banks. The government publicly suggested it would push on with plans for phased de-pillarization. The problem was that much like their response to the

⁶⁵ Coleman, *Financial Services, Globalization and Domestic Policy Change*, p. 220.

⁶⁶ Robert MacIntosh, then head of the Canadian Banker's Association, argued that the collapses of the Alberta banks devastated smaller regional banks across the country, undermining their secondary role in the market and entrenching the dominance of Canada's big banks. See, *Different Drummers*, pp. 225-227.

Green Paper, the banks argued that a “level playing field” was required, which meant that they should be allowed into the other pillars at the same time as their smaller competitors were.⁶⁷ While federal finance officials and regulators had been responding to the bank collapses, events were unfolding in the provinces which ultimately would strengthen the banks’ demands that they be allowed into the other sectors as soon as possible.

VI) The Securities Industry – Ontario and Deregulation (1984-1987):

In 1986 Ontario’s Liberal Government announced that it planned to end ownership restrictions on provincial securities firms. This was the result of four years of struggle inside the Ontario securities policy network over how to respond to globalisation. The announced policy would allow other kinds of FSPs, both domestic and foreign, to own an investment dealer in the province. The announcement undermined the Federal Government’s Green Paper proposals for phased deregulation as policymaking quickly degenerated into a “classic” federal-provincial jurisdictional quarrel.⁶⁸

In the mid 1980s, Canada’s largely Ontario-based brokerages were still small, often management-owned firms. Canadian banks and foreign investors, by law, could own no more than 10% of a brokerage. Foreign firms had been effectively barred from entering the Canadian industry since 1971, though several had been “grandfathered” when the restriction was put in place. This situation was increasingly at odds with elsewhere in the world. In Britain and US, “big bangs” had altered the industry and in particular the size of firms.⁶⁹ In Germany, the universal bank model was well entrenched. However, in Canada the pillars system prevented this from occurring.

⁶⁷ See, Babad and Mulroney, p. 23.

⁶⁸ G. Bruce Doern and Brian W. Tomlin, *Faith and Fear*, (Toronto: Stoddart, 1991), p. 119.

⁶⁹ Babad and Mulroney, p. 10.

Indeed in the securities sector, pillarization was firmly supported by the Ontario securities industry which had “captured” the provincial Securities Commission (the OSC), and used it to prevent new market participants from challenging their position.⁷⁰

However, the existing ownership restrictions were increasingly seen as a problem in Ontario as they limited the size and capitalization of securities dealers, potentially undermining their ability to provide services that multinational corporations required. When investment dealers purchase an offering of securities, or “underwrite” the stock prior to having brokerages sell the stock at a future profit, they must pay the full price of the offering themselves. Generally, dealers borrowed the funds to cover the cost of unsold underwritten stocks from one of the big banks. Thus as the size of underwriting expanded in relation to the size of corporations, the size of the pool of capital available to an investment dealer became crucial to its ability to conduct large deals.⁷¹ If Canadian firms remained small, and globalisation made it possible for investment dealers in other jurisdictions to underwrite stock offerings of Canadian firms, then the industry in Canada might be undermined:

There is no dispute that the driving force behind the dismantling of barriers to entry in the Canadian securities industry was fear that unless securities firms in Canada were able to increase their capital basis, they would over the course of time, begin to wither and die.⁷²

⁷⁰ This was particularly evident in the web of ownership restrictions that limited the access of new participants to the industry. For the most thorough investigation of this see, Stephen Harris, The Political Economy of the Liberalization of Entry and Ownership in the Canadian Investment Dealer Industry, Ph.D. Dissertation, Carleton University, 1995). While there had been pressure on the Ontario government and the OSC for some time to allow greater access to foreign firms and other Canadian FSPs, these pressures had been resisted.

⁷¹ See, Boreham, “Three Years After Canada’s ‘Little Bang,’” Canadian Banker, September/October, 1990, Vol. 97, Issue 5.

⁷² *Ibid.*, p. 8.

This concern could be alleviated by allowing the securities firms to acquire partners among other large FSPs. Indeed, in the wake of deregulation, observers noted that the underwriting capacity of Canada's brokerages was significantly increased.⁷³

Furthermore, to policymakers, the small size of Canada's investment dealers and brokerage firms threatened Canada (and Toronto's role) as a financial centre. Quebec's finance minister, Jacques Parizeau saw this situation as an opportunity, a way to create alternative, strong, Quebecois financial institutions that could replace the "English" giants of the "four pillars." As a young Quebec civil servant in the 1960s Parizeau had chaired a task force that argued for de-pillarization.⁷⁴ As Finance Minister for the *Parti Quebecois* in the 1980s he had the chance to put his ideas into practice. As early as 1983 the Quebec Securities Commission (QSC) made it clear that it was prepared to let banks and other large FSPs into the investment dealer business.⁷⁵ Quebec saw a competitive deregulation of its rules governing the securities industry as a way to either give provincially regulated near banks an advantage, or to lure business away from other jurisdictions. Coleman argues that Quebec's program was essentially "anticipatory," a programmatic response to the opportunities created by globalisation and the existing regulatory structure in Canada.⁷⁶ While Quebec's plan has ultimately achieved many of the goals set by the government, in 1986 the securities industry radiating out from the TSE was a largely Ontario affair and Quebec's moves were seen as a direct threat to the

⁷³ Ibid., p. 5.

⁷⁴ Coleman, Financial Services, Globalization and Domestic Policy Change, p. 214.

⁷⁵ Harris, The Political Economy of the Liberalization, p. 286.

⁷⁶ Coleman, Financial Services, Globalization and Domestic Policy Change, p. 215.

Ontario industry. Debate in Ontario about deregulation was centrally concerned about this factor.⁷⁷

There were signs that things were going to change in Ontario as well. In 1983, Toronto Dominion opened a discount brokerage service. "Green Line Investor Service" had a shaky legal basis. In theory, it violated the Federal *Bank Act* which prohibited the banks from owning securities firms, regardless of what provincial rules said; however, the business was allowed to go ahead, provided it did not act as a full brokerage, but remained a discount house. Despite some opposition from the Ontario Securities Commission (OSC), Toronto Dominion got its way.⁷⁸

In 1984, in response to interest in entering the closed Canadian sector among larger American securities companies, the OSC Chairman launched an internal study of the securities industry.⁷⁹ The report argued that ownership restrictions were hurting Ontario's competitive position.⁸⁰ A subsequent policy review process led to an OSC report to the Government, *A Regulatory Framework for Entry into and Ownership of the Ontario Securities Industry*.⁸¹ The OSC recommended some relaxation of rules to allow foreign firms to invest in the Ontario industry; provided that those firms remained Canadian controlled (foreign firms would be allowed to acquire a 30 percent stake in a firm). Likewise foreign securities dealers should be allowed to open up directly in Canada provided that their business did not comprise individually more than 1.5 percent of the capital of the industry as a whole. Most importantly the report suggested that

⁷⁷ Harris, *The Political Economy of the Liberalization*, p. 286. See also, Doern and Tomlin, p. 119.

⁷⁸ Babad and Mulroney, p. 12.

⁷⁹ *Ibid.*, p. 13.

⁸⁰ See Ontario Securities Commission, "Policy Review," Press Release, May 2, 1984.

⁸¹ Ontario Securities Commission, *A Regulatory Framework for Entry Into and Ownership of the Ontario Securities Industry*, Report of the OSC to the Minister of Consumer and Commercial Relations, Province of Ontario, February, 1985.

Canada's banks should be allowed to own as much as 30 percent of a securities firm. The proposals were incremental, but they soon gained momentum, despite opposition from the securities industry.⁸²

The securities industry opposed this kind of deregulation. They were particularly "panicky" about the prospect of large foreign based firms entering the Canadian market.⁸³ In fact, the industry argued throughout 1984 and 1985 that Canada's trade negotiators should work to ensure that the government had the latitude to protect the domestic industry from foreign competition.⁸⁴ Also, the Investment Dealers Association (which represented securities firms) argued that Ontario's position was premature in that there would need to be some sort of national securities regulator in place before the boundaries between different pillars were blurred.⁸⁵ This was a constant theme inside Ontario policy circles: the timing was poor for such a move.

On the other hand, Canada's banks were eager to take advantage of the situation. Aside from the international pressure of securitization and disintermediation, they had other reasons to want into the securities industry. The banks believed that they were "over branched." Eventually adding functions to their branches, like offering investment

⁸² Harris notes that given the existing range of interests vested in the status quo of the ownership regime, and the broad support in the Ontario policy community for these principles, it would have been hard for the OSC and the provincial government to do anything other than move incrementally towards liberalization. Harris, The Political Economy of the Liberalization, p. 331.

⁸³ The industry began to lobby both the Minister and the Premier to hold the line against a potential "de-Canadianization of the domestic securities industry and a consequent loss of influence and control over the domestic financial market." James Pitblado, Chairman of the Securities Industry Capital Markets Committee in a letter to then premier, Frank Miller – quoted from Harris, The Political Economy of the Liberalization, p. 344.

⁸⁴ This is a point illustrated in Harris, The Political Economy of the Liberalization, in his analysis of the industry's position on deregulation. See for example: Joint Securities Industry Committee, "Regulation and Ownership of Market Intermediaries in Canada," Report of the Joint Securities Industry Committee, (Alberta, Montreal, Toronto and Vancouver Stock Exchanges and the Investment Dealers Association of Canada, 1984), p. 298.

⁸⁵ A. G. Kniewasser, "A Preliminary Analysis of the Ontario Securities Commission Report," Investment Dealers Association of Canada, February 22, 1985.

services, were a way to turn those branches to their advantage.⁸⁶ Similarly, bank profits were down in the period as a result of the Less Developed Country (LDC) debt crisis, and the banks saw a more rapid program of domestic deregulation as a way to improve their bottom lines. In particular, the Bank of Nova Scotia intensified the pressure on the Ontario government by negotiating a license with the Quebec Securities Commission that would allow it to become an investment dealer in Quebec, suggesting it might relocate to the more permissive environment.⁸⁷

Stanley Beck, a proponent of deregulation, was then appointed to head the OSC. Beck sought the removal of the ownership restrictions as he feared that Toronto's position as an international financial centre was under threat.⁸⁸ In particular, Beck tried to convince Ontario's minister responsible for financial institutions, Monte Kwinter, of the need to let banks own securities firms because only they had the deep pockets necessary to ensure sufficient capital in Toronto's Stock Market.⁸⁹ The recently-elected Liberal government in Ontario also wanted to protect the status of Toronto's market and supported Beck.⁹⁰ Thus the OSC's incremental proposals were subsequently supported by Monte Kwinter's provincial government "Task Force on Financial Institutions."⁹¹

⁸⁶ Babad and Mulroney, p. 133.

⁸⁷ Harris, The Political Economy of the Liberalization, pp. 350-351.

⁸⁸ Babad and Mulroney, p. 13.

⁸⁹ *Ibid.*, p. 14.

⁹⁰ Premier David Peterson had personally expressed concern that Montreal would supplant Toronto as the major financial centre "... in the absence of a concerted liberalization in Ontario." See Harris, The Political Economy of the Liberalization, p. 351.

⁹¹ Ontario, Task Force on Financial Institutions, Final Report: A Report to the Honourable Monte Kwinter, Minister of Consumer and Commercial Relations, (Toronto: Queens Printer, December 1985). Interestingly, as Harris has pointed out, the Task Force also argued that Canada should avoid making any preemptive liberalization of barriers to foreign firms while the GATS talks were ongoing as such items were up for negotiation subject to some sort of reciprocity from Canada's trade partners. Essentially, the argument was that it was foolish to be even considering such a preemptive move. See Ontario, Task Force on Financial Institutions, Final Report, p. 110.

When Ontario learned of Quebec's plans to allow the Bank of Nova Scotia to set up a full service brokerage, Kwinter feared that some of the securities industry would be lost to Quebec. Indeed, Kwinter and his colleagues in Ontario were already nervous about the federal government's plans to designate Montreal and Vancouver as special "international banking centres."⁹² Kwinter met privately with the banks to discuss their position on the barriers to entry in the Ontario securities industry. They told Kwinter that the restrictions should be lifted or they might be forced to relocate some of their business elsewhere.⁹³ Thus, the banks used "relocation threats" to push Ontario into a more aggressive program of deregulation.⁹⁴ As a result, Kwinter's Ontario government proposed a "mini-bang" in which the federally-regulated banks *and foreign securities firms* would be allowed into the industry in a "limited" way. External investors were to be limited to 30 percent ownership stakes in existing securities firms.⁹⁵

The federal government was upset with Kwinter's initiatives, as they were still in the early stages of formulating their own plans for financial services deregulation. Barbara McDougall, had announced the Green Paper proposals in 1985, but consideration had been slowed by the bank failures of that year. McDougall thought that Ontario's precipitous proposals, which she had apparently not been advised of, could also affect the ongoing free trade negotiations with the US, in which the US was asking for improved

⁹² Robert MacIntosh argues that deregulation would never have occurred the way it did if the Mulroney Government had not announced its largely symbolic plans to designate Montreal and Vancouver as "International Banking Centres." According to MacIntosh, the industry and the Ontario government both saw this as a signal that Federal authority was going to be used to shift the industry away from Ontario. See *Different Drummers*, pp. 262-263.

⁹³ Babad and Mulroney, p. 14.

⁹⁴ Stewart, *Bank Heist*, p. 62.

⁹⁵ Babad and Mulroney, p. 15.

access to the Canadian financial services market.⁹⁶ The same could be said of the GATT negotiations on financial services. Babad and Mulroney argue that McDougall was surprised that Ontario would consider doing this without some discussion about whether it might be possible to get a *quid pro quo* from the Americans on some other issue before allowing their firms into the Canadian market. McDougall said, “I think that would have been a conversation that would have been useful to all of us.”⁹⁷ Ontario’s actions took the issue off the table as a bargaining chip for the Canadian government.⁹⁸

Indeed, the lack of concern for the implications of the move for international trade negotiations mirrored the general “shallowness” of the entire process of deregulation. The self-propelling way in which the momentum towards deregulation built meant that a variety of serious policy considerations were being ignored. For example, one crucial factor that was being downplayed in Ontario’s debate about letting the banks take an ownership stake in securities firms was the serious conflict of interest problem that could emerge, like self dealing. In short, while the Green Paper had stimulated serious discussions about the need for new regulations for a depillarized environment, Ontario seemed oblivious to these problems.⁹⁹

Any chance that a wider debate about the advisability of unilaterally deregulating the securities industry prior to an agreement with the United States, or how to regulate the industry to prevent problematic conflict of interests, was shunted to one side as, behind the scenes, the banks and their potential “competitors” in the securities industry reached

⁹⁶ Indeed, access to ownership in the Canadian securities industry was one of the major items the US was seeking in the financial services negotiations of CUSFTA. See Doern and Tomlin, p. 159.

⁹⁷ Babad and Mulroney, p. 15.

⁹⁸ Doern and Tomlin, p. 159.

⁹⁹ Boreham provides a useful summary of the kinds of arguments that were made against deregulation at that time. See Boreham, p. 2.

their own understanding about just whose interests the deregulation of ownership rules would serve. After its initial opposition to the OSC proposals, the securities industry switched its position and began to lobby for even looser restrictions on who could own a Canadian securities firm.¹⁰⁰ The banks had advised the leading securities firms of their potential sale value if the banks were allowed to buy stakes in them. Deregulation of the securities industry promised windfall profits for the existing shareholders. In fact within a few days, the industry was suggesting the simplest proposal yet put forward: banks and foreign firms should be allowed to buy up to 100 percent of a Canadian securities subsidiary. The feeling amongst the securities firms was that “If there was going to be competition [from new industry entrants] they might as well walk away with millions. So they began to pressure Kwinter to go far beyond what he had originally intended.”¹⁰¹ The head of Wood Gundy, at that time one of the larger brokerages, felt that that the Canadian dealers would get “hammered” by increased US competition unless they could “. . . gain access to capital through a marriage with a bank.”¹⁰² The same CEO also said that he would have moved the company to Quebec where he could sell at least part of the company to a bank if Kwinter would not agree to rules that allowed it Ontario.

As a result, abandoning the gradual, incremental approach proposed by the OSC, on June 11, 1986, Kwinter announced in the Ontario Legislature that the government would adopt the principles of the *Task Force* report for relaxing ownership barriers. However, his proposal went beyond the *Task Force*, suggesting even looser limits on both how much of a securities firm the banks could own as well as how soon they could

¹⁰⁰ Representatives of the securities firms approached Kwinter and asked that the 30 percent limitation on foreign or bank ownership of securities firms should be raised to 50 percent. See, Babad and Mulroney, p. 16.

¹⁰¹ Ibid.

¹⁰² Ibid.

own it. Kwinter also called on the federal government to make the necessary changes to the *Bank Act* that would allow the Banks to own securities firms.¹⁰³

The June announcement again caught the federal government off guard. Barbara McDougall, Minister of State for the Department of Finance was “incensed” by Ontario’s announcement as work was still ongoing on the series of papers being released by the Federal Government to map out its proposals for a more orderly deregulation. Harris notes that Ontario’s announcement gave the Federal Government “extraordinarily short notice” of their decision. Ontario’s new rules were to be in place by the start of 1987.¹⁰⁴

Privately, the CBA and the banks used the Ontario announcement as an opportunity to increase their pressure on McDougall and federal officials to amend the *Bank Act* to allow them into the industry. Robert MacIntosh (CBA) wrote to the minister:

Our sense of urgency arises from the fact that Ontario intends to implement its proposals by January 1, 1987. Unless the Government of Canada gives a clear signal that it will respond with comparable permissive amendments to the *Bank Act*, the banks will be unable to undertake any sort of strategic planning with respect to the securities industry. This could put them at a severe disadvantage and further tilt the playing field away from the federally supervised banking industry.¹⁰⁵

MacIntosh actually defended the province of Ontario saying that such precipitous actions were necessary given what Quebec had already done. As such, the industry could not await the outcome of trade negotiations and how those might affect the status of foreign entry rules. MacIntosh then sent McDougall a document with suggested language for *Bank Act* revisions.

¹⁰³ See Monte Kwinter, Minister of Financial Institutions, “Statement in the Legislature Re: Entry and Ownership of the Securities Industry,” June 11, 1986.

¹⁰⁴ Harris, *The Political Economy of the Liberalization*, p. 354.

¹⁰⁵ Quoted from Robert MacIntosh, Letter to the Honorable Barabara J. McDougall, Minister of State for Finance, June 13, 1986. See, MacIntosh, *Different Drummers*.

McDougall's response was that the Government was in a difficult position given ongoing trade negotiations. However, while in theory, securities deregulation could have been a good bargaining chip for the Mulroney Government in its trade negotiations, in practice the federal division of powers prevented it from interfering with Ontario's move to allow foreign firms into the industry. Already hostile to the Federal Government's plans to promote Vancouver and Montreal as financial centres, Ontario was not cooperative. Indeed, Doern and Tomlin argue that coordinating strategies with Ontario on this issue would have been difficult under any circumstances given the province's attitude to the FTA talks as a whole.¹⁰⁶ McDougall also argued that the federal government was still in the midst of its policy review and that the Estey Report on bank failures had not been completed. More to the point she argued that Ontario's decision was a concern because it ignored a host of regulatory problems that she wished to address in the movement towards greater "industry integration" (i.e. self dealing and conflicts of interest).¹⁰⁷

VII) "Esoteric Politics" and Reactive Policy Reform:

It was against this backdrop that the bank chairmen held their meeting with Michael Wilson at Montebello where they made their plea that the Federal Government should both remove restrictions barring them from entering the securities industry immediately, and accelerate industry-wide deregulation. Publicly, the banks were already pressuring the government on the issue, calling for support for the position they found themselves in. Allen Taylor, the Royal Bank's CEO, in a speech to the Canadian

¹⁰⁶ Doern and Tomlin, p. 119.

¹⁰⁷ The full text of McDougall's letter to MacIntosh is available in Harris, The Political Economy of the Liberalization, pp. 360-361.

Club in Toronto just prior to the Montebello meeting, argued that those who suggested that domestic regulatory concerns should take precedence over the international competitiveness of the industry were wrong:

. . . these people have watched the growing trend towards “securitization” – Canadian corporations raising funds in capital markets offshore. They’ve watched 55 foreign banks – among the world’s top competitors – take root and grow in Canada since 1980. They know that Canada’s banks now earn income abroad on 160 billion dollars – one-third of their total assets – and bring home the dividends to Canadian shareholders. These people read the reports of London’s “Big Bang” and deregulation in the other international money centres. They see all this, and they say that Canada has a choice whether we want to “go international” or not. I say the only choice we have is whether Canada wants to do it well, or do it BADLY.¹⁰⁸

Taylor argued that because Canadian banks could offer investment banking services to their offshore clients but not to clients in Canada there was a large incentive for the banks to go offshore and leave Canada behind.

In November, after the Montebello meeting, the Bank of Nova Scotia went public with its intentions to establish its own brokerage in Quebec. It did this with the intention of forcing Ontario to continue to pressure the Federal Government, despite the fact that its plans were legally questionable without changes to the federal *Bank Act*.¹⁰⁹ Federal officials were unaware that the move was going to be taken, and “When officials subsequently did find out they were shocked. The damage to rational policy formulation, decision-making, and implementation had already been done. Federal and provincial officials needed to act quickly to salvage the situation.”¹¹⁰ In Ontario, the move only

¹⁰⁸ Allan Taylor, “What’s Good for Canada? Strategic Change in the National Financial System,” Vital Speeches of the Day, EBSCO Publishing 2003, pp. 133-136.

¹⁰⁹ Patricia Lush, “Scotiabank stretches law in new venture,” Globe and Mail, November 13, 1986, p. B1.

¹¹⁰ Harris, The Political Economy of the Liberalization, p. 365.

reinforced the fear that Toronto was going to “lose” the banks and other large FSPs if deregulation was not accelerated.

The situation was problematic for the Federal Government. Even if they ignored the banks’ request that they be allowed to take part in Ontario’s “little bang,” it was not clear, given the Bank of Nova Scotia’s stance, that the banks were going to listen. Furthermore, to hold the banks back would simply place federally regulated institutions at a disadvantage relative to both provincial and foreign firms. Tom Hockin who had replaced Barbara McDougall as Junior Finance Minister sought a deal with Ontario while the Department of Finance drafted a new “discussion paper” to replace the Green Paper. Hockin informed Stanley Beck (the head of the OSC), that the Federal Government had advised the banks that they were going to remove the regulations in the *Bank Act* that prevented them from entering the securities industry.¹¹¹ The Federal Government had abandoned its own plans for the phased deregulation of the Green Paper and was now committed to the more rapid “little bang,” hopefully one which they would control. They told the Ontario government to wait with its legislation while the Federal Government drafted its own rules.

However, Kwinter complained that the Mulroney government was moving too slowly and the Bank of Nova Scotia threat was still “hanging out there.”¹¹² Ontario’s primary concern was still the need to head off the relocation threat posed by the more attractive rules in Quebec. In December of 1986, Kwinter announced plans for his “steadily-bigger bang.” Ontario was now proposing “open access” to the industry for all. Under Kwinter’s plan, effective June 30, 1987, Canadian financial institutions would be

¹¹¹ Babad and Mulroney, p. 17.

¹¹² Ibid.

allowed to own 100 percent of a securities firm. Effective June 1988, foreign firms would be granted the same right.¹¹³

Hockin again tried to stop Kwinter, since federal regulations still precluded the banks from buying controlling stakes in the sector. Hockin claimed that the Federal Government had jurisdiction over the matter:

Banking is a federal power and there is no definition of banking. Banking is what banks do. And so we said if you want to play this game Monte [Kwinter], banks are going to do a lot of things and all of a sudden your dealers are going to be regulated by us because they're banks.¹¹⁴

A deal was eventually worked out. The agreement designed by Deputy Minister of Finance Stanley Hart, promised banks that under federal rules, they would be allowed to take full ownership of securities subsidiaries. Ontario similarly promised to revise its rules. Foreign firms would get the same right one year later. When Kwinter announced Ontario's side of the bargain the following day he suggested the Bank of Nova Scotia's threats had raised the stakes for Ontario, requiring more rapid deregulation.¹¹⁵ Federal guidelines were then issued to make this "little bang" a reality, effective August 1987. The speed of these legislative responses is notable, particularly given the complexity of the industries involved. The governments' responses were undoubtedly rushed.

The two governments then tried to resolve the massive jurisdictional questions they had created, as to who would now regulate securities dealers. Again, an informal accord between Hockin and Kwinter in the spring 1987 "resolved" the matter. Ontario and the Federal Government agreed to share the jurisdiction. Ottawa would oversee the regulation of the banks and their in-house securities activities, while the provinces

¹¹³ Boreham, p. 2.

¹¹⁴ Quoted from his interview with Babad and Mulroney, p. 18.

¹¹⁵ Harris, The Political Economy of the Liberalization, p. 361, citation 72.

(Ontario) would regulate the activities of brokers and the activities of “arms length” bank-owned securities firms. However, the new federal watchdog, the Office of the Superintendent of Financial Institutions would oversee the industry as a whole.¹¹⁶ The regulation of the securities industry remains confused to this day, as the Federal Government continues to try to clarify the situation.¹¹⁷

This jurisdictional arrangement was necessary however, because, also in December (only two months after Montebello), Hockin released the Department of Finance’s revisions to the Green Paper, New Directions for Financial Services, (Commonly referred to as the “Blue Paper”). This paper proposed that the Federal Government should move more quickly towards the deregulation of ownership restrictions in all financial services pillars.¹¹⁸ Indeed, given events, the Blue Paper was much more aggressive than the Green Paper, suggesting full de-pillarization. All players should eventually be allowed into all sectors. The Blue Paper was the start of deregulation proper as it announced the framework for complete de-pillarization that would take place in the 1992 *Bank Act* revisions. The fact it was in large part a response to Montebello is obviously instructive of the politics of the sector. Indeed, the Blue Paper is somewhat ironic. It purports to be a discussion paper proposing principles for deregulation; principles that the government had already agreed to with the provinces and the banks, at least in regards to the securities sector.

The Blue Paper also led directly to the rushed 1987 *Bank Act* revisions with little time for parliamentary study. The 1987 revisions both deregulated federal rules

¹¹⁶ Boreham, p. 2.

¹¹⁷ Little progress has been made twenty years later. See Canada, Report of the Wise Persons Committee to Review the Structure of Securities Regulations in Canada, (December, 2003).

¹¹⁸ Canada, Minister of State for Finance, New Directions for Financial Services, (Minister of Supply and Services Canada, 1986).

regarding the securities industry, and also implemented the *ad hoc* reforms to the regulatory structure the government had drafted in response to the 1985 bank failures, principally the establishment of the OSFI.

Adding to the reactive and *ad hoc* nature of these changes, when tabling the Blue Paper in the House of Commons, Hockin also made a crucial promise that the rate of concentration would be closely monitored in the industry:

The philosophy underpinning financial services integration will be to build, not buy. To protect against harmful concentration, acquisition of financial services companies will require the approval of the Minister of Finance. As a general rule, large financial institutions will not be allowed to acquire other large financial institutions.¹¹⁹

Hockin echoed the Green Paper in suggesting that the government should use its powers to disallow mergers between large federally-regulated institutions, that there should be a policy that “big shall not buy big,” in order to ensure that deregulation of ownership restrictions actually encouraged competition rather than simply wholesale conglomeration. However, no legislative provisions were included to ensure that this would be the case.

The 1987 revisions allowed all federally regulated institutions to own and operate securities subsidiaries, although they were still barred from offering investment advice “in branch,” meaning that they could not fully network the services of their securities affiliates.¹²⁰ This sudden end to pillar ownership restrictions at the federal level in combination with policy changes in Ontario radically altered the securities industry. The Banks argued that allowing them into the industry had been essential to their future

¹¹⁹ Babad and Mulroney, p. 120.

¹²⁰ See Freedman, p. 10.

profitability.¹²¹ However, the change in policy was rash, particularly in light of the measured approach initially proposed by the Green Paper. Rather than the staged implementation of deregulation in which trust, insurance and credit unions would be given first crack at creating affiliate companies in different pillars, with the banks not to be granted the same rights until after 1990, deregulation had been “hijacked” as the banks were let in right away. The result was predictable.

The *Bank Act* changes prompted a frenzied round of takeover talks between banks and major brokerages (talks began long before the government had even drafted the legislation). Industry observers knew that despite the government’s protests that this would stimulate competition in the sector, what was more likely was simply a series of hasty marriages between banks and major brokerages as had happened in Britain’s “Big Bang.” In short order, the Royal Bank acquired Dominion Securities, the Bank of Montreal acquired Nesbitt Thompson, the Bank of Nova Scotia acquired McLeod, Young and Weir, the Canadian Imperial Bank of Commerce acquired Wood Gundy and National Bank acquired Lévesque Beaubin. Toronto Dominion satisfied itself with existing Green Line service. At least initially, foreign firms also acquired Canadian brokerages. Security Pacific bought a share of Burns Fry. Citibank, Germany’s Deutsche Bank and Japan’s Sanwa Bank all purchased small Canadian dealers.¹²² In all, \$1.4 billion changed hands and Canada’s sleepy little brokerages sold for a premium, often at double their book value.¹²³

¹²¹ For a discussion of these issues see Freedman, pp. 9-10.

¹²² For a comprehensive list of the mergers and takeovers that occurred immediately in the wake of deregulation, see Boreham., p. 4.

¹²³ Babad and Mulrone, p. 19.

It should also be noted that this deregulation occurred at a bad time for the securities industry. In the wake of the stock market crash of the fall of 1987, the industry went through an extremely lean period as it dealt with huge losses. Boom times would not return until the 1990s when most firms had been taken over by the banks.¹²⁴ In the interim, the crises in the industry placed them in a position where selling to a bank probably made a lot more sense than trying to expand to compete with the bank-owned brokerages. Indeed it is also important to note that no major securities firm was purchased by a trust company or insurance firm.¹²⁵ None of the securities firms tried to stay independent and open their own Schedule II bank. “By the time the dust settled, every large bank had its own securities firm, but no securities firm had a bank. The brokerage business had become an offshoot of banking.”¹²⁶ Furthermore, despite initial US interest in the sector, in response to competition from Canada’s bank-owned securities firms, several American subsidiaries actually left the Canadian market, including Merrill Lynch.

For the architects of deregulation this was not the optimal outcome. The links between Canada’s major brokerages and banks ensured that the brokerages had access to larger levels of capital and the banks gained a profitable new sector, which had rivaled their financing services for their corporate clients. However, now when Canadian corporations were seeking investment, either through bank financing or through

¹²⁴ Following bank takeovers in the securities industry, the sector emerged from its slump in the 1980s with renewed profits - profits that primarily accrued to the largest bank-owned securities dealers (Industry net profits were \$338 million in 1991, with almost 70 percent of those profits accruing to the 8 largest firms). From David Toole, “How do you tell them apart?” Canadian Business, July 1993, Vol. 66, Issue 7, p. FSG13.

¹²⁵ Supporters of deregulation initially highlighted the exciting expansion of trust companies into the sector, pointing to Central Guarantee Trust’s attempts to get into the business. See for example, Boreham, p. 7. However the company would be effectively bankrupt within the year as a result of its acquisitions.

¹²⁶ Stewart, Bank Heist, p. 64.

commercial paper, one way or another they would have to deal with one of Canada's big banks. Arguably there were fewer potential sources of capital.

Given the fact that many of the fears promoting deregulation in the securities industry centred on the long term viability of Canada (and Toronto, specifically) as a major financial services centre given the small size of Canada's brokerages, it is important to note that the major result of the bank takeover of the securities industry was a stronger, Canadian-owned industry with the capital to compete globally. It was, however, an industry dominated by a few "big banks."¹²⁷

VIII) Conclusions:

While globalisation and the international competition for business confronting financial services firms was an important backdrop for deregulation, as Harris suggests, its biggest impact in Canada was that it armed pro-deregulation policy entrepreneurs (like the banks) with more effective arguments. "The new policy entrepreneurs had learned that these phenomenon had threatened both the viability of the domestic industry and Toronto as a financial centre."¹²⁸ It was this concern that influenced Ontario officials. Some federal officials and members of the financial services industry were concerned about the timing of deregulation given Canada's commitment to international trade negotiations on liberalizing service barriers, and worried about the need for a well-planned process that would not simply result in a rapid bank takeover of the securities industry. Ultimately, however, Ontario moved preemptively within its own jurisdiction to

¹²⁷ In fact, despite the predictions that it would allow Canadian securities firms the capital to capture foreign underwriting business, making Canadian a more important financial centre, this did not occur. The foreign operations of Canada's major securities firms actually shrank after deregulation. See, Boreham, p. 7.

¹²⁸ Harris, The Political Economy of the Liberalization, p. 354.

protect Toronto's position as a financial centre. Facing this, and confronting considerable pressure from Canada's banks, the Federal Government lurched into an *ad hoc* and rushed process of deregulation, in a way very illustrative of Coleman's esoteric politics in this sector. Outcomes were negotiated informally; Parliament had little control over events, and Canada's weak state institutions in the sector provided only reactive policy to the pressure they received from the banking industry.

Unsurprisingly, of all the players, the banks were the major winners of the 1987 "little bang." Boreham puts it plainly, saying that the banks became the "ruling class" of Canada's securities industry.¹²⁹ While supporters of deregulation were fond of pointing out that some trust companies and credit unions took small steps towards getting involved in the securities industry, the more straightforward conclusion was that ". . . about 80 percent of the industry has come under the control of the big six chartered banks."¹³⁰

While this promised to be a boon for the banks' goals of diversifying the range of financial services they could offer their clients, what the government gave with one hand they could take away with another. Ominously, following less than a year after passage of the Government's 1987 changes to the *Bank Act*, under the provisions of the Canada-United States Free Trade Agreement (1988), the Canadian government lifted size restrictions for US banks' commercial operations in Canada. While this move fit within the broader government goal of increasing competition within the Canadian financial services sector, it was the starting point for a decade of moves which would *potentially* expand the presence and market shares of foreign banks in Canada. Previously, the Canadian banking sector was virtually closed to foreign competition, as Canadian banks

¹²⁹ Boreham, p. 8.

¹³⁰ *Ibid.*, p. 3.

were sheltered from having to compete with larger US banks for Canadian customers. Understandably the spectre of a post-FTA influx of huge US banks was a concern for the Canadian financial services companies. For the banks, the clarion call of the 1990's would quickly become that due to the threat of foreign competition "bigger was better." As such, conglomeration emerged as the most important business strategy of the decade. In 1987, Canada's five biggest banks owned 132 subsidiaries, by the mid 1990s that number would triple.¹³¹

The "little bang" left a host of issues unresolved.¹³² For example, most observers remained concerned that the government had done little to create necessary regulations for the new environment. Michael Babad and Catherine Mulroney, and Walter Stewart, all industry observers at the time, were concerned about the potential conflicts of interest being generated in the industry through deregulation. Stewart argued that the bank collapses of the 1980s offered important insights into the kinds of problems which might emerge in the deregulated environment, problems which would be made potentially more risky by the increased scale of the firms involved.¹³³

More importantly, the *ad hoc* reform of Canada's prudential regulators also meant that Canada ended up with a weak regulator. The OSFI had a very limited mandate to protect consumers from improper business practices and no mandate to ensure competitiveness in the industry. Even celebrants of the little bang assumed that there would eventually be some sort of a comprehensive federal regulator of the industry as the government proceeded down the path of deregulation; however, this has not been the

¹³¹ Stewart, Bank Heist, pp. 64-65.

¹³² Despite the *ad-hoc* dissolving of the securities pillar in Canada's "little bang," progress was slow on other regulatory questions. Indeed the Federal Government did not table proposals for regulatory changes in the banking sector until 1990. These would become the 1992 changes to the *Bank Act*.

¹³³ He has several examples of the risks. See, Stewart, Bank Heist, pp. 66-67.

case.¹³⁴ Crucially, this meant that the regulators were unprepared for the events of the early 1990s in which the banks would pursue a massive program of conglomeration. Indeed the regulators proved inadequate even in their prudential responsibilities.

More importantly, Parliament would increasingly emerge as a residual regulator of the industry for matters like industry competition. Over the long run, that would create the conditions for an erosion of esoteric politics in Canada.

Finally, the process of sectoral integration, the collapsing the policy sectors of the four pillars into a single policy network begun by the Green Paper, had unclear long term implications. In the wake of the “little bang,” it seemed that whatever the blurring of federal and provincial subsectors, the banks still dominated policy concerns in Ottawa. Indeed James Darroch concludes that the “little bang” fit the historical pattern for bank-Federal Government relations. It ensured that banks were in the best position to benefit from deregulation and opened new business avenues to them at a time when they were meeting increased international competition: “These expanded powers were fundamental to restoring competitive strength. The reason for this is that increased competition had lowered the profitability of the core lending business at a time when banks needed to be profitable . . .”¹³⁵

¹³⁴ See Boreham, p. 8.

¹³⁵ James Darroch, “Global Competitiveness and Public Policy: The Case of the Canadian Multinational Banks,” Business History, 34:3 (July 1992), p. 165.

**CHAPTER 5: “THE CLOSED POLICY COMMUNITY OF
CANADIAN UNIVERSAL BANKING (1987-
1997)”**

“Banking was conceived in iniquity and was born in sin. The Bankers own the earth. Take it away from them, but leave them the power to create money, and with the flick of the pen they will create enough money to buy it back again . . . if you wish to remain the slaves of Bankers, and pay the cost of your own enslavement, then let the bankers continue to create money and control credit.”

Sir Josiah Stamp, director of the Bank of England, 1920

I) Introduction:

The process of sectoral regulatory reform did not end with the 1987 revisions to the *Bank Act* which allowed deposit-taking institutions to own subsidiaries in the securities industry and also established the Office of the Superintendent of Financial Institutions (OSFI). The industry was still waiting for the more substantive, industry-wide deregulation promised by the Conservative Government in the 1986 Blue Paper. The Federal Government’s *ad hoc* responses to the bank collapses of 1985 and the precipitous deregulation of the securities sector by Ontario left many questions unresolved. How would de-pillarization unfold? When would firms be allowed to fully network an array of services “in branch” and become true “one stop shopping” universal banks? What rules would be created to prevent problematic conflicts of interest in the industry? And finally, what steps would be taken to ensure that de-pillarization did not undermine domestic competition for financial services? This chapter will examine the political and economic developments in the sector surrounding de-pillarization and the adoption of the universal bank model in Canada.

Ultimately, the 1992 *Bank Act* changes, which virtually abolished the four pillars system were “derivative” of the decisions in 1986. Indeed, the government had already made it clear when it removed ownership obstacles in the securities sector that it intended to move towards full de-pillarization in the next round of *Bank Act* changes. Again, much like the process of securities deregulation, the 1992 *Bank Act* changes also primarily benefited the “big banks” as their interests dominated policy outcomes.

Over the period the government also made a host of other policy decisions which helped ensure that the banks emerged as the dominant players in the new financial services marketplace. The banks asked for and received special tax treatment for their LDC debt crisis exposure. They also received a reduction in reserve requirements. At the same time, working cooperatively with the government, they managed to avoid serious parliamentary intrusion into an array of consumer complaints. Finally, and perhaps most tellingly, given the government’s earlier promises to encourage competition and prevent unhealthy conglomeration, federal agencies helped the banks effectively close down Canada’s trust industry. Government support for the banks’ takeover of the troubled industry reduced the possibility that trust firms could serve as an important regional second tier of financial services companies. This revealed problems with the regulatory reform of 1987. Powerless to ensure that conglomeration did not reduce competition and the government’s “big shall not buy big” rule, the new OSFI actually embraced bank takeovers as the desired way to “bail out” troubled competitors.

The decade-long process of deregulation and conglomeration following the release of the hurriedly prepared Blue Paper illustrates the operations of a closed policy community in which the big banks and the key federal agencies continued to informally

negotiate outcomes, relatively isolated from broader political pressures. Looking back on this period in comparison to the policymaking environment since 1998, Ray Protti, the long-serving head of the Canadian Bankers Association (CBA), referred to this (ironically) as the “one stop shopping era of bank lobbying.”¹ Rather than having to lobby an array of parliamentarians and officials, the banks were able to focus simply on the Ministers of Finance, relying on them to ensure the banks’ concerns were met. This policymaking environment ensured that the banks’ political demands remained central to policy outcomes. Globalisation and the adoption of the universal banking paradigm seemed to be entrenching esoteric politics.

II) 1992 Depillarization Delivered:

After 1987 banks (and other FSPs) could purchase a securities firm, however they were still prohibited from offering investment advice to their in-house bank clientele via the bank itself. Banks had to keep their investment dealing subsidiaries at “arm’s length.” This was in part to ensure that the banks, with their extensive private information about their basic banking clients, would not quickly squeeze out non-bank competitors in securities dealing. More importantly, it was reflective of the fact the 1987 changes were rushed. The government still had to develop the complex legislative proposals necessary to implement the program of de-pillarization promised by the Blue Paper. The legislative proposals were scheduled for 1990, but they were slowed by the complexity of issues involved. In particular, the government had to systemically consider

¹ Source: Interview, 2006.

the effects on the insurance industry, which had not received serious Federal Government attention in fifty years. The insurance industry subsequently emerged as a major opponent of wholesale deregulation, and an important set of interests which would play a role in undermining esoteric politics as the boundaries between financial services policy sectors eroded.

Between 1987 and 1992 there was still considerable concern about the impact of de-pillarization, despite the fact it was a *fait accompli* in the securities sector. Many industry insiders were afraid of universal banking:

They fear that the concentration of several sectors of business “under one roof” will lead to self-dealing, and conflicts of interest and that financially-integrated conglomerates will resolve the competing interests between suppliers and demanders of capital as well as consumers of financial services to the disadvantage of the weakest (generally the smaller) customers.²

In addition, the full integration of securities functions into banking operations might undermine the “safety and soundness” of banks, as they would be infected by the “risk taking” business culture of investment dealers.³ Opponents of deregulation also noted that Canada had already gone further than the US where in the late 1980s the *Glass-Steagall Act* continued to divide commercial and investment banking. Canadian banks had already achieved more latitude than banks in the US.⁴ Furthermore, many argued that there were a host of unresolved regulatory concerns that required attention before de-pillarization could proceed.

² Gordon Boreham, “Three Years After Canada’s ‘Little Bang,’” *Canadian Banker*, Sept/Oct. 90, vol. 97, Issue 5.

³ *Ibid.*

⁴ It was not until 1994 that deregulation of the banking industry really took hold in the United States. Legislative changes in 1994 “obliterated” the legacy of *Glass-Steigall*. See Theresa Morris, “Bank Mergers Under a Changing Regulatory Environment,” *Sociological Forum*, Vol. 19, No. 3, September 2004, p. 440.

Most notably, after 1987 the securities industry was still regulated by the provinces; however, the banks that now owned many of these companies were regulated federally and their in-house trading activities were likewise regulated federally.⁵ The banks and their new securities subsidiaries were to be divided by “Chinese walls” which were supposed to prevent confidential information from passing back and forth between the banks’ primary business and their securities subsidiaries.⁶ The banks’ securities subsidiaries could sell the banks’ products, like mutual funds, but they were theoretically limited from using the banks’ information about its clients for selling purposes. This also should have reduced the risk of improper conflicts of interest. However there was considerable confusion about what rules regulated the interaction between these various arms of a bank.⁷

Even after 1993, when the full set of deregulatory rules had been promulgated, and banks were allowed to directly offer “in house” portfolio advice, it was still a fuzzy question as to who should or would regulate investment counselors and portfolio managers. The informal deal made in 1986 between the federal and provincial governments became problematic. Since the federally-regulated banks were now allowed to offer investment advice in branch, it seemed to require some sort of new regulatory

⁵ Essentially, the provinces had been left with the responsibility of regulating the behaviour of brokers, while the Federal Government was to oversee the potentially problematic conflicts of interest that could emerge in the behaviour of the companies themselves.

⁶ Michael Babad and Catherine Mulroney, *Pillars: The Coming Crisis in Canada’s Financial Industry*, (Toronto: Stoddart, 1993), p. 81.

⁷ Robert MacIntosh, who, as the head of the CBA, promoted the merging of investment and commercial banking for years, was personally uncomfortable with some of the questions it raised, “I was in an awkward position as president of the CBA because I had to take the industry’s position on that . . . I always thought there was a conflict between a bank as a commercial lender to a corporation and the bank as underwriter of that same institution.” In an interview, he questioned the effectiveness of the “walls” between the two arms of the banks in securities, pointing out that in the European universal bank model such conflicts of interests had almost become normal business practice. See his interview in Babad and Mulroney, p. 83.

apparatus to cover the federal portion of the jurisdiction, optimistically, an apparatus which would have coordinated its rules with those of the provinces.⁸

The unresolved rules were only one side of the problem. Opponents of deregulation also noted that the reformed banking regulator, the OSFI, was a poorly suited institution to oversee things like industry conflicts of interest. Charles Caty of the Investment Dealers Association (IDA) argued that:

. . . there are inherent conflicts between being a banking regulator and a securities regulator. A banking regulator thinks of confidence in the system and keeping things under cover and under control down here – don't let them know how bad things are or there might be a run on a bank. The securities industry says the absolute opposite. We're not holding your funds per se. We help you invest them. And you need to know the facts – absolute disclosure. If it's done by one body, is that body going to be concerned about the investor or about the depositor? I would argue that he'll always take the depositor first and the investor will be shortchanged.⁹

Indeed, the industries themselves have fundamentally different orientations towards risk and safety. This is why most countries had kept the functions of commercial banking (safety for deposits) separate from investment banking (risk-taking investment instruments).

The *ad hoc* creation of the OSFI in response to the bank failures of 1985, and its resulting single-minded focus on prudential concerns made it a poorly suited agency to protect consumers from other possible industry problems in the deregulated environment. In fact OSFI officials, most of them at one time or another employees of one of the big banks, personally reject the whole notion that there was a need for the OSFI to monitor consumer protection. In an interview for this project one official said the feeling was that

⁸ The Federal Government has launched several efforts to clarify the regulation of the securities industry in recent years; however, the point remains, that almost twenty years after deregulation, the situation is still nebulous.

⁹ Babad and Mulrone, p. 98.

consumer protection was something for the market to look after. If firms treated customers poorly they would lose business.¹⁰ However, since no clear plan emerged to resolve the federal-provincial jurisdictional problem in a synthetic way, debate as to what the shortcomings of the OSFI were was muted. Five years after allowing the banks to virtually take over the securities industry, senior officials responsible for regulating the industry were still complaining that there had been no intergovernmental cooperation on what was to be done about these problems.¹¹

Beyond regulatory confusion, others worried that the move to full universal banking could lead to a “dangerous aggregation of economic and political power” that might threaten the “democratic process.”¹² Indeed, the transition to universal banking, while often portrayed as ‘Canada is catching up to how things were done elsewhere in the world,’ was problematic. Canada’s financial services market was different than other jurisdictions. It was more concentrated to begin with. The archetypal German “universal banks” exist in a fundamentally different context, as there have traditionally been more “second tier” institutions there. German universal banks comprise only one quarter of the market for financial services.¹³ German *Länder* had been more successful than Canada’s provinces in supporting alternative regional savings institutions to big “centre” banks.

¹⁰ Source: Confidential Interviews, 2006. In fact they used several expletives to outline their “thinking” on the subject. The bottom line is that the OSFI did not care about these types of concerns.

¹¹ Babad and Mulroney, p. 98. Robin Wright, the head of the Ontario Securities Commission openly complained in an interview that the governments had not even begun to discuss the problem.

¹² Boreham.

¹³ See Daniel Verdier, “State and Finance in the OECD: Previous Trends and Current Change,” Politics and Society, Vol. 28, No. 1, March 200, p. 44, Richard E. Deeg, Finance Capitalism Unveiled: Banks and the German Political Economy, (Ann Arbor: University of Michigan Press, 1998, and, William Coleman, “Lessons from Germany,” Canadian Banker, Sep/Oct. 1992, Vol. 99, Issue 5.

Regardless of the array of concerns about the wholesale transition to “one stop shopping,” the government advanced its plans. Keeping in step with the banks’ demands for deregulation, the government released the Department of Finance’s final pre-legislation discussion paper as the framework for the legislation that would follow shortly after. The 1990 White Paper clarified the Blue Paper’s proposals, specifying just what the government intended in the legislation.¹⁴ The paper promised wholesale de-pillarization of both ownership restrictions and the in-house powers of financial service providers. The only major exception was that the White Paper made it clear that banks and trusts would not be allowed to directly sell a full array of insurance products or provide car leasing from their branches – important omissions.

1992 *Bank Act* Changes:

The 1992 *Bank Act* changes dissolved the traditional pillars of the industry by erasing many of the limitations on financial service companies’ right to offer services outside of their domain, either through the purchase of subsidiaries already active in other sectors or through new in-house powers. This represents the major shift in policy paradigms, from pillarization to the universal banking model.¹⁵ The policy changes were designed to increase competition across all four pillars. All financial service providers could “network” services offered by affiliates active in other pillars of the sector. This allowed companies active in one sector to cluster the types of financial instruments they

¹⁴ Junior finance minister, Gilles Loiselle, released the Department of Finance’s “White Paper” in 1990, the last of the “three colored papers” that the government released in preparation for de-pillarization. Canada, Department of Finance, Reform of the Federal Financial Institutions Legislation: Overview of Legislative Proposals, (Ottawa: Minister of Supply and Services, 1990).

¹⁵ Charles Freedman concludes that the impact of these changes (or the intended outcome) was to allow, for the first time, the emergence of true financial service conglomerates, offering a full range of financial services. See, Freedman, “The Canadian Banking System,” (Bank of Canada, March, 1997), p. 15.

could provide clients, through the acquisition of affiliates in another sector. Those involved continued to argue that the reforms were necessary due to the complex interaction of new technology, globalisation and new market behaviour.¹⁶

Most important among the 1992 changes were two new privileges accorded to Canada's major banks. Banks were now allowed to own and operate insurance companies, but they could not actually sell insurance through their branches. Banks were also allowed to directly offer securities services (portfolio management and investment advice) as the "arms length" restrictions of 1987 were lifted. In effect, banks could now offer an almost full range of financial services to their clients, albeit in the case of insurance, through an affiliated company rather than "in branch." Concurrently with the legislation, the government also promised that there would be another round of deregulation in 1997 which would further remove obstacles to industry integration: obstacles such as the remaining restrictions on insurance and car leasing services.¹⁷

In theory the banks' new privileges were also offered to other deposit-taking FSPs. The 1992 changes to the *Bank Act* involved a major update of the regulation of near-bank companies like credit unions and trusts: issues which had not been addressed in 1987, despite the original intentions of the Green Paper.¹⁸ Under the legislation, widely held non-bank financial service providers, such as trust companies, insurance companies and credit unions with diversified ownership structures, were allowed to own and operate second-tier Schedule II banks without many of the restrictions that had

¹⁶ See Freedman, p. 10, and, Ian Roberge, The Internationalization of Public Policy and Multi-level Governance: A Comparison of Financial Services Sector Reform in Canada and France, (Doctoral Dissertation. McMaster University, 2004), pp. 119-120.

¹⁷ The Government also promised to work on resolving regulatory confusion with the provinces in the future. See Roberge, p. 20.

¹⁸ Effectively all types of financial service providers had the same potential powers. The different industry "origins" of an institution became increasingly irrelevant. David Toole, "How do you tell them apart?" Canadian Business, July 1993, Vol. 66, Issue 7, p. FSG13.

previously existed. These new banks would have the same ability to network services that Canada's Schedule I banks had been given. Credit unions and trusts had more room to maneuver after 1992.¹⁹ Furthermore, the government allowed trust, loan, and life insurance companies full consumer and commercial lending powers which had been restricted to the banks prior to 1992. These changes were somewhat moot, however, since outside of Quebec and British Columbia, near-banks virtually disappeared as important market participants over the following decade.

Indeed, while the intent of the 1992 changes was to stimulate competition across the pillars by letting everyone dabble in other sub-sectors, the legislation was exceedingly complex and many industry participants assumed that the real impact would be a wave of conglomeration which would ensure that only the big banks benefited from the changes. Catherine Swift, representing the Canadian Federation of Independent Business, a group representing the banking industry's small business clients, argued in 1993:

In theory, financial deregulation is a good thing because it should lead to a little more diversity of lenders and financial service offerers, but because we didn't start off with a real market situation – we started off with very much a regulated oligopoly, with the banks being so powerful – some of the original intent has been subverted.²⁰

Industry analysts argued much the same. Increased technological costs and global competition both created incentives for business strategies focused on conglomeration: “There's going to be a reduction in the number of players across the board, and the big banks seem to be the winners in the process.”²¹

¹⁹ For example, these changes paved the way for VanCity, a regional Vancouver-based credit union, to establish the Citizens Bank of Canada, a new market participant for basic banking services.

²⁰ Quoted from Toole, p. FSG13.

²¹ In an interview with investment analysts before the rules had even gone into effect, David Toole found that people were “betting” on a resulting wave of bank-led conglomeration. See, Toole, p. FSG13.

Before exploring the effect of these changes on the industry, however, it is important to note that there were other policy changes occurring in the sector which also acted to the benefit of the banks.

III) Supporting the Competitiveness of the Big Banks During Deregulation

A number of scholars have noted that from a “bird’s eye view,” policy developments in this sector over the deregulatory period could be seen as efforts on the Federal Government’s part to prepare the banks for globalisation. James Darroch argues that federal policy outcomes during deregulation were intended to ensure the banks’ profitability given the increased international competition they faced.²² William Coleman and Tony Porter suggest much the same. Distancing their analysis from those who assume that government policy has in some sense been driven, or determined, by global market forces, they argue that Canadian policymakers played a key role in managing the globalisation of Canada’s financial services firms. The government acted to “prepare” Canadian firms and the Canadian market for the advent of global competition by nurturing the domestic economic interests of Canadian banks.²³ In the decade after the “little bang,” the government not only implemented the universal banking model, it also made several important policy decisions that ensured the financial health of the big banks during deregulation.

²² James Darroch, “Global Competitiveness and Public Policy: The Case of Canadian Multinational Banks,” *Business History*, 34:3 (July), pp. 153-175.

²³ William Coleman and Tony Porter, “Playin’ Along: Canada and Global Finance,” in Wallace Clement and Leah Vosko, eds. *Changing Canada: Political Economy as Transformation*. Montreal and Kingston: McGill-Queen's University Press, 2003), pp. 241-264. Indeed, Coleman and Porter see these developments as the major legacy of the 1990s, a legacy which suggests not only that the Canadian state remains the key actor in regulating the sector, but that domestic politics, and the intentions of Canadian politicians and policymakers, remain the key consideration in understanding the trajectory of public policy in the sector.

International Prudential Cooperation and Reserve Requirements:

Reflecting the growing complexity of the banking industry in light of globalisation throughout the 1980s and 1990s there were efforts to coordinate states' regulatory activities internationally. Retrospectively, it is clear that international regulatory cooperation inherently favoured the interests of Canada's banks since the dominant international norms supported conglomeration, deregulation and liberalization. More importantly, international efforts supported the "bottom lines" of larger global banks. As discussed in Chapter Two, one of the most important international developments over the period was the negotiation of new capital adequacy standards at the Basle Committee on Banking Supervision in 1988. The Basle Accord is often overlooked in the context of the domestic regulation of the industry.

In response to the fallout of the LDC debt crisis and the huge debt restructuring agreements that it required, the Bank of International Settlements (BIS) sought to dampen the blow on the banks by coordinating national regulators in the development of new capital standards which would supplant different national legislated standards for non-interest bearing reserve requirements. An ironic move given the lessons of the debt crisis. These efforts were reflective of the degree to which securitization made reserve requirements on banks "unfair" since securities firms did not have the same requirements, and the fact that banks could avoid the impact of existing reserve requirements by unregulated "off ledger" lending in offshore financial centres.²⁴

²⁴ Internationally, it was felt that banks would simply find ways to dampen reserve requirements, with uncertain consequences. The switch to capital adequacy standards was therefore a pragmatic alternative. As Harris notes, in such a complex environment, regulators increasingly focused on doing what was "doable." Stephen Harris, "The Globalization of Finance and the Regulation of the Canadian Financial Services Industry", in G. Bruce Doern et al., Changing the Rules: Canadian Regulatory Regimes and Institutions, (University of Toronto Press, 1999), p. 366.

Domestically, Canada's banks had been arguing since the 1970s that non-interest-bearing reserve requirements were unfair to them since they meant that a portion of their deposits produced no return and decreased overall bank profitability. Since some Canadian near-banks were not required to keep reserves, the banks argued that this was a competitive disadvantage. Walter Stewart argues that the Basle negotiators were "allied" with the "big five banks" on this question, believing that the reserves were unfair given industry changes.²⁵

The Bank of Canada, Canada's representative at the BIS agreed to the new standards on behalf of the Canadian government without any serious parliamentary investigation or approval.²⁶ Under the new Basle provisions, Canada's banks were well inside the safety line, meaning that Canada's legislated reserves were no longer required.²⁷ The final program for eliminating the reserve requirements was subsequently included in the 1992 *Bank Act* changes (four years after the agreement), where a brief provision announced that they would be gradually eliminated by 1994. The Canadian banks viewed this as a victory, suggesting that they were "no longer subject to primary reserve tax." "Banks will be on a level playing field with non-bank financial institutions."²⁸

The Bank of Canada, narrowly interested in the monetary policy implications of abolishing the reserve requirement, focused its attention on how the role of the reserve in

²⁵ Walter Stewart notes that Charles Freedman, the Bank of Canada economist, wrote a series of papers for the Bank of Canada (1987-1991) which simply assumed that the reserve requirement would be abolished, despite the fact that Parliament had passed no law to this effect. See, Bank Heist: How Our Financial Giants Are Costing You Money, (HarpersCollins, 1997), p. 117.

²⁶ Stewart, Bank Heist, p. 116.

²⁷ Indeed, most countries' national regulatory requirements (aside from the US and Japan) were inside of these ratios already. Tony Porter, "States, Markets and Regimes in Global Finance," (St. Martin's Press, 1993), p. 71.

²⁸ Kerry Sufirin and Barbara Amsden, "The Real Meaning of Reserve Reform," Canadian Banker, January/February 1992, pp. 14-18.

monetary policy could be supplanted by daily manipulations of short term interest rates.²⁹ There was little analysis of the domestic market implications of suddenly letting the banks loan the additional billions in bank reserves that were freed up. Stewart calculated that the Bank of Canada's implementation of the Basle Accord meant that the big banks' non-interest bearing deposits in the Bank of Canada dropped by \$2.2 billion between 1990 and 1995.³⁰ This meant that the banks had additional billions to loan, from which they could derive additional profits. This benefited the banks in the deregulatory period's mergers and acquisition "frenzy" as it placed them in a more secure position than they might have otherwise been.

International regulatory cooperation sustained esoteric politics, because of the "democratic deficit" it has opened in this sector over the last twenty years. The shift from decision-making about reserves to ". . . a more remote global process . . . exacerbated by the exclusivity of the highly technical language and concepts with which policy discussions are carried out . . ." reduced consideration of domestic concerns in cases like this, and worked to the benefit of the most powerful market participants.³¹

The Basle negotiations were not the only development in this area. For example, the North America Securities Administrators Association developed a Multi-jurisdictional Disclosure System with the US Securities and Exchange Commission. Canada's provincial securities regulators, which were members of the association, entered into this information sharing agreement to improve oversight.³² These attempts to harmonize standards and share information amongst North American regulators in

²⁹ Stewart, Bank Heist, p. 118.

³⁰ *Ibid.*, p. 120.

³¹ Tony Porter expresses this concern succinctly in Globalization and Finance, (Polity Press, 2005), p. 193.

³² See, William Coleman, Financial Services, Globalization and Domestic Policy Change, (London: Macmillan, 1996), p. 223.

light of NAFTA is interesting, given that domestically, little attempt was made to harmonize federal and provincial regulation of the sector. Of course, domestic harmonization might have increased regulatory burdens on the banks and their new securities subsidiaries. In short, the international activities of the Canadian state primarily benefited Canada's big banks.

Bad Debts and Government Support for the Banks:

Directly related to the government's international regulatory cooperation is the handling of the LDC debt crisis. International banks, having loaned billions to poor nations which, as a result of spiraling oil prices, food costs and interest rates could no longer manage their payments, turned to governments for help, arguing that the debt crisis could bring down the international financial system. The Basle Accord, government cooperation through the Paris and London Clubs to reduce the risk of collapse, and state pressure to ensure that delinquent nations did not default on their loans, all helped ensure that major banks were safely ushered through the crisis. Implicitly, the Canadian government's participation in these efforts worked to the benefit of Canada's big banks relative to their domestic competitors, since it was the big banks that were exposed to the bad loans of the debt crisis. In fact, the purely domestic responses of the Federal Government to the problem were starkly different than its response to bad loans and financial instability amongst the banks' competitors in the trust industry.

Despite the perceived depositor security of the big banks, it was estimated that they had made \$23 billion in loans to LDCs in the early 1980s.³³ When the OSFI was created in 1986, the scale of the debt crisis was already in full effect. One of Michael Mackenzie's first initiatives as the new Superintendent was to have the banks increase LDC loan loss reserves to 45 percent by 1988.³⁴ However, unlike normal reserves, Mackenzie had the government treat the new LDC loss reserves as tax deductible. This was a major tax windfall for the banks, costing Canadian taxpayers billions as the banks were able to use potential lost revenue on LDC reserves to offset their domestic tax exposure on other more profitable operations.³⁵

In 1986 the Bank of Montreal's gross LDC exposure had been \$5.9 billion (\$5.2 billion when loan loss reserves were subtracted). This equaled 173 percent of the bank's total equity at that time. Benefiting from both Mackenzie's tax subsidized bailout package and the Basle Accord's reduced domestic reserve requirements, by 1992 BMO's exposure was down to \$1.5 billion (only \$544 million after reserves) which was less than 12.6 percent of bank equity at that time.³⁶ Aside from the degree to which this illustrates again the close supportive relationship between the banks and the Federal Government, the point here is that this was a well-timed "rescue" for the banks. Had they still been carrying these bad loans in 1992, their response to deregulation might have been considerably different.³⁷

³³ Babad and Mulroney, p. 172.

³⁴ This means the banks were required to temporarily increase the size of their loan loss reserves in relation to the size of their LDC lending.

³⁵ Babad and Mulroney, p. 173.

³⁶ See Babad and Mulroney, p. 173, for discussion.

³⁷ Even with the government's help, one expert argue that in total the banks still lost \$8 billion to the LDC crisis over the period. It could have been much worse. Source: Confidential Interview, 2006.

Government regulators may also have given the banks privileged treatment during the real estate crisis which hurt the financial services industry during the recession in the early 1990s. Indeed, both the banks and their smaller trust company competitors were hit hard by the collapse in real estate prices. The banks had made a number of extremely large loans secured against real estate collateral, in particular to Canadian-based Olympia and York (the world's largest real estate company at the time). When Olympia and York (O&Y) went bankrupt, it owed \$14 billion, \$3 billion of which was owed to Canada's banks alone.³⁸ It has been argued that Canadian regulators favoured the big banks through the bankruptcy proceedings and that they were able recoup a much higher percentage of their loans than other creditors.³⁹

Indeed, having been concerned for some years over the banks' willingness to loan such large sums to single clients, in the wake of the O&Y crisis in 1991, the OSFI issued a guideline saying that no bank could loan more than 25% of its capital to a single client. However, lest this be perceived as an onerous new restriction on the banks, all of them voluntarily set loan maximums below what regulators suggested. For example, after the O&Y and LDC debt crises, CIBC announced that it would have a loan limit of 15% of its own capital to any one client. TD set a similar limit at \$500 million.

Bad loans in the deregulatory period could have hurt the banks much more than they did. However, with the government's support for reduced reserves, tax breaks on LDC loan loss reserves and special treatment in bankruptcy protection, the banks would

³⁸ See Canadian Community Reinvestment Coalition, A Financial Consumer Organization for Canada Balancing the Financial Services Marketplace, CCRC Position Paper #4, (December 1997), <http://www.cancrc.org/english/fincomeng.html> The situation for Canada's major financial firms was potentially so bad that news of O&Y's problems prompted a decline in the value of the Canadian dollar. Babad and Mulroney, p. 176.

³⁹ Babad and Mulroney, pp. 172-179.

quickly return to profitability unlike their competitors in the trust sector. Essentially, regulators did a good job of ensuring the solvency and profitability of Canada's banks as they dealt with the growing complexity of global financial markets, an interesting juxtaposition to their handling of similar problems in the trust industry.⁴⁰

Trade Liberalization and Foreign Competition?

Finally, sectoral policy outcomes over the period ultimately limited the threat of foreign competition, insulating Canada's banks from large external competitors. While discourse about the inevitability of global competition in the Canadian market was crucial to supporting the banks' political demands for domestic deregulation and conglomeration, during the deregulatory period foreign financial service providers continued to be denied access to the Canadian market, even when Cabinet wanted to remove the obstacles to entry. This also illustrates how developments inside the financial service policy network benefited the banks.

Free trade negotiations on services posed a potential threat to the Canadian financial service industry, particularly the big banks which enjoyed a market virtually closed to foreign competition. Consistent with the "free trade in services" line promoted by the USTR in both multilateral and bilateral trade negotiations, the Canada/US Free Trade Agreement (CUSFTA) and the North American Free Trade Agreement (NAFTA) both outlined new "rules of entry" that improved US banks' ability to open up shop in Canada.⁴¹ The CUSFTA exempted US based banks from the 25 percent maximum

⁴⁰ The bottom line was that during the period of deregulation, the government did a good job of guiding the banks through financial instability. From 1980-1992, while two banks failed (CCB and Northlands), seventeen trust companies and ten mortgage and loan companies collapsed. See, Coleman, Financial Services, Globalization and Domestic Policy Change, p. 223.

⁴¹ Coleman, Financial Services, Globalization and Domestic Policy Change, p. 222.

foreign ownership of a Canadian Schedule I banks. Also, size restrictions on the assets of US-owned Schedule II banks in Canada were removed.⁴²

In theory, the trade deals favored US firms. First, many US firms enjoyed economies of scale that simply did not exist in Canada. By the end of the 1990s, banks like Citigroup, JP Morgan Chase & Co., and Bank of America all had assets under administration approaching 1 trillion dollars (US). This made them five times larger than their biggest Canadian competitors.⁴³ Citigroup stands out in particular, as some indexes cite it as the largest corporation in the world. Today, with assets under administration of well over \$1 trillion, Citigroup, in absolute terms, is the most profitable financial services company in the world. In 2005, the company's after tax profit came close to \$20 billion (US).⁴⁴

Second, the slower pace of domestic deregulation in the US made the expansion of Canadian bank operations there difficult.

First the expertise and technology possessed by Canadian banks in branch banking will not be able to come into play until the interstate banking reforms are fully implemented [in the US]. Second the conversion of Canadian banks into universal banks still runs up against Glass-Steagall provisions from the Federal Reserve under Section 20 of the Act to deal in securities, this activity remains tightly regulated and restricted. In the seven years following the US-Canada agreement, no significant gains had been made in the US market by Canadian banks.⁴⁵

Canada's banks simply could not do the things in the US that they were now allowed to do in Canada. At the same time Canada's more rapid deregulation not only made its

⁴² Under NAFTA provisions these rules were extended to include Mexico as well in 1994.

⁴³ See for example, "Top 1000 World Banks," The Banker, July 2, 2004, <http://www.thebanker.com>.

⁴⁴ Citigroup's growth has come with risks. It spent much of 2004/2005 under Federal Reserve Board restrictions that prevented it from making new acquisitions. The Reserve's actions were prompted by concerns that the rapidly growing bank had improper internal financial controls to ensure prudential regulation. See Associate Press, "Citigroup free to acquire," Globe and Mail, 04/04/2006, globeandmail.com. The bank has also been accused of insider trading by Australian regulators.

⁴⁵ Coleman, Financial Services, Globalization and Domestic Policy Change, p. 223.

market more attractive to US firms, it also made the regulatory environment less complicated for them to operate in.

Despite these factors, and the considerable hand-wringing they generated in Canadian policy circles, most US banks ignored the Canadian market. In part this was because Canada's general ownership restrictions on banks prevented mergers and takeovers from US firms. Under FTA and NAFTA rules, US banks (or eligible financial institutions) *collectively* could own more than 25 percent of a Canadian Schedule I bank, but each firm could individually own no more than 10 percent of the shares under the general widely held ownership restrictions on Schedule I banks. This provision limited the likelihood of a foreign takeover of one of Canada's Schedule I banks. US banks were still effectively limited to operating a Schedule II affiliate even after the trade agreements. Thus while CUSFTA and NAFTA potentially increased access to the Canadian market, significant obstacles remained.⁴⁶ American Express' failure to enter the Canadian banking sector, despite considerable political effort, illustrates this.

American Express (AMEX), which had traditionally provided traveller's cheques and credit card services to Canadian consumers, was eager to expand and offer a full array of financial services, including banking, in Canada. The AMEX case is interesting since it was one of the leading proponents of international efforts to liberalize trade in services (see Chapter Two) and thereby increase its access to consumers in other jurisdictions. AMEX was also an important industry lobbyist in both the US and Canada

⁴⁶ Ibid., p. 222.

for the 1988 Free Trade Agreement.⁴⁷ The company first applied for a Canadian bank license in the summer of 1986. At that time the Canadian Government told AMEX that they would have to wait until the rules for deregulation were in place since under the existing regulations AMEX was not an “eligible” foreign institution to operate a closely held Schedule II bank.⁴⁸ At the time AMEX was the biggest diversified financial service provider in the US with assets of \$116 billion, but it was not a bank under US law. Under Canadian rules, Schedule II banks could be operated by foreign banks, but the rules precluded a foreign non-bank from acquiring a controlling share.

Despite the fact that a comprehensive deregulation plan was still not in place, and would not be until 1992, and despite the fact that the Canada US Free Trade Agreement failed to provide AMEX with the right to become a bank in Canada, on November 21, 1988 (the day of the Federal election) the Mulroney Cabinet passed an Order in Council granting AMEX the right to acquire a Canadian numbered company which in turn would then apply for a bank license.⁴⁹ Canada’s bankers did not find out that the government had done this until mid-December, at which point they were furious. Robert MacIntosh, the head of the CBA at the time, claims that the first he heard of the government’s commitments to AMEX was a month later when the Assistant Deputy Minister of

⁴⁷ Linda McQuaig has documented the considerable political efforts AMEX went through in supporting and promoting Canada-US free trade in the hopes of securing access to the Canadian market. See, The quick and the dead : Brian Mulroney, big business and the seduction of Canada, (Toronto: Viking, 1991).

⁴⁸ Only a foreign bank could own a controlling stake in a Schedule II bank. AMEX was not a bank under US law. There are several sources which reveal AMEX’s various attempts to get a bank license in Canada. Both Babad and Mulroney and Robert Macintosh’s Different Drummers, provide insiders’ views of the events.

⁴⁹ A Canadian numbered company like this could “closely hold” a Schedule II bank. However, the implication was clear. If the government did this, then any foreign company could form a Canadian intermediary holding company to avoid existing regulatory restrictions.

Finance responsible for banking called to draw his attention to what was going on.⁵⁰ The CBA and the banks publicly responded by accusing the government of ignoring Canadian law.⁵¹

AMEX posed a competitive nightmare for the banks and a regulatory challenge for the government. Its size made it an automatic threat to the banks' hefty market shares, but more importantly, AMEX had powers that the banks did not. For example, as an already diversified FSP, AMEX sold insurance to its card holders. Canadian banks were barred from doing likewise. Opponents to AMEX obtaining bank status in Canada argued that it would mean that AMEX jumped to the front of the line in gaining the benefits of deregulation. Furthermore, it could set the precedent that other FSPs might be able to do the same thing. General Motors, through its auto loan and lease financing operations was a large financial service provider in Canada. They too might want to establish themselves as a full service Schedule II bank.⁵²

The banks' anger at the government over the issue was clear. Ironically, given what had occurred in the deregulation of the securities sector a year earlier, they argued that this was a "fast and loose" way of regulating the sector. TD's chairman publicly accused Prime Minister Mulroney of doing a "secret favour" for his personal friend and American point man on the Canada/US Free Trade Agreement, AMEX CEO James

⁵⁰ MacIntosh, Different Drummers, p. 181.

⁵¹ Ibid., pp. 180-184.

⁵² It was the precedent the Government was setting that seems to have most concerned the CBA. See MacIntosh, Different Drummers, pp 182-183.

Robinson.⁵³ Observers say that despite the competitive threat, what really upset the banks was that *they* were not told what was being done in regards to AMEX, instead, they, along with the rest of the public were only told after the fact.⁵⁴

On January 25, 1989 a delegation of bankers led by CBA chairman, Robert MacIntosh, had a private meeting with Finance Minister Michael Wilson. The meeting was hostile, as Wilson refused to budge, insisting that AMEX was effectively a bank, and could acquire a Schedule II bank under the government's interpretation of the rules.⁵⁵ As a result of the 1980 *Bank Act* amendments, the government did not need parliamentary approval to issue the license. Wilson could do it himself.⁵⁶ Publicly, the bankers gave up, realizing the government would not move and dropped their threat to launch a formal complaint to the OSFI.

The OSFI did try to slow the approval process. Michael Mackenzie (at the OSFI) investigated the issue himself and advised the government that they should delay any further action until they had fully planned deregulation.⁵⁷ However, the government followed through with its promise and issued AMEX a license in April of 1990.

Despite the government's insistence, the banks got their way in the end. When AMEX finally got their bank license they ran into problems with access to the Interac network, a large problem for a bank with no existing branch structure. The big banks had

⁵³ James Robinson and American Express had thrown their influence in the US into maintaining support for the free trade agreement with Canada. When the government refused to change its position, TD chairman Thompson issued a press release retracting his accusations of an improper special deal, citing a lack of proof. See Stewart, *Bank Heist*, p. 5. Brian Mulroney had been a director of CIBC prior to becoming Prime Minister. After his retirement from political office he became a board member for AMEX, Bank of Canada. See, United Financial Consumers, <http://www.ufc.ca/about/main.php>.

⁵⁴ Babad and Mulroney, p. 164.

⁵⁵ *Ibid.*, p. 163.

⁵⁶ The 1980 *Bank Act* Changes empowered the Finance Minister to issue a bank charter – in the past it had taken a private members bill. See Stephen Harris, "The Globalization of Finance and the Regulation of the Canadian Financial Services Industry," in G. Bruce Doern et al., *Changing the Rules: Canadian Regulatory Regimes and Institutions*, (University of Toronto Press, 1999), p. 372.

⁵⁷ Babad and Mulroney, p. 164.

paid the cost for developing the Interac network and had traditionally charged a \$100,000 membership fee to smaller institutions that wanted to join the system. From AMEX they demanded \$7.50 per card to join the network (a considerable cost to AMEX's potential expansion in Canada).⁵⁸ The Government has allowed the banks to privately regulate access to the Interac system. AMEX has never emerged as an important competitor to Canada's banks. Thus, again, the banks were insulated from serious industry challenges.

Perhaps ironically, the more public lesson of the AMEX affair was that most thought it proved the banks' claims that foreign competition was coming. Larger US firms were eager to enter the Canadian market, threatening the existence of a Canadian-controlled industry. Fear of firms like AMEX supported progress towards universal banking and industry conglomeration. Observers saw this as evidence that deregulation needed to be accelerated.⁵⁹

IV) Insulating the Policy Community - Esoteric Politics:

While the banks and the Department of Finance worked out the arrangements for the financial services industry post deregulation, Members of Parliament took an increased interest in the growing public and small business dissatisfaction with the banking industry. Several attempts were made by House of Commons committees to regulate banks' consumer practices. Since the legislative process of the 1980 *Bank Act* changes, the House of Commons had shown an increasing interest in developing policy for the sector, gradually displacing the "clubby atmosphere" of the Senate banking

⁵⁸Ibid., pp. 166-167.

⁵⁹ Stewart, Bank Heist, p. 64.

committee and its reputation for technical knowledge in the area.⁶⁰ Despite this growing appetite for a larger role, throughout the deregulatory period, the government, the ministers of finance, and the regulatory agencies resisted parliamentary demands. The result was that, despite pressure to widen the policy network, policymaking was still closed as even MPs were isolated from real influence in the sector.

Credit Card Interest Rates and Service Fees:

Throughout the late 1980s and early 1990s the Canadian public, small business and the press expressed a range of concerns about the banks' treatment of their customers. High credit card interest rates, the proliferation of new services fees and the absence of an industry ombudsman were all lightning rods of dissatisfaction which attracted parliamentary attention.

Credit cards had become a major business in Canada and a major source of personal debt financing for ordinary Canadians. Use of the cards grew almost fourfold in the 1980s.⁶¹ The reliance on the cards to provide credit which individuals and small businesses may once have received through small loans from the banks made the extremely high interest rates on the cards a source of concern. Often interest rates went beyond three times the prime lending rate, an attractive spread to financial services firms.

In 1987 the Conservative MP and chair of the Commons Finance Committee, Don Blenkarn, conducted a parliamentary investigation of the issue which argued that rates

⁶⁰ For a discussion of some policy struggles between the House of Commons and the Senate in this sector, see Stewart, *Bank Heist*, pp. 58-60. As discussed in Chapter Three, House of Commons Committees have increasingly supplanted the Senate Banking Committee as the most important parliamentary sites in this sector. Indeed, as will be illustrated, House of Commons demands for more influence have played an important role in the erosion of esoteric politics after 1997.

⁶¹ Between 1981 and 1991 volumes charged on Credit Cards went from \$11 billion to \$40 billion. See, Babad and Mulroney, p. 160.

were too high. The Committee recommended government legislation to pressure the banks to lower their rates.⁶² Similar to the subsequent investigation of bank service fees, however, Blenkarn's Committee found that the government was unwilling to pursue the proposal. Instead an informal agreement was worked out between the banks and the government which only required that the banks be clearer in disclosing their rates to customers.⁶³ In 1989 and 1992 the credit card issue resurfaced. Standing Committee on Consumer and Corporate Affairs reports argued for a cap on credit card interest rates at a level substantially below current market rates.⁶⁴ Again, nothing happened, but this illustrated not only continued frustration over the high rates, but also that the House of Commons remained active in its desire to set detailed, ongoing regulatory rules on the conduct of FSPs.

Service Fees :

Complaints about credit cards paled in relation to Canadians' frustration with the proliferation of service fees since the arrival of automated banking in the mid 1980s. Banks began to impose charges on a range of services they had once provided free of charge. Many of these fees seemed onerous. A withdrawal could cost more than the prime lending rate compounded on a loan for a full year.⁶⁵ Banks also charged service

⁶² Canada. Parliament. House of Commons Standing Committee on Finance and Economic Affairs, Credit Cards in Canada: Report of the Standing Committee on Finance and Economic Affairs, (Ottawa: Queens Printer, 1987).

⁶³ Babad and Mulroney, p. 162.

⁶⁴ See repetitively, Canada. Parliament. House of Commons. Standing Committee on Consumer and Corporate Affairs and Government Operations, Charge it; Credit Cards and the Canadian Consumer, (Ottawa: Queens Printer, 1989). And, Canada. Parliament. House of Commons. Standing Committee on Consumer and Corporate Affairs and Government Operations, Credit cards in Canada in the nineties, (Ottawa: The Committee, 1992).

⁶⁵ For example, using a bank card to withdraw \$20.00 from an automated teller machine could cost \$1.50. If done at a bank machine affiliated through the Interac network an additional fee of \$1.50 might be levied, meaning bank clients could pay 15% just to withdraw their own money.

fees for cheques, for maintaining balances that were too low, for leaving an account inactive for too long, for transferring money from one account to another and for statement updates and account balances. Service charges were also regressive, not only because the charges were fixed regardless of the amount of money being transferred (meaning smaller transactions paid a higher rate in percentage terms) but also because Canadians with larger bank deposits did not always have to pay many of the fees.

The fees were also hard on small businesses. The Canadian Federation of Independent Business, speaking for its 80,000 members, told a parliamentary committee that the fees cost their members \$2,000.00 to \$10,000.00 a year on their transactions with the banks.⁶⁶ In addition, the banks did not always disclose to their clients the imposition of a new fee or disclose the full array of fees at their institutions so that people could comparably “shop around” at other institutions.⁶⁷ Exacerbating the level of hostility to the fees was the recognition that service fee-based income had become an important source of income for the banks, ensuring profitability through lean years.⁶⁸

In 1988, in response to public anger, Blenkarn’s Commons Finance Committee held a public inquiry on the issue. At the hearings, even government backbenchers liked to attack bank service fees and embarrass bank executives over some of the worst examples, a fact which made the government uncomfortable: at most, the government was willing to consider the issue of fee disclosure, so that consumers again could shop around.⁶⁹

⁶⁶ Babad and Mulroney, p. 153.

⁶⁷ Technically the *Bank Act* required banks to get consent to levy new fees but the banks were ignoring these requirements. Babad and Mulroney, p. 151.

⁶⁸ Darroch, “Global Competitiveness and Public Policy,” p. 167.

⁶⁹ Babad and Mulroney, pp. 150-153.

Blenkarn was, however, in a unique position since Mulroney Government parliamentary reforms had strengthened the role of committees. Blenkarn had taken advantage of the new rules to reduce the size of his committee to about ten members (the committee had once had as many as 50 members) and to discourage the substitution of casual, visiting MPs. On top of this, Blenkarn sought unanimous support from all three parties on all reports, which increased their credibility in the House. On these reforms, Robert MacIntosh said:

I knew that Blenkarn's committee was more focused and carried more weight with the public than its predecessors. I was also aware . . . that having decided . . . that he would never make it into a Mulroney cabinet because of his outspoken views, Blenkarn had earned a reputation of being a maverick . . . prepared to contradict the Minister of Finance in public and to challenge the government's position on fundamental issues.⁷⁰

Circumventing a reticent government, Blenkarn's committee formed a bipartisan subcommittee which met privately with the banks in an effort to set voluntary rules limiting service fee proliferation. In particular they wanted the banks to agree to offer a basic savings account to ordinary Canadians that had no service charges.

The banks refused the committee's proposals. MacIntosh, representing the CBA, argued that the process was unconstitutional and lacked any legal standing as this subcommittee was usurping the powers of the government of the day.⁷¹ The banks did not want to engage in any informal process directly involving the parliamentary committee, in large part because they knew they would get better treatment dealing directly with the government through the Department of Finance. The banks said that in

⁷⁰ MacIntosh, *Different Drummers*, p. 241.

⁷¹ *Ibid.*, p. 249. MacIntosh was particularly upset that Blenkarn tried to meet individually with the banks rather than the CBA, trying to break their solidarity on the issue.

the end there was “no issue,” that they did not report to the committee, and that the MPs were just “pursuing political gains.”⁷²

Paul McCrossan, another Conservative Party member of the subcommittee threatened that they might pursue legislation if the banks would not come to some sort of compromise, telling the banks, “If it’s a question as to whether we have the power or not, let’s see.”⁷³ When the banks would not cooperate, and the government would not introduce legislation, the Commons Finance Committee tacitly introduced its own legislation through a McCrossan Private Members Bill, *The Fair Banking Practices Act*. The legislation proposed the elimination of the worst of the fees and would have created a government Ombudsman within the OSFI to investigate complaints and issue fines for violations. The banks, who were used to a more cooperative relationship with the government responded publicly by saying that the legislation would not work. The policy would simply force them to raise other kinds of fees or reduce interest payments.⁷⁴

The government had been presented with a thorny problem. Tom Hockin, the minister responsible for financial institutions was in the midst of a five year program of deregulation for the industry, but his own party’s backbenchers were engaged in what the banks complained was “bank bashing” and attempting new, more onerous forms of direct regulation of the industry. Hockin complained that, as the minister responsible, he had

⁷² See, Babad and Mulroney, p. 155. It wasn’t only the banks that did not want to deal with Blenkarn’s committee. Department of Finance officials have said that they hated being called to appear before the committee. Source: Confidential Interviews, 2006.

⁷³ Babad and Mulroney, p. 155.

⁷⁴ Ibid., p. 156.

his own proposals under development that were being undermined.⁷⁵ The committee proposal generated some institutional confusion as the Ministry of Consumer and Corporate Affairs, claiming responsibility for the issue, tried to become involved in the negotiations with Blenkarn's support. The Department of Finance and the OSFI responded by opening their own negotiations with the CBA on some sort of limited guidelines.⁷⁶

Despite these secret negotiations, through a fluke in legislative process, McCrossan's bill won a "lottery" which meant that among the pool of private member's bills it would come up for debate after only a short wait. Mulroney Government parliamentary reforms had guaranteed that, chosen at random, six private members bills a year would come forward for a vote. As a result, the Ministers, Wilson and Hockin, worked out an *ad hoc* reform package in which the banks would agree to some legislation to regulate their activities and some voluntary rules. Crucially, the banks would not have to accept the creation of an ombudsman or the basic no service charge account.⁷⁷ In return, the government got McCrossan to drop the Private Members Bill.

The outcome was really not what the Commons Finance Committee might have hoped for. The government's rules did not regulate service fees *per se*, but rather required clearer disclosure from the banks on the nature of the fees they were imposing on their customers. Understandably, opposition members were not satisfied. Bank revenue from service fees continued to skyrocket in the wake of the agreement. Royal

⁷⁵ In point of fact, the Government was simply seeking a way to remove Blenkarn and the committee from the process as they too felt the "government's" role was being usurped. Blenkarn, in his review of MacIntosh's autobiography, rejected MacIntosh's conflation that the "Blenkarn Committee" was "the Government" as they were not cooperating on the issue. Said Blenkarn, "The Prime Minister must not be pleased." See Don Blenkarn, "Different Drummers," *Canadian Banker*, Sep/Oct. 1991, Vol. 98, Issue 5, P. 36. 5p.

⁷⁶ MacIntosh, *Different Drummers*, pp. 250-251.

⁷⁷ Babad and Mulroney, p. 158.

Bank revenues grew from \$356 million to \$500 million between 1988 and 1992, the CIBC's rose from \$272 million to \$428 million.⁷⁸

Service fees remained a public relations problem for the banks throughout the 1990s. They were an obvious sore spot in the *Mackay Task Force's* public opinion research. While polling Canadian attitudes towards the industry in 1997 and 1998, EKOS Research found that three quarters of Canadians expressed satisfaction with the range of services and overall quality of services offered by FSPs, but a majority of respondents were "dissatisfied" with bank service fees. Indeed, EKOS said that the issue was "omnipresent" in focus group discussions:

There is a widespread perception of injustice and greed in that the banks have continued to implement service fees while making record profits. Many participants seemed angry with the growing realization of how little the average customer is worth in the enormous revenues of financial institutions. It is difficult for the average consumer to understand what fees are charged for which services, and to make adequate comparisons among institutions.⁷⁹

When asked to agree or disagree with the statement, "In my opinion, the level of service fees are justified given the services provided by banks," 55 percent of Canadians disagreed while only 28 percent agreed.

More to the point, the struggle between the Commons Finance Committee on the one hand and the banks and the Department of Finance on the other over whether the government should regulate business practices more closely, is illustrative of Parliament's growing dissatisfaction with esoteric politics. Indeed, its desire to charge regulators with additional responsibilities and create an ombudsman to deal with

⁷⁸ Ibid.

⁷⁹ EKOS Research, "Public Opinion Research Relating to the Financial Services Sector," Research Paper prepared for the Task Force on the Future of the Canadian Financial Services Sector, (Ottawa: Minister of Supply and Services Canada, 1998), p. 41.

complaints and administer fines, coming only a few years after the Estey report, suggests that Parliament had an appetite for more regulation, at least on matters that struck a chord of dissatisfaction with the public and small business. However the issue is also illustrative of the government's relationship with the sector in the deregulatory period and of the status of esoteric politics. The House of Commons committee's investigation of service fees illustrates how isolated members were from real decision-making in the sector. The government was simply seeking ways to exclude Parliament from the policy process. Looking back at the Blenkarn episode in light of contemporary politics of the sector, one bank lobbyist suggested that Blenkarn accomplished a great deal, given the environment he was working in, but that ultimately policy decisions were being made by the Minister and that proposals were coming out of the Department of Finance exclusively. The official said that Blenkarn's "activism" was just "too early."⁸⁰

The Ombudsman:

Also contributing to Parliament's increasing interest in the area was the simple fact that there was no "safety valve" to handle individual complaints against the banks. In the absence of an industry-wide regulator or at least a government ombudsman, members of the public had no choice but to take their complaints to Members of Parliament which served to politicize consumers' bank complaints.

In 1994, Duff Connacher's "Democracy Watch," responding to the sea of complaints that consumers were directing against the banks, suggested that the government should establish a banking ombudsman to investigate complaints against the

⁸⁰ Source: Confidential Interviews, 2006.

banks.⁸¹ The House of Commons Standing Committee on Industry supported the idea. In its October 1994 report “Taking Care of Small Business” it concluded that:

The Committee recommends that the Government establish an independent office of the Bank Ombudsman to investigate complaints of breach of duty or maladministration by the banks. As in the United Kingdom, the ombudsman should have the power to require banks to pay compensation to complaints for financial loss, inconvenience and stress.⁸²

The main concern of the Commons committee was the difficulty small businesses had in getting redress for any problems they encountered with a bank.

The banks responded by appointing Michael Lauber as their own “ombudsman for small business” in June of 1996.⁸³ Lauber’s office, “The Canadian Banking Ombudsman,” required that complaints be first directed to the bank involved, and then, only if a small business could prove that the bank would not redress the complaints, would the Ombudsman become involved. The government chose to ignore the committee’s recommendation:

The Ombudsman was to have been established by the government; instead he was established by the banks, and is a private corporation. He was to have been independent; instead, he is, in Duff Connacher’s words, “funded by the banks.” He was to have the power to enforce his findings; he has no powers.⁸⁴

⁸¹ Stewart, Bank Heist, p. 174.

⁸² Canada, Commons Standing Committee on Industry, Taking Care of Small Business, p. 20.

⁸³ Stewart, Bank Heist, p. 174.

⁸⁴ *Ibid.*, p. 175.

Not surprisingly, the Canadian public remained almost completely unaware that any bank ombudsman existed to hear their complaints.⁸⁵

Thus, over this period, despite some efforts by Parliament to become more involved in regulating the sector, in large part, policymaking continued to be dominated by the relationship between the banks and a limited number of state agencies. Ministers seemed to prefer that it stay that way.

V) The Collapse of the Trust Industry:

Given that much like the 1987 changes, the principle aspects of the 1992 *Bank Act* revisions involved the removal of ownership restrictions, the changes promised to spark another wave of industry takeovers and mergers. “The government may have instead set the stage for a crisis that could see Canada’s financial industry, already highly concentrated, dominated by a handful of players, primarily a select group of banks.”⁸⁶ Indeed to the extent that regulators and the government were concerned about possible reductions in domestic competition, their de-pillarization program placed a great deal of weight on trust companies to provide competition for the banks. In 1990, Canada’s three largest trust companies, Royal Trust, Canada Trust, and National Trust all had deposits and assets under administration that placed them in a position to compete with the banks.⁸⁷

⁸⁵ The EKOS study for the *MacKay Task Force* revealed that the public was simply unaware of the services of bank ombudsmen, only 19 percent were aware they existed (EKOS, p. 32). The debate over whether there should be a public ombudsman for the industry continued into 2001. When consumer groups continued to complain that the banks’ ombudsman was insufficiently independent, the banks appointed a number of independent board members who did not work for the banks. See “Interpreting Bill C-38 – Interview with Ray Protti,” *Canadian Banker*, Third Quarter 2000, Vol. 107, Issue 3, p. 23.

⁸⁶ Babad and Mulroney, p. 7.

⁸⁷ Canada Trust had almost \$40 billion in assets under administration. Toole, p. FSG13.

In reality, deregulation ultimately killed the trust industry. Three factors were crucial in this outcome. First, the industry itself had been struggling in the period before deregulation and was poorly prepared for the aggressive, desegmented expansion that deregulation encouraged. Second, the industry faced significant regulatory disadvantages relative to the banks, even after deregulation. Third, due to the reactive and *ad hoc* way that deregulation had occurred, the OSFI as established in 1987 was poorly suited for the challenges of deregulation. When facing troubles in the trust industry, the OSFI ignored broad concerns like industry competitiveness and the government's promised "big shall not buy big" policy, and actively encouraged bank takeovers of the largest trust companies. These factors compounded the government's earlier decision, under pressure from the banks, to abandon the Green Paper proposals that the trusts should be given a head start in the deregulatory environment.

Economic Problems:

The trust industry had been in considerable turmoil before deregulation. Many small firms had disappeared in the 1980s. The recession of the early 1990s and, in particular the real estate collapse in Canada's urban centres, undermined some of the remaining larger firms. "Banks grabbed market share away from trusts in areas they once dominated, such as residential mortgage lending. And the recession has dented the financial health of trusts, especially those that loaned big money to troubled real estate developers. These factors made them likely takeover targets."⁸⁸ Royal Trust, First City Trust, General Trustco, Standard Trust and Central Guaranty Trust all ran into problems despite the tightened regulatory oversight of the financial services industry in the wake of

⁸⁸ Toole, p. FSG13.

Estey's investigation of the CCB and Northland collapses. This could not have happened at a worse time. Not only did it symbolically signal the instability of this sector as a possible alternative to the banks for consumers, the troubles of the sector as a whole meant that the trust companies were unprepared to take advantage of deregulation by expanding their operations.⁸⁹

Double Regulation:

Another problem facing the Trust industry in a de-pillarized environment was that trusts were under both federal and provincial jurisdiction. While the OSFI regulates all federally-chartered deposit-taking institutions and insurance companies, the provinces regulated companies chartered within that province. Ontario also required that all trust companies operating within its borders follow its rules everywhere they operated. The trusts found this regulatory burden to be inefficient and confusing. For the more successful companies like Canada Trust, one of the only ways they could escape this burden and compete with the banks on equal footing was to transform themselves into a Schedule II bank. Unfortunately, trust companies did not always have this option because of ownership restrictions on banks under the *Bank Act*.⁹⁰ Thus, banks had an inherent advantage over trusts in the post deregulation marketplace.

⁸⁹ Aside from its "special" regulatory challenges, a successful firm like Canada Trust also had to deal with the bad press generated for the trust industry by the failures of its rival trust companies in the deregulatory period.

⁹⁰ In business terms, Canada Trust (CT) was well positioned to take on the banks in the deregulated environment by becoming a universal bank itself. The problem for Canada Trust was that unlike some of the other trusts which might have pursued this strategy, CT was owned by the non-financial firm, Imasco, in 1993. Federal rules required that banks not be closely held, or that if they were closely held in the case of Schedule II bank, that they be closely held by an "eligible" financial institution, meaning that Canada Trust simply could not become a bank. Canada Trust thus continued to compete with the banks on an unbalanced basis. Canada Trust CEO, Peter Maurice, argued apologetically to his own shareholders in 1993, "I don't think we've ever left any doubt that we want to become a bank." See Toole, p. FSG13.

Avoiding costly bailouts:

Finally, federal regulators and the Department of Finance ultimately were more concerned with avoiding costly failures than ensuring that firms survived deregulation to compete with the banks.

When Central Guaranty Trust (CGT) ran into financial difficulty, it was a large company. In the early 1990s CGT was Canada's fourth largest trust company, with 154 branches.⁹¹ It was the largest potential failure ever confronted by the CDIC and the OSFI. Indeed the major challenge facing federal regulators was that having failed to prevent the trust from becoming insolvent, liquidating the firm and paying the deposit insurance would cost as much as \$10 billion: \$4 billion more than the CDIC was allowed to spend under its own rules. CDIC would have required its own bailout by the Federal Government had it not found a financial institution willing to take over the assets and liabilities of the trust.

In the industry it was widely believed that there was implicit 100 percent insurance protection from the Federal Department of Finance. In the case of a failure the CDIC and Finance had always either fully compensated depositors for their losses or merged the institution into a larger company so that deposits were secured. Helen Sinclair of the CBA told a House of Commons subcommittee investigating the failure of Central Guaranty Trust that:

We have tended to cover all depositors by merging institutions rather than putting them into liquidation. In those instances where we do liquidate we either bail out uninsured depositors and other creditors or advise institutions well beforehand not to accept deposits over \$60,000 . . . The

⁹¹When Toronto Dominion finally took over the trust, despite its troubled years, CGY had had 800,000 depositors and held over 10 billion dollars in deposits. Babad and Mulroney, p. 45.

resulting message to depositors is that they will suffer no financial loss whatsoever if their institution fails.⁹²

This practice, however, gave the government a direct stake in finding the highest bid buyer for a failing financial institutions since that would reduce the insurance cost to the federal treasury. For example, in the Central Guaranty case, eventually Toronto Dominion (TD) came forward with an offer to take over the company. In dollar terms, the acquisition was the largest in Canadian history. In order to induce TD, the regulators agreed to partially finance the rescue by having CDIC pay \$3.75 billion to the bank.⁹³

Despite the attempt to manage the problem through a quick bank takeover, in the subsequent political fallout, allegations that the regulators had failed were numerous. In November of 1992, Canada's new Auditor General, Denis Desautels, suggested that the government and the OSFI had significant problems with how they were monitoring the industry, arguing that ". . . while more financial analysis was being done, there was nothing formalized to insure consistency."⁹⁴ Indeed, the previous Auditor General, Kenneth Dye, had suggested that the CDIC and OSFI work more closely to integrate their supervisory roles and coordinate their activities with the provinces. The two agencies had themselves recognized the need for a closer working relationship in a draft memorandum of understanding in 1989, but the Auditor General noted that the understanding still had not been signed in 1992.⁹⁵ Many questioned whether the regulators were adequately monitoring the financial health of firms.

⁹² Quoted from Babad and Mulroney, pp. 57-58

⁹³ Babad and Mulroney, p. 57.

⁹⁴ See, Canada, Auditor General, Report of the Auditor General of Canada to the House of Commons, (Ottawa: Supply and Services, 1992).

⁹⁵ Babad and Mulroney, p. 54.

Some made “institutional” arguments. Rowland Fleming, the head of National Trust said that Central Guaranty Trust’s problems had simply fallen through the cracks created by the competing “irresponsibilities” of the two regulators:

We need to get the OSFI and the CDIC knowing who’s in control when there’s a problem, and we don’t need to have what must have been a wonderful debate between the chairman of the CDIC and the Superintendent on who was to do what to whom once we know there’s a problem.⁹⁶

Babad and Mulroney argue that the case illustrated the failure of the post-de-pillarization regulatory system and provided evidence as to why a broader regulator with clearer responsibilities was needed. Indeed, the Commons Finance Committee subcommittee that subsequently investigated the case agreed, concluding that both regulators failed to act “fast enough” to respond to the spiraling problems at Central when real estate prices began to plunge. The subcommittee concluded that the actions of the agencies:

. . . took place too late because CDIC and the Office of the Superintendent of Financial Institutions (OSFI) each had separate roles to play, and the lead regulator, OSFI, was not the one bearing the cost of mistakes. CDIC, on the other hand, does bear at least the initial cost of financial failures. However, it too, could sit back and state simply that OSFI was the regulator and that CDIC met its obligations by asking OSFI to prepare a report.⁹⁷

In response to criticism, CDIC head Ronald McKinley told the Commons subcommittee that they were the insurer, not the regulator, and that the OSFI had assured

⁹⁶ Quoted from Babad and Mulroney, p. 55.

⁹⁷ Ibid., p. 45. When Central Guaranty failed in 1992, the HOC Finance Committee conducted its own investigation of the regulators. The committee concluded that the regulators’ overlapping responsibilities meant they had been “passing the buck.” The committee concluded by recommending that the responsibilities for insuring and supervising deposit-taking institutions be integrated into one organization, much as the *Estey Report* had suggested several years before. Coleman noted that the Committee’s view of events was not supportive of the regulators. See Coleman, Financial Services, Globalization and Domestic Policy Change, p. 224.

them that there was no real problem.⁹⁸ Michael Mackenzie (at the OSFI), in turn told the subcommittee that while it was OSFI's responsibility to foresee crises like Central Guaranty, the OSFI had done all it could within the limits of the law. Mackenzie argued that the company had simply grown too quickly as it had been rapidly cobbled together through a series of mergers and acquisitions.⁹⁹ However, the Commons subcommittee investigation found OSFI's response to have been problematic, noting that the mergers that had created the Trust "... [were] approved and watched over by the very organizations [The OSFI and CDIC] who now cite this as one cause of failure. Such rapid growth by acquisition often causes organizational problems and this should have been foreseen at the time."¹⁰⁰ Interestingly, the CBA also blamed the regulators, arguing that they were too slow, waiting for proof of insolvency before acting and that OSFI should have acted to slow the rate of growth of the company's takeover activities.¹⁰¹ As already noted, the legislation creating OSFI four years earlier did not give it a mandate to monitor mergers in the industry. This would seem a problematic oversight given that the failure of Central Guaranty Trust was due in large part to rapid growth spurred on by the opportunities of deregulation.

OSFI officials reject the notion that there is a deficiency in the Superintendent's office. They argue that OSFI is an adequate "reliance" regulator and works well when dealing with firms that behave in an appropriate manner. One official interviewed for this study suggested that Canada's big banks did not need "more regulation" for prudential reasons. Rather, it was the smaller firms which stretched OSFI's resources as they were

⁹⁸ Minutes of proceedings and evidence of the Sub-committee on Financial Institutions Legislation of the Standing Committee on Finance. (Ottawa: Queen's Printer, 1991-1993).

⁹⁹ Ibid.

¹⁰⁰ Ibid.

¹⁰¹ Babad and Mulroney, p. 53.

far more difficult to deal with and more likely to engage in improper practices. The attitude at OSFI has always been that some small firms may fail, but the big banks are safe institutions and thus the OSFI is adequate to the regulatory task.¹⁰² It is often disconcerting to speak to OSFI officials, because of the problems that extremely large institutions have run into in other jurisdictions. OSFI seems to believe that conglomeration in Canada has removed some of the rationale for regulation, as Canadian banks are “too big to fail” now that the smaller institutions have disappeared.

For many observers, the Central Guaranty Trust case illustrates the shortcomings of regulatory institutions post-deregulation. As a result of the 1992 Commons investigation, the government passed *Bill C-48* (1992), the *Financial Institutions Restructuring Provisions* (FIRP). Another “quick fix” attempt to strengthen the regulator in the wake of industry failures, the Act theoretically allowed the CDIC to seize the shares of troubled financial institutions and sell them to a stronger and more stable investor. The legislation did nothing to resolve the built-in irresponsibility of the relationship between CDIC and OSFI, though the subcommittee had echoed Estey’s earlier call that they should be merged.¹⁰³ Further, forced bank takeovers of troubled trust companies was already effectively the federal agencies’ standard response.

This was again apparent when Royal Trust ran into troubles. Royal Trust was Canada’s oldest trust company. In 1992 it had 144 branches and administrated assets of \$152 billion.¹⁰⁴ In the late 1980s the trust was owned by the Bronfman’s Hees-Edper Group. Traditionally, the central business of the trust had been residential mortgage loans and trust management for wealthy Canadians; however, the Bronfmans became

¹⁰² Source: Confidential Interviews, 2006.

¹⁰³ Coleman, *Financial Services, Globalization and Domestic Policy Change*, p. 224.

¹⁰⁴ Babad and Mulrone, p. 111.

more aggressive with the firm, getting it involved in big real estate loans.¹⁰⁵ Of particular concern, they had made substantial loans to troubled Olympia & York.

The company's value initially soared. However, despite the fact that regulators did nothing, the OSFI was worried that the company's management was more concerned with share value than the company's long term health.¹⁰⁶ Royal Trust was soon in trouble, losing \$943 million between July 1992 and March 1993. In 1993, new management decided that the situation required a "new partner" to replace the Bronfmans. They began to look for a takeover from one of the banks.¹⁰⁷ Had the trust failed it would have been a much larger disaster than Central Guaranty. Don Blenkarn's Commons Finance Committee expressed an interest in examining the case; however, before Parliament could become involved, the situation was resolved through a deal worked out between the regulators and the Royal Bank. The bank agreed to takeover Royal Trust for \$1.65 billion, for which the bank gained \$124 billion in assets under administration.¹⁰⁸

Prior to the announcement of the Royal Bank's takeover package, John Evans, the head of the Trust Companies Association, told the press:

¹⁰⁵ Stewart, *Bank Heist*, p. 153.

¹⁰⁶ *The Economist*, July 10, 1993, p. c3.

¹⁰⁷ There is an argument to be made that trust company's economic problems were in part a hangover of pillarization itself. Prior to 1992, trusts were not allowed to engage in ordinary commercial lending, which mean that they had a "real estate bias" in their portfolios as they were allowed to offer mortgages. See, Toole, p. FSG13. Obviously, a collapse in real estate prices was likely to have more dramatic effects on the trust industry than banking. Between 1981 and 1984, the previous bust cycle in Canada's real estate market, fifteen trust companies had failed. See, also Harris, "The Globalization of Finance," p. 378.

¹⁰⁸ Babad and Mulroney, p. 117. Industry observers expected bank takeovers of trust companies as they offered similar opportunities to the takeovers in the securities industry; new, more lucrative services to replace lost commercial lending revenue in light of globalisation. Trust companies' role in "wealth management," providing comprehensive portfolio management and planning services across a range of financial service products, like trustee pension funds (which the banks had not been able to manage until after 1992) included about \$300 billion dollars in assets in the early 1990's. Getting access to the commissions and proceeds from these products was something all of the major banks were interested in doing. See Toole, p. FSG13. Developments in the trust industry were more than a little ironic. While the industry was well situated to benefit from the booming business in wealth management, the firms themselves did not seem to benefit.

I don't see why Royal Trust or Canada Trust should be candidates to be acquired by anybody. It would to my mind be a significant lessening of competition that's going to raise the eyebrows of the competition policy people, if not the people [in the finance department]. If the Royal Bank or the Bank of Montreal tried to buy Canada Trust or Royal Trust, I think there would be some questions as to whether or not this is something that is in the public interest.¹⁰⁹

However, the Competition Bureau was never involved. Instead, government regulators working behind the scenes simply wanted Royal Trust rescued. Thus, with virtually no political investigation, Canada's largest bank (which already owned the largest securities dealer in the country) was able to take over the second largest trust company. Indeed, the situation was so bad at Royal Trust, that important public policy questions were "overlooked" on Bay Street at the time. In the business press:

. . . there were a spate of newspaper articles wondering about the wisdom of the [takeover], but there was no public criticism from the OSFI, no attempt to find out what had gone so disastrously wrong, and no reference whatever to the Mulroney government's pledge to keep one large financial institution from swallowing another. The general tenor of the press coverage was to reflect profound relief that the Royal Bank had stepped in to rescue the trust, even if it was bound to lead to the dismissal of 2000 employees.¹¹⁰

The buyout ensured that there was no Commons investigation and that Finance was financially off the hook for the insurance.

Coleman suggests that one explanation for why finance ministries are so interested in banking policy is because finance is often on the hook for bailouts when a bank goes under. This means that finance ministries are less concerned about levels of competition than the degree of depositor security. Coleman notes that finance ministries tend to be much less interested in the securities industry since they are not responsible for

¹⁰⁹ Quoted from his interview in Babad and Mulroney, p. 119.

¹¹⁰ Stewart, Bank Heist, p. 154.

bankruptcies. Finance ministries thus tend to be much more *laissez faire* in that sector, simply concerned with efficiency.¹¹¹ This also helps explain why the Canadian Department of Finance supports the big banks, since they are thought to be “too big to fail” compared to a market composed of many smaller institutions.

Critics of deregulation argue that when the Mulroney Government made its reforms it put the banks in the “enviable” position of being able to buy out the troubled trust companies. While the government had promised a “big shall not buy big” policy, “in the breach,” there seemed to be no one to ensure adherence to the policy during negotiations to manage the collapse of the trust companies. In the Royal Trust case, like Central Guaranty Trust, federal regulators actively supported the rescue of these companies by larger, more stable, firms. Understandably, given its mandate, the OSFI (and for that matter the CDIC), seemed to have been far less concerned about the competitive impact of the takeovers than the risk of a major firm failing. Simply:

The issues of concentration and competition are not within the mandates of the OSFI or the CDIC, and their perspective would obviously be that the stronger the acquiring institution the better. And there is something to be said for that because we are dealing with depositors’ money. But other options were available, particularly in light of the amount of support the CDIC was willing to provide to whomever stepped in to salvage Central Guaranty.¹¹²

After the Royal Trust case, Gilles Loiselle, Finance Minister for Kim Campbell’s brief government argued that the “big shall not buy big” policy was still in place. There was no policy to favour the banks; however, echoing the perspective of regulators “. . .

¹¹¹ See Coleman, *Financial Services, Globalization and Domestic Policy Change*, p. 72.

¹¹² Babad and Mulroney, p. 120.

there comes a time when you have to pick and choose.”¹¹³ Whatever precedent these government supported takeovers may have set for the wave of mergers and takeovers that began in the 1990s, the regulation of these mergers remained a political question. Parliament was the only institution actively concerned with the problem. Policy network participants concerned about these developments would have to focus their concerns on elected government officials, because levels of competition were not a concern in the secret deals worked out between the regulators and the banks.

When the initial phase of deregulation was over the trust industry had been decimated. Royal Trust would survive only until 1993, when news of a takeover by the Royal Bank became public. Even before the full onset of deregulation after 1992, First City Trust had been taken over by North American Life, Central Guaranty Trust by Toronto Dominion, with the financial assistance of federal regulators, while General Trustco was broken up and sold to National Bank and Laurentian. Several remaining small trust companies also disappeared, including Saskatchewan and Shoppers Trust in 1991 and 1992 respectively. The 1998 deal between the longest-surviving, Canada Trust, and Toronto Dominion would be the final step in a five year process in which the trust industry was displaced by the big banks.

¹¹³ Quoted from his interview in Babad and Mulroney, p. 120. Once again illustrating the close relationship between many leading government officials and the financial services industry, following his defeat in 1993, Loisel became an advisor to Paul Desmarais, the CEO of Power Corporation of Canada, one of Canada's largest non-bank financial services companies. Also he served as one of the industry-funded ombudsmen, responsible for the Canadian Health and Life Insurance industry as part of the Financial Services Ombuds Network. See: The Centre for Financial Services Ombudsmen Network, <http://www.cfson-crcsf.ca/en/>

One final point is that bank takeovers of the trust industry also reduced Canada's likely exposure to the various financial services trade agreements.¹¹⁴ Under the loosened ownership restrictions provided by CUSFTA, NAFTA, and the GATS, foreign banks could have purchased and "closely held" Canadian trust subsidiaries, which, post-deregulation, had similar powers to banks. Since the big banks could not be taken over by foreign firms, their takeover of the trust industry ensured that those assets stayed under Canadian administration. It also removed one possible avenue for foreign bank expansion in Canada.

During the "deregulatory period" the banks not only received new powers to diversify the range of products they offered, but also received tacit support for massive industry conglomeration. Between the Green Paper and the implementation of the 1992 *Bank Act* changes, many worried that the process of deregulation had "gone off the rails," or that the Mulroney Government had "botched" deregulation. The Mulroney Government had argued that the major point of deregulation was to spur competition for the banks, "Yet through their lobbying efforts the banks have at the same time achieved almost everything they wanted."¹¹⁵ In public, banks turned the debate from the needs of consumers, commercial borrowers, and Canadian economic efficiency and growth, to a dialogue focused on the need to produce globally competitive firms in Canada. Between 1989 and 1994, the Canadian financial services industry lost 15 small banks, 17 trust and loan companies, 33 life insurance firms and 74 property and casualty insurance firms to

¹¹⁴ See Robert MacIntosh, "The Future of the System," *Canadian Banker*, Sep/Oct. 1991, Vol. 98, Issue 5, p. 36. Of course MacIntosh thought this was a good thing since he thought the expansion of trust powers in 1992 had been a risky mistake. Don Blenkarn's response to MacIntosh was that the former head of the CBA did not seem to think that trusts and small banks should have much of a role in the Canadian market. See Don Blenkarn, "Different Drummers," *Canadian Banker*, Sep/Oct. 1991, Vol. 98, Issue 5, p. 36. 5p.

¹¹⁵ Babad and Mulroney, p. 27.

takeovers and conglomeration.¹¹⁶ This was in addition to the banks' acquisition of almost all of the major securities firms. Furthermore, the trust industry, the governments' principal vehicle for increasing competition to the banks, had been decimated. "This further concentration of economic power into the hands of the largest players appeared to position Canadian firms well in the more integrated continental market, while raising questions about consumer protection and democratic policy-making."¹¹⁷ There is little doubt that deregulation failed to increase domestic competition, if that was ever a serious policy goal. Despite having high real interest rates (in the period) relative to other countries in the years following deregulation, interest rate "spreads," the difference between the interest rates received by depositors and the interest rate paid by lenders, increased, suggesting the banks faced less competition, not more.¹¹⁸

Furthermore, despite the rhetoric surrounding globalisation and the persistent concern that US financial service giants were eager to enter the Canadian market, the transition to universal banking seems to have closed the door to US banks and FSPs. The Canadian market was more effectively dominated by Canada's big banks than in the past, and those banks simply could not be bought out by US investors.

VI) Conclusion - "Esoteric Politics" in the Deregulatory Period (1984-1997):

The transition from the four pillars system to universal banking was dominated by the policy demands of the federally-regulated big banks and their relationship with key federal agencies. Coleman's hypothesis that globalisation would entrench the esoteric

¹¹⁶ Stewart, *Bank Heist*, pp. 156-7.

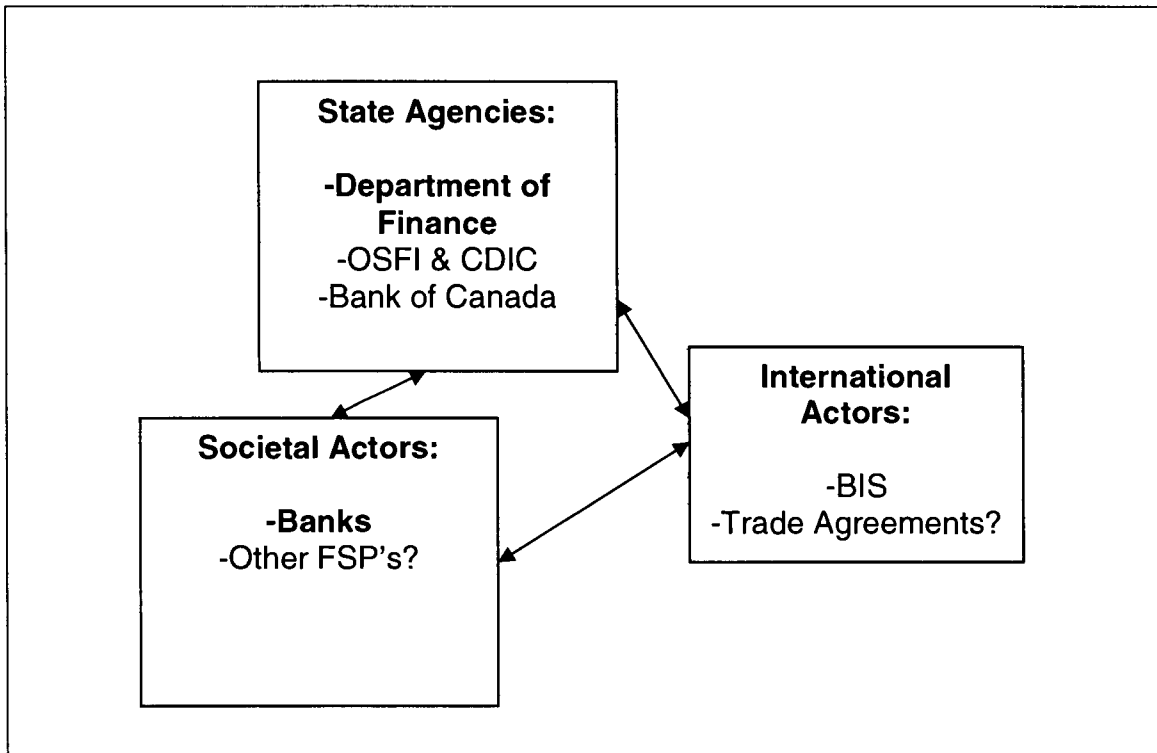
¹¹⁷ Coleman, *Financial Services, Globalization and Domestic Policy Change*, p. 222.

¹¹⁸ Stewart, *Bank Heist*, pp. 22-23.

politics of the closed policy community of financial services seems correct. In this period, policymaking was very *ad hoc*, often private, and favoured the banks' policy demands in almost every instance.

Domestically, the banks dominated both the process of securities deregulation and the 1992 *Bank Act* changes. They emerged from de-pillarization with a wider array of business powers, and little in the way of increased competition in their market segment. Despite widespread public demands for closer regulation of service fees, credit card interest rates and a range of other consumer complaints, federal officials blocked parliamentary efforts to increase industry regulation. After the 1985 bank failures, the banks did not have to deal with a substantially revamped and more powerful industry regulator. Perhaps most illustrative of sustained esoteric politics was the way the banks and the Federal Government dissolved the trust industry. Federal regulators and the Department of Finance, despite parliamentary concerns about the level of domestic competition, helped engineer bank takeovers when many of the major trust companies ran into financial difficulties: financial difficulties which government policies had worked to insulate the banks from. Indeed the basic "exchange relationship" between the banks and the Department of Finance at the centre of the policy network (See Figure 5.1) is most clearly visible in the trust company takeovers, as the banks, eager to take control of the trusts' assets and wealth management business were supported by government officials seeking to avoid financial instability and government bailouts of troubled firms.

Figure 5.1: The Canadian Financial Services Network – Deregulatory Period (1985-1997)



Policy Network Structure:

The number of participants in the financial services policy network was relatively small. In fact, the actor constellation of the deregulatory period was remarkable for its stability, reflecting a continuation of the federal banking policy network into the early years of the new, post-deregulation, financial services policy network.¹¹⁹

In terms of government institutions, the Department of Finance was central, with the reformed OSFI and CDIC playing a subsidiary role limited to prudential oversight.¹²⁰ The Department of Finance advised the Minister and the Junior Minister for financial institutions, the key government officials in the sector. Finance also had a virtual

¹¹⁹ Roberge, pp. 139-140.

¹²⁰ Harris notes that while there was some attempt to increase the policymaking capacity of the OSFI, generally it and the CDIC played a subservient role, focusing on technical details. See Harris, "The Globalization of Finance," p. 369.

monopoly on policy formulation and review. Inside governments, the exclusive use of Department of Finance discussion papers in the policy process ensured a level of control over policy. In the lead up to the 1992 *Bank Act* revisions, there were no federal task forces or royal commissions, rather the ministers responsible simply released the series of Finance “coloured” papers which served as frameworks for legislation.¹²¹ This was very different from the process in the late 1990s in which a *Task Force* and parliamentary consultations preceded any government response.

Finance also dominated the various coordinating mechanisms established during deregulation. For example, it chaired the Senior Advisory Committee (SAC) established in 1992 to coordinate government policy perspectives. The SAC is comprised of the Deputy Minister of Finance, the Governor of the Bank of Canada, the Superintendent of Financial Institutions, and the president of the CDIC. Below this is a “sub-SAC” of next-level-down officials who have had “. . . primary policy formulation responsibilities. This Committee in turn, oversees quadripartite policy drafting committees.”¹²² All of this ensures that Finance brings together a comprehensive and broad view of the sector.

The picture was similarly centralized amongst societal actors in the policy network. While there is a wide range of possible policy-domain-affected-interests, the banks dominated other groups, excluding them from a role in policymaking. Deregulation initially appeared to ensure that. While Canada’s large insurance companies potentially become a more important constituency in the policy network given the collapsing boundaries of the different industry subsectors (see Chapter Six),

¹²¹ This is a point Roberge makes several times. See Roberge, p.122 and p. 142.

¹²² Coleman, Financial Services, Globalization and Domestic Policy Change, p. 211.

deregulation allowed the banks to take control of the securities and trust industries, increasing their power both in the marketplace and in the associational system.

Internationally, through the Basle Accord, the Committee for Banking Supervision has also played a role in the policy network, through its influence on domestic reserve requirements. Beyond this the international dimension is “cloudy.” Despite the centrality of “globalisation” in domestic arguments supportive of deregulation and conglomeration, the banks also were effectively insulated from serious foreign competition throughout the period. Canada’s major trade agreements had not opened the door for foreign competition.

Globalisation, Domestic Politics and Deregulation:

Coleman argues at the end of the period that it was not entirely clear what globalisation had meant in Canada in market terms: “Canadian banks have lost ground in international banking and securities over the last decade. That said, international activity centred in Canada remains largely in the control of domestic rather than foreign firms.”¹²³ The domestic financial service industry was even more tightly dominated by big Canadian firms than in the past. Coleman concludes that policymakers had tried to coordinate strategies of action to respond to the challenges of globalisation but these largely failed. There remained no national policy framework and big decisions were made in an *ad hoc* and reactive way. The demands of the major banks dominated events, in light of their interpretation of globalisation.

From this perspective, one could say that the government had not so much “botched” deregulation as it had responded to the banks’ policy demands and a particular

¹²³ Ibid., p. 36.

understanding of the challenges posed by globalisation. Indeed, discussion about “globalisation” was central to the policy debates of the 1980s and 1990s. Of particular concern was the importance of Canada’s financial centre, Toronto, given increased competition from more deregulated jurisdictions, and the declining *relative* global market shares of Canada’s big banks. Those with influence inside policy circles saw deregulation and conglomeration as the best way to meet these challenges.

Realizing that the government could no longer protect all aspects of the banks’ operations from foreign competition, the government opted to focus on strengthening the banks domestically, so that they would be better situated to compete with international firms for a share of the global financial services business. Darroch sees deregulation in this light:

The key to the earlier rise to prominence of Canadian banks was the protected domestic market which allowed them to develop the skills and products necessary to compete in international markets. Globalization and deregulation of capital markets both altered the demand for ‘traditional’ products and lessened the ability of public policy to protect the domestic market. The banks increasingly turned to the more protected retail banking sector. At the same time, Canadian bankers successfully persuaded regulators to expand their powers vis-avis other financial services sectors to allow increased revenues from domestic sources and to secure a base to develop the skills demanded in the new international environment. Once again, policies affecting the domestic base have been critical for competitiveness.¹²⁴

However, suggesting that this “globalisation” helped entrench esoteric politics, or that Federal Government policy was a response to banks’ “needs” given globalisation does not mean that globalisation determined events. Certainly, globalisation strengthened the position of the banks in the policy network and in policy debates. It also forced the government to rethink the system of pillarization, given the market changes in

¹²⁴ Darroch, “Global Competitiveness and Public Policy”, pp. 171-172.

international banking. But the policy outcomes themselves were very much determined by domestic political struggle, much as they had been in the past. The politics of the deregulatory period suggest not only that the Canadian state remained a key actor in regulating the sector, but that domestic politics, and the intentions of Canadian politicians and policymakers and their relationship with dominant firms, remained the key consideration in understanding the trajectory of public policy. Deregulation unfolded the way it did, not because globalisation was changing the nature of Canada's market but because dominant Canadian firms wanted deregulation.

**SECTION THREE: “CANADA’S BACKLASH AGAINST
ESOTERIC POLITICS”**

**CHAPTER 6: “THE SOURCES OF OPPOSITION TO
‘ESOTERIC POLITICS’ FOLLOWING
DEREGULATION”**

“A bank is a place where they lend you an umbrella in fair weather and ask for it back when it rains.”

Robert Frost

I) Introduction:

Esoteric politics was seemingly well-entrenched in the wake of deregulation. The banks still seemed to be able to determine the course of public policy. In tearing apart the trust industry, regulators worked more closely with the banks than with Parliament. Globalisation was further entrenching the power of the banks as arguments about growing international competition were accepted as proof of the need to allow the banks to remake the Canadian industry in such a way that they would dominate all sectors of the industry. Only the insurance industry was still segmented from Canada's big banks. Lastly, international regulators also supported the banks' policy demands.

Nevertheless, there were indications that this situation was going to face some challenges. There were signs of a growing backlash against the banks and their agenda, amongst an array of domestic interests and in Parliament.¹ This chapter explores the growing source of opposition to the policy demands of the banks, arguing that there were important changes occurring in the policy network that would challenge the closed policy community which had dominated the deregulatory period. Institutionally, the collapsing of several policy domains into a single federal financial services sector, combined with the increased role of Parliament in the policy process, meant that influential constituencies opposed to further deregulation and conglomeration, like the insurance

¹ Adam Tickell, “Global Rhetorics, National Politics: Pursuing Bank Mergers in Canada,” *Antipode*, 32:2, 2000, pp. 152-175.

industry, small business associations and consumer groups, could force an opening in the policy network.

II) Macro-institutional Change and the Policy Network:

William Coleman concludes his 1996 comparative analysis by suggesting that the economic and political developments of the last twenty years:

. . . have added to the economic power of domestically-owned commercial banks in Canada. They now dominate banking and securities markets to a greater extent than commercial banks in any of the other four countries. They own the largest securities houses, and they have become a major player in residential mortgages, the one large credit market that had been denied them. Having taken over several large trust companies and having seen many others collapse; the banks face much weaker competition from these firms. Financial cooperatives continue to offer some competition, but only in Quebec might they be described as a significant force.²

Coleman argues, however, that this economic power does not translate directly into political power: much depends on the strength and independence of state actors.

Coleman suggests that the level of independence of state actors from the economically powerful, depends a great deal “on the openness of the policy network.” Officials:

‘consult’ widely before formulating policy, but who do they consult? We saw . . . that the commercial banks enjoyed a very strong position in the Canadian financial services policy networks. This position is even stronger in the mid-1990s. With the decline of the trust companies and the continued divisions among financial cooperatives, no association can come close to matching the resources and expertise of the Canadian Bankers Association.³

In short, the growing economic domination of the banks over the financial services industry post-deregulation *could* translate into increased political power in relation to a

² Financial Services, Globalization and Domestic Policy Change, (London: Macmillan, 1996), p. 224.

³ *Ibid.*, p. 225.

Canadian state lacking “anticipatory” policy making capacity, in the absence of other powerful actors in the policy network:

Faced with such structural power, the state can take steps to broaden the composition of policy networks. In France, the state reconstructed the associational system to ensure smaller firms and cooperatives had a voice. In the US and in France, consumer interests were incorporated into the attentive public of the policy community with financial support from the state. In the absence of similar steps, the Canadian policy process is likely to incorporate and to consider interests outside of financial services on an *ad hoc* and informal basis only. Commercial banks, accordingly are left in a strong position that we must conclude that they have a highly dominant position. Policy reform and policy outcomes have narrowed the opportunities for democratic policy-making in financial services in Canada.⁴

Understandably, Coleman was sceptical of the Canadian government’s ability to pursue independent policies since he concludes that “The Canadian financial services policy networks have not fostered any systematic representation of consumer interests.”⁵

As was argued in Chapter Three, there are a number of factors that need to be added to this analysis. Deregulation, by collapsing several policy sectors into a single “national financial services policy network,” potentially expanded the array of affected economic interests that may attempt to influence policy. For example, removing the ownership restrictions that kept the banking, insurance and securities industries segmented, meant that all of these industries now had a direct stake in Federal Government policymaking. This could “open” the policy network. Likewise, deregulation, due to a combination of weak regulatory agencies, limited state capacity, and poor planning on the government’s part (given the way the process was rushed), also left Parliament with a residual role in regulating the sector, particularly in regards to issues of consumer protection and industry competition. Parliamentary committees,

⁴ Ibid., p. 225.

⁵ Ibid., p. 223.

eager since the early 1980s to assert this role, could provide an important conduit for allowing new groups into the policy network.

Centralization and the Formation of the Financial Services Policy Network:

Financial services experts argued that in light of globalisation and market desegmentation, financial services policy in Canada should be centralized with the Federal Government. Centralization reflected the increasing scale of the industry and the need to reduce inefficiency generated by duplicate provincial regulation. The *Mackay Task Force* emphasized the need for further centralization in 1998, suggesting greater harmonization of rules and regulations within Canada; in particular, national securities regulation.

Following deregulation, the banks had emerged as dominant players in the securities industry and had reduced the role of regional trusts as deposit-taking institutions. Likewise over the 1990s, through institutional mergers, a single national securities exchange (the Toronto Stock Exchange) had supplanted a number of smaller regional exchanges. Financial services markets had centralized. Politically, the federal OSFI had been given the role of overseeing provincial trust companies, and the federal policymaking role in regards to securities and insurance had been expanded, illustrating, “. . . how the federal government has strengthened its ability to regulate the financial services industries as a result of the internationalization of public policy.”⁶ Furthermore, despite the fact that much of the financial services industry had been provincially

⁶ Ian Roberge, The Internationalization of Public Policy and Multi-level Governance: A Comparison of Financial Services Sector Reform in Canada and France, (Doctoral Dissertation. McMaster University, 2004), p. 113.

regulated, the various economic subsectors had traditionally organized themselves into single national industry associations.⁷ The expanded role of the Federal Government “fit” the associational system as national peak organizations increasingly dealt with federal policy makers.

Centralization has been identified in the past: commentators have noted the increased federal power in the sector. What has been less recognized is that this also should have “. . . expanded considerably the number of players involved in the policymaking process. . . . to include not only the Department of Finance, OSFI, the Bank of Canada, the CBA and the chartered banks, but also, the CPS, the provincial authorities, the Trust Companies Association of Canada, the Canadian Cooperative Credit Society, and the provincial credit union centrals.”⁸ The federal banking policy network became a national financial services policy network.

Both Stephen Harris and Ian Roberge note that de-pillarization complicated policymaking in the sector after 1990. Harris saw the other non-bank industry participants entering the federal policy process as “rent seeking” groups that attempted to slow and block deregulatory efforts that would allow the banks into their industry. These firms emerged as potential opponents to the banks’ policy demands.⁹ Roberge argues more generally that this proliferation of economic interests, some of which were extremely large and powerful corporations rivaling the banks, meant that the banks

⁷ Coleman notes that aside from the Credit Union Central which has a federated structure, Canada’s financial services associations had organized nationally (e.g. The CBA, the TCAC, and the IDA). Coleman, Financial Services, Globalization and Domestic Policy Change, p. 60.

⁸ Roberge, p. 140.

⁹ Harris argues that deregulation was driven by industry interests, but that the politics of deregulation was complicated because the legacy of segmented markets and pillarization ensured that the industry often did not speak with one voice. Each component subsector fought to protect its turf while trying to gain access to other sectors. Stephen Harris, “The Globalization of Finance and the Regulation of the Canadian Financial Services Industry,” in G. Bruce Doern et al., Changing the Rules: Canadian Regulatory Regimes and Institutions, (University of Toronto Press, 1999), p. 364.

“...started to lose their privileged position with governmental authorities and became less influential in decision-making. It was not solely the banking industry that was consulted any longer, but the whole financial services sector.”¹⁰

Mitigating this was the degree to which the banks had moved to dominate both market segments and the associational systems of the securities and trust industries. However, as the process of deregulation brought the banks and Canada’s large insurance companies into conflict, that industry became an influential participant in the policy network, and one often opposed to the banks’ policy agenda.

A Regulatory Role for Parliament?

An increasing role for Parliament could also undermine esoteric politics. During deregulation the government failed to respond to Estey’s call for a “consolidated” regulator that could deal with more than prudential concerns. Prior to the tabling of *Bill C-8* in 2000, little effort was made to respond to persistent complaints that regulators were ineffective at ensuring competition and providing consumer protection. Indeed, the regulators’ mandates have been extremely limited and ideal to ensuring that banks dominate *ad hoc* government decision-making, such as how to deal with the troubled trust industry. This has meant that those opposed to the banks: smaller financial services companies, the insurance industry, small business interests and consumer groups have increasingly relied on their access to members of the House of Commons as a way to register their complaints with the direction of policy in the sector. Several interviewees recognized this dynamic. One bank official went so far as to suggest that perhaps OSFI should have been given a wider regulatory mandate in 1987 to deal with things like small

¹⁰ Roberge, p. 141.

business complaints and consumer protection, something the banks had resisted at the time.¹¹

Since deregulation, many “anti-bank” groups have found an increasingly warm reception from MPs, as the broad public dissatisfaction with the banks has made it “good politics” for Parliament to assert some sort of supervision over the industry. In the decade leading up to the merger debate of 1998, although initially sporadic and uncertain, Parliament increasingly became a site of what the banks would call “bank bashing” or “anti-bank” politics, particularly for consumer and small business groups.¹²

At the same time, the weakness of OSFI has been compounded by a decline in the influence and capacities of the Department of Finance in policymaking. Observers have suggested that Finance’s expertise has been “hollowed out” since the early 1990s as staff were re-allocated to new responsibilities. In particular, veteran staff were moved to the Department of Foreign Affairs and Trade to participate in trade negotiations on services at the GATS and elsewhere.¹³ Moreover, the policy process for subsequent *Bank Act* changes was markedly different than the 1992 process, as Finance “discussion papers” became less important.

The interaction between Parliament’s residual role in regulating the sector, and the virulence of “anti-bank” political interests and public antipathy for the growing power

¹¹ Source: Confidential Interviews, 2005 & 2006. Many in the banking community have come to recognize that a more powerful regulator may be a better option for pursuing the banks’ interests than leaving many issues to Parliament to resolve.

¹² Roberge suggests that the House of Commons Standing Committee on Finance became part of the “attentive public” of the policy network as a result of this process. See Roberge, p. 140. However, the mergers debate and the policy process surrounding the subsequent *Bill C-8* illustrate a more pervasive role than this suggests. The House of Commons Finance Committee has become a key state agency in this policy network.

¹³ Harris, “The Globalization of Finance,” p. 368.

of the banks, all set the stage for the backlash that has subsequently undermined much of the banks' agenda for policymaking in the sector.

III) Antipathy for the Banks and Esoteric Politics:

One of the background research reports for the Mackay *Task Force on the Future of the Canadian Financial Services Sector* was an extensive survey done by EKOS Research Associates on Canadians' activities and attitudes towards the sector.¹⁴ The data provide an exhaustive summary of Canadians' use of financial services and their attitudes towards the sector.¹⁵ According to EKOS' data, less than half of Canadians used just one financial institution: only 39 percent of those surveyed reported doing business with only one FSP. Of the remaining 61 percent, half reported dealing with two institutions. EKOS concluded that this indicated a degree of competitiveness in the sector, despite the wave of conglomeration that occurred in the wake of deregulation.¹⁶ Their research was not clear, however, about whether Canadians viewed "arms length" subsidiaries as separate institutions.

The data did clearly reveal a diversification in the consumption of financial services *products*. Canadians use a wider variety of financial service instruments than in the past. In the three years preceding 1998, 50 percent of respondents reported having taken out a personal loan, 38 percent a mortgage, 31 percent a GIC, and 43 percent reported having bought mutual funds.¹⁷ Consistent with the universal bank concept,

¹⁴ EKOS Research, "Public Opinion Research Relating to the Financial Services Sector," Research Paper prepared for the Task Force on the Future of the Canadian Financial Services Sector, September 1998.

¹⁵ After news broke of the proposed Royal Bank/Bank of Montreal merger, EKOS delayed the collection of data until some of the media coverage had died down – "This was considered necessary in order to minimize any possible "noise" in the findings." EKOS, p. 9.

¹⁶ *Ibid.*, p. 44.

¹⁷ *Ibid.*, pp. 15-16.

consumers tended to purchase almost all of those products from one institution, a practice referred to in the industry as “bundling.” For example, 67 percent of the respondents reported that one of the “big five” Schedule I banks was their *primary* institution. The rate was much higher for Atlantic Canada and Ontario. EKOS noted that many Canadians relied on their “primary” institution to purchase a range of products: “Over two in three Canadians with mortgages (68 percent), loans (74 percent) and their credit cards (74 percent) got them from the same institution where they primarily do their personal banking.”¹⁸ Only in the case of mutual funds were Canadians “likely to shop around” as half of respondents said that they got them from someone other than their primary institution. This tendency reflected the continued insulation of the insurance industry from full competition from the banks as they were the major alternative source of mutual funds.

Thus, ignoring the respondents’ own concerns that there was not sufficient competition, EKOS informed the *Mackay Task Force* that there seemed to be evidence that Canadian consumers were “shopping around” for financial services and that there was evidence of adequate competition. In fact, most Canadians did almost all of their business with one of Canada’s big banks, regardless of whether they were using more products. If they did use another institution, it was likely for insurance, which banks could not provide in branch, and perhaps, mutual funds.¹⁹ Understandably, this created conditions in which Canadians might have reasons to be frustrated with their primary institution and its treatment of their finances, particularly if they believed their only alternative was another big five bank.

¹⁸ Ibid., p. 16.

¹⁹ Had the government allowed the banks into the insurance industry in 1992 it seems probable that a majority of Canadians would have ended up using only one financial service provider.

In fact, many industry observers noted that as “one stop shopping” financial services centres, the banks were notoriously poor financial planners. As Stewart points out, Canadians had good reason to avoid the banks’ mutual funds as they were consistently poor performers in industry rankings.²⁰ The huge, impersonal conglomerates simply had a reputation for not taking enough care and concern with their client’s financial needs.

General Attitudes Towards Banks – Growing Consumer Anger:

To the extent to which conglomeration reduced choice for consumers, it also may have increased the cost of financial services. Many Canadians believed this has been the case. Their banks were “ripping them off:”

Respondents with the most negative views of banks tended to be university educated, male and single family parents. The experiences and behaviour were also good predictors of viewing banks as heartless, including being required to wait for cheques to clear, using multiple financial institutions, had a serious problem at their primary financial institutions, and the perception of tied selling.²¹

Also revealing were the respondents’ attitudes towards the relationship between the banks, the government and Canadian society. When asked, 59 percent agreed with the statement that “the large banks exert too much influence and power in Canada.” 47 percent disagreed that bank profits were “fair and reasonable.” Most importantly, when asked to agree or disagree with the statement “banks do not have any public responsibilities compared to other businesses,” 58 percent disagreed, while only 26

²⁰ See for example, the performance of CIBC’s mutual funds. Stewart, Bank Heist, p. 222.

²¹ EKOS, p. 40.

percent agreed.²² Finally, while the EKOS study suggested that Canadians tended to be unclear as to what the regulatory role of the government was in the sector, there was a general sense that policy leaned “towards too little government involvement.”²³ These attitudes were clearer when specific banking topics were probed, which brought the public’s negative views of the banks to the surface. There was a range of “irritants.”

For example, young Canadians and lower income groups complained about problems with cheque holding periods, the period between depositing a cheque in an individual’s account and when those funds become available. Particularly irritating was the fact that banks regularly employed a holding period on government-issued cheques, a problem for low income people and those on social assistance. One of the EKOS focus group participants, echoing the complaints of many, pointed out that “It’s not as if the cheque is going to bounce.”²⁴

Another problem area was consumers’ perception of tied selling.²⁵ Bank critics worried that the post-de-pillarization regulatory “fog” was going to facilitate rampant tied selling and other predatory practices by the banks, and there was evidence that Canadians felt that this was occurring, perhaps contributing to the high incidence of bundling. While the EKOS study for the *MacKay Task Force* optimistically concluded that 80 percent of respondents had no experience of tied selling,²⁶ 16 percent said that they had been under pressure to purchase additional products from an FSP while awaiting the

²² Ibid., p. 41. See Summary Table, Exhibit 6.2, “Images of Banks (II)”.

²³ Ibid., p. 38.

²⁴ Ibid., p. 27. Indeed, many wondered why the banks had holding periods on government cheques while local grocery stores were often willing to cash social assistance cheques and the like.

²⁵ Tied selling was an improper practice where banks or other FSPs, while considering customers for loans or mortgages, would demand that they also purchase their other financial services from the institution.

²⁶ EKOS, p. 54.

approval of a loan or mortgage, a worryingly high figure for an improper practice, deemed illegal by the Department of Finance under existing rules in the *Bank Act*.

Branch closures were also a sensitive issue. While most respondents liked the new technology of automated and internet banking services, and many preferred it to dealing with banks in a traditional manner, respondents nonetheless felt that access to financial services was a public good and that therefore the banks were obligated to maintain their branches. For example, “A majority (56 percent) disagree that banks should be able to close any branches they need to as long as Canadians can still get access to services through new technology. Only 31 percent agree.”²⁷

Finally, the EKOS data revealed that credit card interest rates and service fees, which had been sources of public and parliamentary concern in the 1980s, remained problem issues for the banks. These topics were particularly irritating to small business operators. If the banks learned anything from the struggle over regulating service fees in the 1980s it was that the public hated service charges. Ironically, they used promises of reduced or frozen service charges as a marketing program throughout the 1990s.²⁸

In part, service fees remain a particular irritant simply because of the larger context in which they are seen by the public. Aware of the banks’ rapid growth and skyrocketing profits, the proliferation of service charges seem unnecessary and unfair to the public. Despite the recession in the early 1990s, bank capitalization grew by 214 percent between 1990 and 1996.²⁹ The banks would often argue that they were “slipping” in international rankings, but this was only a product of mergers and acquisition activities in other countries, because Canadian banks were actually growing in

²⁷ Ibid., p. 25.

²⁸ Babad and Mulrone, p. 159.

²⁹ Stewart, *Bank Heist*, p. 210.

size. Furthermore, when all of the banks began to rack up successive years of record-breaking profits in the 1990s, it was hard for Canadians to not draw a link to the additional billions that banks had been making on service fees. This was something the public told the *MacKay Task Force* in the public opinion research, although the *Task Force* did not investigate the complaints.

Small Business Antipathy for the Banks:

Upset over proliferating service fees and their inability to get redress for complaints, small business groups were also concerned that they were finding it increasingly difficult to get loans, since the banks had reduced the pool of capital available to small and medium-sized enterprises during the recession of the early 1990s.³⁰ In 1992, the Canadian Federation of Independent Business (CFIB), which had been actively trying to influence policy in the sector for some time, commissioned a study of bank lending practices. The study, which surveyed 11,000 companies, found that service fees and the lack of credit offered to small businesses were perceived as serious problems.³¹

The Federal Government, ever-sensitive to the concerns of “small business,” had responded to this perceived problem in 1993. The government expanded the *Small*

³⁰ In confidential interviews, both bank officials and small business lobbyists noted that during the recession of the early 1990s, the banks’ “called in” small business capital. A bank lobbyist argued that this was the major source of growing small business hostility to the banks and that they would not make the same “mistake” again. Source: Confidential Interviews, 2005.

³¹ Over the last 20 years, CFIB has commissioned several major studies of members’ attitudes regarding the financial services sector and a number of reports and position papers on bank regulation in particular. CFIB’s research is available at <http://www.cfib.ca>.

Business Loans Act (SBLA) to encourage loans,³² and under the program the Federal government guaranteed part of a loan. However, as the number of possible lenders shrank, many businesses would systematically find it harder to secure credit, especially new firms. “There can be no question that the lending system in Canada has been skewed. This becomes even more important as the banks grow while the financial services industry consolidates.”³³

The extent of the small business lending problem was always hard to pin down. The banks resisted efforts to measure their lending activities in regards to small business. In a Commons Standing Committee on Industry investigation the banks refused to provide any statistics, saying that it amounted to giving away “trade secrets.”³⁴ One lobbyist for consumers and small businesses in the sector suggested that their organization’s internal data on declining bank lending to small business was clear and compelling when related to loans made to MPs.³⁵ Indeed, the Commons Committee collected its own data from the Bank of Canada and the OSFI and concluded that on small business loans, there was evidence of a “substantial decline in loans outstanding over the past two or three years.”³⁶

Whatever the scope of the problem, the fact is that small business groups like the CFIB and many Members of Parliament made the direct link between the problems of

³² While these changes initially increased the pool of capital available to small business under the SBLA, by the end of the decade even this source of small business declined. See Canada, Industry Canada, Small Business Research and Policy, Canada Small Business Financing Act Loans Decline Study – Report to Industry Canada, January 2002, <http://strategis.ic.gc.ca/epic/internet/insbrp-rppe.nsf/en/rd00924e.html>.

³³ Babad and Mulroney, p. 189.

³⁴ Stewart, Bank Heist, p. 176.

³⁵ Source: Confidential Interviews, 2005.

³⁶ Canada, Parliament, House of Commons, Standing Committee on Industry, Taking care of small business: report of the Standing Committee on Industry, (Ottawa, Supply and Services Canada., 1994), p. 16. Walter Stewart collected his own data. He argues that between 1983 and 1992 total commercial loans, as defined by the Bank of Canada, grew by 50% while business loans under \$200,000 dropped by 30%. See Stewart, Bank Heist, p. 176. See also Bellyyn Small Business and the Banks, p. 22.

small business lending and bank conglomeration. Having eliminated so much of their competition, the banks were now almost the only choice for small business finance. Advocates of the interests of small business, like the Standing Committee of Industry, argued that the banks were killing this job-creating segment of the economy:

While the Committee understands that we have been in a recession, during which the call on credit would naturally go down, we believe that the actions of the banks have exacerbated the situation. Evidence gathered informally, as well as in the letters and testimony received, strongly suggests that the banks called in credit to get their houses in order.³⁷

While the banks rejected these claims, the *Mackay Task Force* found in their survey data that one of the few predictors of a respondent's view that "banks exert too much power in Canada" was whether the individual was categorized as "self-employed" (which EKOS viewed as a proxy for people in small business). The self-employed were the most likely to believe banks did indeed exert too much power.³⁸

The Government of British Columbia's *Task Force*, which reviewed public positions on the proposed 1998 bank mergers, revealed small business hostility as well.³⁹ One member of the *Task Force* said he was surprised by the level of hostility to the banks from local "chamber of commerce types." While there was a general frustration with the banks expressed throughout their hearings regardless of location, in smaller towns there seemed to be even more consensus. It was felt that the banks were already failing to meet the capital needs of those communities and that therefore further conglomeration should

³⁷ Canada, Standing Committee on Industry, Taking care of small business, p. 17. Ultimately, according to Walter Stewart, and "bank watchdog" Duff Connacher, the Commons Committee was "not very smart" because it did not demand an ongoing reporting requirement from the banks on the scope of their small business lending activities, so that they could be evaluated. Instead the banks continued to obfuscate by suggesting that claims that they were not lending to small business were just wrong. The entire complaint was simply a product of unfair "bank bashing." See, Stewart, Bank Heist, p. 178.

³⁸ EKOS (1998), p. 42.

³⁹ For the final report see David Rosenberg, Marjorie Griffin Cohen and Blair Lekstrom, Report of the British Columbia Task Force on Bank Mergers – A BC Perspective, (September 1998).

be halted.⁴⁰ Small town businesses also worried that banks “anchored” their downtown cores. Potential branch closings were thus a sensitive issue, particularly given a general sense that there had already been significant rural job loss in the industry as service functions had been centralized (i.e. into calling centres).⁴¹

Much like the independent insurance dealers and financial planners who worked for the insurance industry, these kinds of small business interests were constituencies that tended to receive a great deal of attention from MPs. This was a constituency which could influence events if sufficiently angry with the trajectory of policy in the sector. In fact, as early as 1993 the CBA was concerned about the links that were developing between small business groups, insurance dealers and Liberal MPs. One bank official said that the “bank bashing” found in the infamous Liberal “Red Book” in 1993 was a direct product of the parliamentary influence of these groups.⁴²

The Banks Response to their Public Relations Problems:

In the lead up to the expected round of *Bank Act* revisions in 1997 and 1998, the banking industry was worried about slumping public approval. Led by the CBA, in January of 1998 they put together a nationwide public relations campaign to improve their image, reminding Canadians of the value they provided. The Chairman of the CBA, Gord Feeney (vice chairman of Royal Bank Financial Group) argued in an interview with Canadian Banker, “Addressing these challenges is especially important over the next few years as the government reviews our roles and business powers. If we cannot create the

⁴⁰ Source: Confidential Interview, 2006.

⁴¹ Source: Confidential Interviews, 2006.

⁴² Source: Confidential Interviews, 2006.

climate of public opinion that will allow governments to make the right decisions, then the consequences could be profound.”⁴³

As part of these efforts, Ray Protti, the president of the CBA, wanted local bank managers to become more involved with local MPs in their constituencies. This was a direct response to the increased importance of MPs in policymaking and their “hostility” towards the banks. What Protti referred to as Cabinet’s traditional “stranglehold lock” on policy was being challenged:

The Finance Committee and the Industry Committee, [of the House of Commons] for example, have an increasingly significant influence on decisions that get taken. For these reasons, we clearly have to make more of an effort with individual MP’s, both to listen to their concerns and to explain our industry – and do so not just in Ottawa but in their constituencies as well.⁴⁴

Jim Peterson, the Secretary of State for Financial Institutions, in an interview conducted the day of the first big bank merger announcement in 1998, also noted the political challenges that were emerging for the banks. An expert on the industry, having worked as a financial services international tax and business lawyer prior to entering politics, Peterson noted that the banks did have some public relations problems, particularly with MPs. “Its important that Members of Parliament and bankers have a lot of dialogue - and that bankers understand the problems of MP’s . . .”⁴⁵ MPs were getting lots of negative views on bank services from their constituents. Derek Lee, a long time member of the Liberal parliamentary caucus, argued that while banks lobbied cabinet

⁴³ Quoted from Carolyn Green, “Can we talk,” *Canadian Banker*, Jan/Feb, Vol. 105, Issue 1, p. 11.

⁴⁴ Quoted from an interview in Green, p. 11. Officials at the CBA were concerned that the attitude of many Liberal MPs, in conjunction with the poor public opinion of the banks, was going to derail previous government commitments to remove the remaining barriers that prevented banks from selling insurance “in branch” which they expected would occur in the 1997 *Bank Act* revisions.

⁴⁵ Quoted from, Guy Christopher, “Capital gains: A banker’s guide to Ottawa,” *Canadian Banker*, March-April 1998, Vol. 105, Issue 2, pp. 27-34.

ministers who had more influence, they needed to pay more attention to individual MPs as they also had what Lee called “micro-clout” in the sector: Caucus had the ability to derail unpopular policies. Lee acknowledged that the banking industry had made real improvements in this area, “. . . from the days when its relationship with the Hill was maintained by an elite group of government-relations lobbyists. . .,” local bank managers efforts to “get to know” their MPs were a real improvement.⁴⁶ Richard Harris, a long time Reform and Canadian Alliance MP from BC, noted much the same thing. After years of serving in the House and on the Commons Finance Committee he noted that the banking industry was paying more attention to MPs.⁴⁷ This is illustrative of the banks’ awareness of their popularity problems in Parliament and the increasing importance of MPs.

Throughout 1997 and 1998, various stories in Canadian Banker, the industry periodical, lauded the banks’ efforts to improve their relationship with Parliament. However, in confidential interviews for this study, Senators and MPs rarely mention the banks as an effective lobby for them personally. Many go out of their way to note how effective insurance industry representatives were in this regard. Not the banks.

Indeed, the bankers’ concerns about their political position in 1997 did not only result in increased efforts to influence individual MPs. The CBA also became “extremely” interested in public opinion, spending heavily on polls to examine the different ways in which the public perceived the industry, something they now do regularly as part of the background research for their lobbying efforts. The goal of this research and lobbying in 1997 was to “defuse” public hostility to the banks.⁴⁸

⁴⁶ Quoted from an interview in Christopher, pp. 27-34.

⁴⁷ See Christopher, pp. 27-34.

⁴⁸ Source: Confidential Interview, 2006.

Globalisation and Foreign Competition:

In terms of communicating their problems and their policy demands, the one big selling card the banks had was the issue of globalisation itself. Perceptions of the threat posed by large international firms to the Canadian financial service industry invariably supported the banks demands for domestic deregulation and conglomeration to ensure Canadian firms were large enough to compete in the new global environment. As such, in the “new politics” of financial services, increasingly the debate over the size and power of Canada’s banks was split into those who thought it was necessary in a global financial services market and those who worried about the implications of this concentration for the domestic market. The tradeoff was increasingly cast as to whether Canadians wanted a strong globally-competitive, and *Canadian*-owned financial services sector, or whether domestic competition and the interests of Canadian consumers and borrowers should be more important. Although it is extremely difficult to disentangle ordinary Canadians’ attitudes towards this tradeoff from a general mistrust of the banks, the *Mackay Task Force* did find that there was an interesting juxtaposition between Canadians’ mistrust of large mergers and their desire to support Canadian ownership in the sector.

Conducting their research while Canadians were just being informed of the banks’ desire to merge with one another in 1998, the *EKOS Task Force* research revealed that the public already saw the issue of mergers between large financial service providers as involving a tradeoff between more conglomeration and reduced domestic competition on one hand and reduced global competitiveness on the other. In the qualitative focus group

stage of the research, EKOS found contradictory views: “Concerns expressed by participants largely focus around the level of competition in the future.”⁴⁹

EKOS argued that the public was being exposed to two competing discourses about mergers and conglomeration between large financial services companies and the desirability of a “big shall not buy big” policy. On the one side, arguments supporting mergers suggested:

Large Canadian banks will be better able to compete globally; Canadian businesses around the world will be better served; mergers will ensure our financial institutions will be under Canadian control in the future; the price for bank services would drop because of efficiencies; and the Canadian banking sector would be strengthened.⁵⁰

This was essentially the argument put forward by banks since 1986 in support of deregulation and conglomeration; that globalisation required it.

In fact, the banks saw globalisation and debates about foreign competition in strategic terms: how globalisation could advance their policy demands. When the banks began to argue for the right to merge with each other, they became *publicly* supportive of efforts to remove barriers to foreign competition in Canada, something they had privately opposed in the past. The banks:

. . . supported foreign branching in the Canadian market when they appeared before the parliamentary committees because they needed an anchor for further arguments to support mergers among them. Presumably, the large Canadian banks could argue that as a consequence of the enhanced competition emanating from foreign banks, competition in the banking sector would not be undermined in the event of a merger between two large banks. Also there would be no danger of a ‘merged’

⁴⁹ EKOS, p. 45. Importantly to the conclusions that the Mackay Task Force would reach, 75 percent of respondents saw the credit unions, smaller banks and trust companies as viable alternatives to the banks.

⁵⁰ Ibid., p. 47.

bank using its dominant position to undermine the competitive positions of the rest of the system.⁵¹

The banks' support for expanded foreign FSP powers in Canada seems disingenuous however, since basic ownership restrictions ensure that a Schedule I bank can not be taken over by a large foreign investor. The banks were simply "positioning" themselves in relation to globalisation for more practical domestic policy debates.⁵² They could hardly oppose increased foreign competition, while at the same time taking advantage of the ideological potential that increased foreign competition created for supporting their demands for new powers and privileges.

On the other side, groups opposed to bank demands for conglomeration and deregulation: small business groups, the insurance industry, and consumer groups, tried to convey a different message to the public. They constantly argued that abandoning the "big shall not buy big" rule would mean that there:

. . . will be significant job losses; there will be a significant number of branch closures; Canadians will get much less personal service; allowing large banks to merge will lead to two or three financial institutions having too much power; and small businesses would have more difficulty accessing loans.⁵³

Throughout the 1990s small business groups had been trying to shift the debate away from challenges of global competition to one focused on levels of domestic competition and services. The CFIB was the most vocal of groups in this line of argument, stating

⁵¹ Harris, "The Globalization of Finance," p. 383.

⁵² Several officials interviewed for this study suggested that the banks' public support for relaxed rules of foreign entry were symbolic rather than meaningful. Source: Confidential Interviews, 2005.

⁵³ EKOS, p. 47.

“We don’t think bigger is going to be better for us. We prefer more players and more competition.”⁵⁴

EKOS tried to measure the “legs” of both of these discourses. In terms of arguments against mergers and conglomeration, they found fairly high levels of public support. Respondents were most likely to believe that large mergers lead to large job losses (68 percent) and branch closures. Respondents were also very likely to believe that this would result in too much power for two or three institutions (65 percent). A majority of respondents also thought that mergers would make it difficult for small businesses to get loans.⁵⁵ In short, Canadians found the arguments against mergers compelling. However, arguments in support of banking conglomeration also resonated with the public at the same time. While respondents were least likely to believe that mergers would reduce prices, many accepted that larger Canadian banks would be better able to compete globally (63 percent). Respondents also believed that allowing mergers between large Canadian banks would ensure Canadian control of the industry in the future (49 percent).

EKOS concluded that opinions were divided: “Typically speaking, younger Canadians and respondents in Quebec are most likely to believe that Canadian banks need to get larger and more international. By contrast, older Canadians and those respondents in British Columbia are more likely to believe the banks are already too large.”⁵⁶ However, in terms of the weighting of these two competing sets of concerns,

⁵⁴ Quoted from an interview with Brenda Dalglish, “Survival of the Biggest,” *Macleans*, July 26, 1993, Vol. 106, Issue 30, p. 29.

⁵⁵ EKOS, p. 48. Interestingly this data was collected after the announcement of the proposal to merge the Bank of Montreal and Royal Bank, but prior to the resulting announcement of a CIBC/Toronto Dominion merger.

⁵⁶ *Ibid.*

the evidence was clear that while Canadians accepted the logic of both arguments, when asked to rate what factors were of most concern to them in evaluating whether such large mergers should be allowed, potential job losses, branch closures, and small business loans all ranked as top criteria, while assessing whether conglomeration would allow Canadian banks ability to compete globally ranked near the bottom.⁵⁷ The public was being exposed to both discourses, but one set of concerns was clearly more compelling.

Furthermore, EKOS reported that “. . . participants saw a direct connection between prices and access on the one hand and competition on the other. Therefore, any trend or potential change that was seen to negatively impact competition was also seen as likely to have negatively impact on individual consumers and small business.”⁵⁸ In the focus groups:

Participants felt that the main advantage to allowing Canadian banks to merge would be increased international competitiveness. Few, however, suggested that this would translate into tangible economic benefits at home, although some suggested that the sector would become more “efficient”. . . From this vantage point, participants saw few upsides to allowing banks to merge.⁵⁹

One wild card in all of this was the issue of “Canadian control.” When asked, Canadians believed that more than any other sector, the banking industry should be “Canadian controlled.” Even if it meant that consumers might pay slightly higher prices, 82 percent believe that the banks should be under Canadian control:

More than three in four (79 percent) respondents also agreed that they would ‘hate to see some giant U.S. bank come into Canada and squeeze out our traditional banks’. . . . It seems that for many participants, Canadian banks have become symbols of Canadian identity. ‘These banks

⁵⁷ See, EKOS, p. 49, Exhibit 7.4.

⁵⁸ Ibid., p. 50.

⁵⁹ Ibid., pp. 50-51.

have been around for years. They took my grandparents' money, they are part of our communities.' 'I don't want to see all the towers in Toronto with American bank logos on them'.⁶⁰

While EKOS did not draw the conclusion, it would seem that while Canadians were unwilling to trade the personal concerns about their treatment in the industry to improve the global competitiveness of Canadian banks, they might be more willing to do so to prevent direct takeovers in the industry by American competitors. It is perhaps understandable then why the banks and their supporters always try to ground their policy demands in arguments that they were necessary to prevent an "American takeover" of the banking industry.

While many of the banks' business practices angered broad segments of society and many were concerned about the way that deregulation had been turned to the benefit of the banks, support for strong Canadian-controlled banks that could compete with American firms remained a powerful political counter-support for the banks.⁶¹ Generally, however, the banks' policy demands remained unpopular, particularly in light of the well-publicized profitability and their equally well-publicized service fee practices. The banks had a particular problem with the small business community.

IV) The Insurance Industry, De-Pillarization and Esoteric Politics:

Perhaps even more problematic than small business groups and the general public antipathy for the banks was the inclusion of the insurance industry in the policy network

⁶⁰ Ibid., p. 52.

⁶¹ It is overwhelmingly the case that in any press conference or public forum discussing the banks' desire for domestic conglomeration and deregulation since 1997, officials from the banks and their lobbyists always emphasize that these moves are necessary to ensure a "Canadian" controlled industry. Bank officials are aware that this argument is one of the few they have that resonates with the public. Obviously, given that existing rules effectively bar foreign takeovers of the big banks, this is little more than a rhetorical use of "globalisation"-related concerns to advance a largely domestic political agenda.

after 1990. Since 1990 the industry has successfully fought full deregulation of restrictions that keep the banks from directly selling insurance. Traditionally subject to some federal regulation, the insurance subsector was largely a provincial responsibility and as long as the functional desegmentation of the market under the system of pillarization, remained it was effectively hived off from the federal banking policy community.⁶² However, when the Federal Government began to consider removing the barriers between these two types of financial service providers they created a significantly more complex policy network.

In the fall of 1990, while the Federal Government was formulating its legislative proposals to put the 1986 Blue Paper program of de-pillarization into effect, it became apparent that there was significant opposition to allowing banks and trusts to sell a full array of insurance products inside their branches. The insurance industry argued that the banks would use tactics like tied selling to decimate the insurance industry. The banks characteristically argued that this would not be a problem as bank staff would be restrained by the market competition, since they would run the risk of alienating a potential “life long” customer.⁶³ Since insurance companies did not have the same opportunities to tie products together (they could not offer mortgages for example), it was felt that in the absence of a regulatory system to prevent tied selling, deregulation in this area would be problematic. Given the size and influence of the insurance companies, and

⁶² Roberge, p. 100.

⁶³ See for example, Randall Pearce’s coverage of the Commons Committee Hearing on this issue in 1991. Randall Pearce, “The man insurance companies love to hate,” Canadian Banker, Jul/Aug 91, Vol 98, Issue 4, p. 23.

the complexities of de-pillarization, the government postponed a decision on this issue.⁶⁴ The 1992 *Bank Act* changes stopped short of full de-pillarization as banks and other FSPs were still not allowed to sell insurance in their branches.⁶⁵

Most expected that the remaining restrictions on banks' right to offer insurance and automobile leasing would be lifted in the scheduled 1997 revision of the *Bank Act*. Observers believed that insurance was so potentially lucrative to the emerging universal banks that the Federal Government would inevitably give in to their pressure to remove the regulations that were preventing them from taking advantage of their economies of scale. Rowland Fleming, the President of National Trust, said in 1993 that the banks would be allowed to sell insurance in their branches, ". . . in the kind of environment . . . which is being actively encouraged by politicians and being furthered by five of the most powerful financial institutions in the country, if not the five most powerful institutions in the country. It is hard to see how this trend will be reversed."⁶⁶ However, even the pro-deregulation Conservative government said before its electoral collapse in 1993 that it would not allow the banks to fully enter the insurance industry after 1997. Banks could buy insurance companies, but they could not network insurance sales through their other financial services activities.⁶⁷ The industry still proceeded anyway on the assumption

⁶⁴ Given that many of the larger insurance firms were mutualized, an ownership structure which would make it difficult for them to acquire subsidiaries in the other deregulated market segments, it was felt by many that allowing the other FSPs to fully enter the insurance sector in the early 1990s would have been premature. Insurance firms would need time to demutualize before de-pillarization was completed.

⁶⁵ Automobile leasing was another area in which the government put off deregulation.

⁶⁶ Quoted from Babad and Mulrone, p. 128.

⁶⁷ *Ibid.*, p. 132.

that the barriers between insurance and banking would be eliminated as they had in other sectors.⁶⁸

Unlike the securities industry which had supported its own takeover by the banks, the insurance industry represented a powerful opponent to the banks in the financial services policy network. Many of the insurance companies were quite large, potentially rivaling the banks. The structure of the insurance industry also posed a problem. While the insurance companies' agent-based system, in which self-employed small business people sold company products on commission, was arguably more costly than the banks' branch structure, it was also a source of political strength. Insurance agents and financial planners were an important group of individuals in grass roots party activism. Allowing banks and lower-paid bank staff to sell insurance in branch would directly undermine their businesses. As such, they have consistently opposed allowing banks to sell insurance in their branches.⁶⁹ More to the point, confidential interviews with parliamentarians for this study clearly illustrated their effectiveness. MPs respect and value the local insurance agents and their professional associations.⁷⁰ Several suggested that they were not just better local lobbyists than the banks, they also made better arguments.

⁶⁸ For example *Desjardins* in Quebec pursued an aggressive provincial strategy of mergers with insurance companies as they felt it was only a matter of time before the industry was dominated by deposit-taking institutions." See Dalglish, p. 29.

⁶⁹ Stewart concludes that the banks did not get to take over the insurance industry because that industry was particularly effective at lobbying MPs. Stewart says that one Ontario Liberal MP told him when the government was again considering letting the banks sell insurance in 1997 that "In the caucus, it was absolutely clear that Doug Peters thought the banks should get the business. He told us we were sticking up for the insurance companies, and the biggest of them were all owned by Americans. I got up and said that in my riding, there were very few banks, and getting fewer, but there were a hell of a lot of insurance agents who didn't sit behind a desk, but were out in the community, active members of the community, and those were the people I was defending." See, Stewart, *Bank Heist*, p. 207.

⁷⁰ Source: Confidential Interviews, 2005-2006. It is interesting to note that Coleman's narrow analysis of the policy network, in which he excludes Parliament, does not allow us to adequately understand the influence of groups like insurance dealers. According to Coleman's model, local pressure on MPs should not matter.

It was not just the insurance dealers that were effective lobbyists, however. Many of the firms themselves had political influence and access to senior officials, which unlike many of the other FSPs, rivaled the influence of the banks. Politically-influential Power Corporation illustrates this. Power Corporation is the investment holding company of the Quebec-based Desmarais family which has enjoyed close links with senior political figures in Ottawa. Its largest subsidiary is Power Financial Corporation, a holding company that controls Winnipeg-based Great-West Life Assurance Co. and IGM Financial Inc., which was one of Canada's largest mutual fund businesses.⁷¹ These financial services subsidiaries would be negatively affected by any decision that increased the banks' hold over the domestic market. As such, Power Corporation is seen as a major opponent of the banks' agenda over the last decade.

When explaining the policy developments of 1997-1998, bank officials and their allies invariably note, "Off the record," that both Prime Minister Jean Chrétien and his long serving Finance Minister, Paul Martin, had prior family business dealings with the Desmarais family, and had brought their own personal "anti bank" attitudes into Cabinet. In particular, it was suggested by several prominent players in the industry that Paul Martin had had trouble getting financing from the banks for Canada Steamship Lines and had turned instead to one of Power Corporation's subsidiaries.⁷² This established the basis of a personal relationship between Martin and an important firm hostile to the banks. In fact, one senior bank lobbyist suggested that both Martin and Chrétien had found the banks so difficult to deal with in their private sector ventures that they were

⁷¹ In recent years Power Corporation has generated profit levels comparable to Canada's banks, coming close to a billion dollars a year, mainly driven by profits from the financial services subsidiaries. See Roma Luci, "Power Corp. profit up," *Globe and Mail*, 04/04/2006, globeandmail.com.

⁷² Source: Confidential Interviews, 2006.

personally opposed to increasing their dominance in the industry.⁷³ It is important to note, however, that both men also had extensive links to the banks, including company directorships in their days in the private sector. What might be most safely suggested here is that some insurance companies had the kind of direct “ministerial access” that had traditionally been reserved for the banks alone.

The insurance companies also had other allies outside of the industry. For example, many public interest lobbies had particular problems with allowing banks to sell insurance. The Consumers’ Association of Canada (CAC) was a constant opponent of allowing banks to sell insurance. The CAC wanted more competition for Canadian consumers, but worried that if the government allowed the banks into the industry this might actually reduce competition over the long term.⁷⁴ The banks would use their privileged position to replace the insurance firms, with their higher-cost agent structure, and ultimately leave consumers with fewer choices. The banks always responded to these kinds of arguments by suggesting simply that they needed to become “globally competitive” firms, meaning they needed to achieve the cost efficiencies of universal banks elsewhere to be able to compete with foreign banks.

It was not clear to analysts how the insurance industry might fare in a fully competitive market. Many suggested that some of the larger insurance companies could survive the entry of banks into the sector, but only if they got ready for the competition. Some of the larger firms in the industry were big, certainly bigger than the securities firms as well as many of the troubled trust companies, and should have had the resources necessary to actually take advantage of the opportunities created by deregulation in 1992.

⁷³ Source: Confidential Interviews, 2006.

⁷⁴ Babad and Mulroney, p. 135.

For example, by taking over some of the larger trust companies they could have developed a branch structure and the “warm leads” of an existing clientele. In fact, Manulife Financial took early steps towards becoming a “one stop financial services centre,” by purchasing several smaller trusts and merging them into a small Schedule II bank.⁷⁵ This was an isolated example, however, as the insurance industry was slow to respond to opportunities for cross-pillar ownership after 1992.

Much like the trust industry, existing structures prevented insurance companies from doing things that the banks did. For example, many insurance firms were mutualized. One of the major implications of this was that they could not raise investment funds through stock and bond offerings to purchase other financial services firms. Demutualization, which the government would approve in 1999-2000, offered a solution to this, albeit a decade after the banks had taken over the securities and trust industries.

Perhaps equally important was that in the period of deregulation, the insurance industry was going through its own troubled period of consolidation. The market for insurance was saturated by the late 1980s as Canadians had been heavy consumers of insurance products. Only Japanese citizens bought more life insurance than Canadians per capita. There was little room for growth in the Canadian market.⁷⁶ Canada’s public health insurance also limited the opportunities in that area. Much like the cases of the securities and trust industry, deregulation caught the insurance industry at a bad time.

The major insurance companies failed to take advantage of deregulation by expanding their operations into other sectors. Instead, it was the banks that would

⁷⁵ Manulife has taken this much further in recent years. In 2003 it quietly proposed to the Federal Government that it be allowed to takeover one of the big banks (see Chapter Eight).

⁷⁶ Babad and Mulrone, pp. 128-129.

emerge as the major buyers in the takeover wave launched by deregulation. The result would eventually give the banks the upper hand in any direct competition between the firms if the government removed the restrictions on banks' insurance dealings.⁷⁷

V) The 1997 *Bank Act* Changes – Completing the Process of De-Pillarization?

Given the increasingly public debates over how events were unfolding in the financial services sector and how the banks should be regulated in the post-deregulatory environment, the required 1997 *Bank Act* review process was likely to be more divisive than that of 1992. In September of 1994 the new Liberal government had released a discussion paper in preparation for the 1997 changes. While the paper took no position on the matter, in the ensuing lobbying, the issue of bank in branch insurance sales and car leasing became central concerns.⁷⁸ While the banks lobbied for deregulation in this area, the insurance industry launched “An intense grass roots campaign, engaging the lobbying efforts of the individual insurance agents, in opposition to enhancing the scope of the banks' powers.”⁷⁹ The automotive dealers association also joined these efforts.

Under intense pressure from various industry lobbyists, Paul Martin refused to make any quick decisions. Martin announced that there would be no recommendation to expand banks' powers in the 1996 budget speech. Instead, the 1997 *Bank Act* changes were to go ahead with relatively minor amendments. Taking the policy review process out of the Department of Finance, Martin decided that broader issues would be set aside

⁷⁷ In the wake of deregulation, despite the remaining restrictions, all of the banks bet on further changes in 1997 and bought insurance subsidiaries in what they saw to be the first steps towards becoming major players in the sector.

⁷⁸ Harris, “The Globalization of Finance,” p. 381.

⁷⁹ Ibid.

until the completion of a Task Force on the “Future of the Financial Services Sector” (the *Mackay Task Force*) was completed. Stephen Harris argues that this “hand off” of these questions to the *Task Force* was a way for the government to stall decision-making on the reform process.⁸⁰

The 1996 budget announcement was illustrative of the changing policymaking environment in the sector. Observers note that in the midst of the budget speech Martin received a standing ovation from his own caucus when it was announced that there would be no rushed decision to expand the banks powers in the 1997 *Bank Act* revisions.⁸¹ One bank official argued that ultimately it was anti-bank sentiment in the Liberal caucus that killed the completion of de-pillarization in 1997. He argued that the real “problem” was that “. . . the Finance Minister was unwilling to spend political capital on behalf of the banks, as he would have had to overturn his caucus which was no friend to the banks.”⁸²

While Martin put off the big decisions about the banks’ demands by establishing the *MacKay Task Force*, the 1997 *Bank Act* revisions still had to go ahead as required by law. The “politicking” over what were relatively minor revisions further illustrates the changing policymaking environment.

In June 1996, the Department of Finance released a White Paper that was intended to lay the ground work for the immediate *Bank Act* revisions. The White Paper’s preamble stressed the positives of Canada’s financial services sector, but suggested that the sector was “evolving rapidly” and there was a need to examine

⁸⁰ More polemically, Harris argues based on interviews with anonymous insiders that the *Mackay Task Force* was intended to serve the Minister’s “anti-bank” agenda and that there was no forward-seeing financial services bureaucracy to stop him. Stephen Harris, “Financial Sector Reform in Canada: Interests and the Policy Process,” *Canadian Journal of Political Science*, March 2004, p 168.

⁸¹ Almost a decade later an interviewee from the banking industry seemed genuinely upset that there would be a standing ovation on a decision like this.

⁸² Source: Confidential Interviews, 2006.

“fundamental questions” that the White Paper did not intend to resolve.⁸³ The White Paper touched only lightly on the rampant criticisms of the banks and the competitive impacts of deregulation. For example, it argued that there was no evidence that industry concentration had hit a problem level.⁸⁴ While the 1992 de-pillarization had assumed there would be increased competition for the banks, the fact that only one large trust company and the *Mouvement Desjardins* had survived as major alternatives to the banks drew no reaction from the Department of Finance. Instead, the paper suggested the need for further reductions of the regulatory burden of the banks, and that domestic banking competition should be increased by reducing restrictions on foreign financial service companies. Relaxing restrictions on foreign banks threatened to be a big agenda item in the future. Harris notes that the effect of the widely held ownership rules, and prohibitions on foreign banks’ right to directly open branches in Canada, acted to ensure that the Canadian market was one of the most protected in the OECD.⁸⁵ US Trade officials were asking the Canadian Government to liberalize policy, particularly in regards to direct branching privileges.⁸⁶

There was also widespread sentiment in Parliament that the 1997 legislation should attempt to deal with consumer complaints about improper bank practices. The House of Commons Finance Committee’s response to the White Paper illustrates this. The Committee’s report, 1997 Review of Financial Sector Legislation: Proposals for Change, argued that the existing provisions of the *Competition Act* and the *Bank Act* that

⁸³ Canada, Department of Finance, 1997 Review of Financial Sector Legislation: Proposals for Changes, (Ottawa: Minister of Supply and Services, June 1996), p.7.

⁸⁴ Canada, Department of Finance, 1997 Review of Financial Sector Legislation, p. 13.

⁸⁵ Harris, “The Globalization of Finance,” p. 383.

⁸⁶ *Ibid.* Harris claims this; however he also notes that in the *MacKay Task Force* hearings, foreign banks did not ask for expanded access to the Canadian market. The proponents of this were Canada’s banks which Harris insinuates supported the idea only to legitimate their own desire to merge with one another under threat of foreign competition.

were supposed to restrict the banks' use of improper tied selling were inadequate. As a result the government added provisions to the *Bank Act* revisions which were intended to tighten restrictions.⁸⁷ The legislation was never put into force, however, as the banks convinced the Minister and the Department of Finance that the rules were unnecessary and that they would prevent product bundling, which they now referred to as "relationship pricing," in which customers were offered a lower price on one product if they purchased other products as well.⁸⁸

Since the government had ignored the committee's concerns, the committee launched a second set of hearings and prepared a second report outlining what it thought should be done. This report would not appear until the summer of 1998, in the midst of the merger debate.⁸⁹ The report directly targeted the banks as the guilty parties, but also criticized the government and the Department of Finance for ignoring the committee's original concerns. Taking the line of argument promoted by the insurance industry, the committee was particularly concerned that under current regulations there were ineffective provisions to prevent a bank from improperly demanding its customers buy additional products, like insurance, in order to receive credit and loans.⁹⁰ The committee called on the government to proclaim the rules as originally passed, arguing that industry promises of greater efforts at self-regulation were inadequate.

⁸⁷ The Department of Finance drafted a new Section 459.1 of the *Bank Act* and this was included in Bill C-82, *An Act to Amend Certain Laws Relating to the Financial Institutions*, the required *Bank Act* legislation of that year. The *Bank Act* still, by law, had to be amended that year, even though Martin had abbreviated the process to put off major changes until after the *MacKay Task Force*.

⁸⁸ The government had hesitated to proclaim the new Section 459.1 in response to industry concerns that the legislation might infringe on legitimate service "bundling" or "cross selling" which benefited consumers. Instead, the industry agreed to a number of voluntary initiatives to reduce improper tied selling. See Standing Committee on Finance, House of Commons, Report on Tied Selling: Section 459.1 of the *Bank Act*, (Report Number 07 – Committees of the House of Commons, June 1998), and "Banks resist ban on tied sales," *MacLean's*, March 13, 1998, Vol. 111, Issue 15, p. 43.

⁸⁹ Canada, Standing Committee on Finance, Report on Tied Selling.

⁹⁰ *Ibid.*

Despite parliamentary pressure, in the end, the 1997 *Bank Act* amendments only "fine tuned" the changes made in 1992.⁹¹ For the first time, however, the 1997 changes included provisions to protect consumers' privacy. More importantly, the changes were consistent with Canada's international obligations, and proposed that foreign banks, which had been required to establish separately capitalized subsidiaries to operate in Canada, would eventually be able to establish branches directly, with some restrictions on the scale of their operations in Canada. Furthermore, under the terms of the WTO Financial Services Agreement, size restrictions on all foreign bank operations in Canada were abolished as they had been for the US and Mexico under NAFTA.

The MacKay Task Force:

The White Paper and the *Bank Act* revisions were only the start, however. The 1997 revisions simply postponed most of the more difficult decisions, like those touching insurance and the reform of the industry regulator. The *MacKay Task Force*, which was to report back to Parliament before parliamentary committees would begin developing comprehensive legislative proposals for an overhaul of the sector, was given a wide mandate and there was a potentially long list of questions they might evaluate. One important issue was whether or not the remaining protections for the insurance industry should be removed. Should banks be allowed to sell insurance in their branches? Indeed, the Government of Quebec was once again precipitating the issue by passing legislation which would allow banks to sell insurance in their branches by reclassifying some tellers as insurance salespeople, thereby avoiding any federal restrictions.⁹² The banks had

⁹¹ See Charles Freedman, "The Canadian Banking System," Bank of Canada, March 1997, p. 15.

⁹² Globe and Mail, June 24, 1996, p. B4.

already been allowed to set up insurance subsidiaries to sell insurance as a transition period until the day they would be allowed to sell directly through their branches. The White Paper also suggested that the *Task Force* should investigate whether entirely new ways of regulating “tied selling” were needed, given the likelihood that the banks would eventually be selling insurance in their branches.⁹³

Another issue was the question of whether the banks would be allowed into the auto leasing business. The government, by continuing to bar the banks from providing automobile leases denied them access to a lucrative and growing sector. Arguably, the existing rules were protecting American companies from competition inside Canada, as the major US car companies were the principle providers of that service. The banks and the CBA made it clear that they wanted this restriction removed; however, others argued that:

The banks say they can deliver leases at a savings to the consumer, and it may be true. They might be able to deliver pizzas at a savings to the consumer, too; but if they take over the pizza racket prices won't stay down for long. The history of banking shows us that, once the oligopoly gets complete control of another sector, prices go up, not down.⁹⁴

Furthermore, there was a host of unresolved regulatory issues which were still awaiting government attention. Walter Stewart, for example, argued that the lessons of the past, whether the bank failures of the 1980s or the trust failures of the 1990s, had all shown that the regulatory agencies themselves were too weak and needed reform.⁹⁵

Many argued that OSFI had been “captured” by the banks and should be replaced by a regulatory body with representations of different groups like small business and

⁹³ Canada, Department of Finance, *1997 Review of Financial Sector Legislation*, p. 8.

⁹⁴ Stewart, *Bank Heist*, p. 208

⁹⁵ *Ibid.*, p. 217.

consumers, like the Canadian Radio and Television Commission (CRTC).⁹⁶ While the White Paper and 1997 *Bank Act* changes put bank demands for further deregulation on hold, they also ignored these kinds of regulatory and consumer concerns. It is clear however that in the lead up to the *MacKay Task Force*, anti-bank constituencies were challenging the trajectory of policy in the sector across a range of fronts, demanding new regulation.

VI) Conclusions:

Deregulation, by collapsing boundaries between different industry subsectors and by inadvertently expanding the role of the House of Commons in overseeing and regulating issues of consumer protection and competitiveness, created conditions for the wide array of groups opposed to further industry deregulation and conglomeration to halt the process in 1997. Instead of delivering the final steps in full de-pillarization, the 1997 *Bank Act* changes were relatively insignificant as the government put off the more contentious issues, awaiting the report of the *MacKay Task Force*.

The *Task Force* set the stage for a significant struggle between the banks and those that had been excluded from the policy process over the previous decade:

There will never be a better time for ordinary Canadians to contribute to the debate than over the next two or three years, while the task force, and then Parliament, wrestles with amendments to the *Bank Act*. If we are going to get any real reforms, the banks must be kept with their feet firmly to the fire of public displeasure, the process which they call “bank bashing” and the rest of us call “restoring the balance”.⁹⁷

⁹⁶ See Bellam, or Stewart, *Bank Heist*, p. 217.

⁹⁷ Stewart, *Bank Heist*, p. 205.

Much like the process in the 1980s, however, the banks attempted to “hijack” the policy debate. The announcement of the big banks’ merger proposals in 1998 turned the *Task Force* process and the ensuing parliamentary committee reports into a virtual referendum on mergers rather than a debate about regulatory reform. However, no one was prepared for the groundswell of opposition that emerged in response to the banks’ proposals.

The numerous complaints leveled against the banks after deregulation, and their resonance with the public, were bringing a steadily increasing number of non-bank NGOs and associations into the policy debate: groups that would all be vocal critics of the bank merger proposals in 1998 and would use the debate over those proposals to advance their own arguments for regulatory reform. Indeed, the number and type of groups alone that would appear before committees in Ottawa over the course of 1998 illustrates this (see Table 6.1). The size of the banking policy network expanded rapidly over the 1990s and the increasing role of new groups (like the insurance industry, small business groups, and consumer organizations) in the policy process ultimately undermined the conditions of esoteric politics and the banks’ domination of policy outcomes.

Table 6.1: Number and Type of Witness Appearing Before Parliamentary Committees Reviewing Financial Services Legislation:⁹⁸

Interveners	1991*	1998**
Government:	3	15
Business:		
Industry Organizations	6	33
Corporate Actors	1	51
Other Societal Actors:		
NGO's	1	12
Consultants	0	1
Academic/Think Tank	0	5
Individuals	0	20
Totals:	11	137
1991 participants remaining in 1998:		6
New participants in 1998:		131
<p>*House of Commons, Sub Committee on Financial Institutions Legislation of the Standing Committee on Finance, (1991). The Committee was reviewing Government proposals for the major deregulatory <i>Bank Act</i> revisions of 1992.</p> <p>**Senate, Report of the Standing Committee on Banking Trade and Commerce, <u>A Blueprint for Change: Response to the Report of the Task Force on the Future of the Canadian Financial Sector</u>, The Senate Committee was consulting the public in response to the <i>MacKay Task Force</i> recommendations.</p>		

⁹⁸ Data is drawn from Michael Howlett, "Do Networks Matter? Linking Policy Network Structure to Policy Outcomes: Evidence from Four Canadian Policy Sectors 1990-2000, [Canadian Journal of Political Science](#), 35(2), (June, 2005), pp. 235-267, Tables 6 & 8.

**CHAPTER 7: “ESOTERIC POLITICS UNDONE – THE
BANK MERGERS QUESTION”**

“Look, I get enough God damned complaints . . . about the banks and their treatment of customers now. Imagine how many I’d get if we had one big bank.”

Doug Peters,
Secretary of State for International
Financial Institutions, 1995¹

I) Introduction:

Deregulatory progress toward universal banking and widespread industry conglomeration had been rapid prior to 1997. There had been a high level of consensus in the *existing* policy network, dominated by the big banks and the Department of Finance. It was generally agreed that these steps were necessary to respond to the rapidly changing global environment that financial services providers were encountering. The banks, government regulators, and the Department of Finance believed that increased conglomeration offset by increased international competition were inevitable, and as such, that industry participants should be set free from any regulatory overhang of pillarization in order to meet that competition. Most of the key participants in sectoral policymaking supported domestic deregulation and industry concentration. Ironically given events, the recommendations of the *MacKay Task Force* itself would illustrate the extent of this policy paradigm.

This consensus or “hegemonic project of bank capital”² might have continued unabated. After 1998, the banks might have been allowed into the insurance and auto

¹ Quoted from Walter Stewart, *Bank Heist: How Our Financial Giants Are Costing You Money*, (Harpers Collins, 1997), p. 203. Peters had also been a banker for thirty years.

² Adam Tickell, “Global Rhetorics, National Politics: Pursuing Bank Mergers in Canada,” *Antipode*, 32:2, 2000, pp. 152-175.

leasing business and the government might have allowed an even deeper wave of conglomeration. This did not happen. Instead, the sector moved into a period of deregulation and “politicisation.” The banks’ surprise requests that they be allowed to merge in 1998, given the underlying opposition to their agenda which had been building, ultimately opened the door to new network participants, new policy goals, and a far more unpredictable policymaking environment.

Chapter Seven illustrates how a combination of the altered institutional context of policymaking in the sector, the growing array of opposition groups, and poor political planning by the banks served to undermine the carefully-crafted policy consensus. The events of 1998 served to open the policy network to politically-important “anti bank constituencies” like the insurance industry, small business organizations, and consumer groups. In part, this was possible because Members of Parliament asserted their role in scrutinizing large mergers in the financial services industry. Indeed, the policy network expanded considerably,³ and against a back drop of public hostility to the banks, many new groups emerged as consistent and important voices in sectoral policymaking. These factors ultimately led the government to reject the mergers in 1998. More importantly, they altered the overall trajectory of policymaking, as the “new politics” of the sector ushered in by 1998 would produce significantly different policy outcomes.

³ See for example, Michael Howlett, “Do Networks Matter? Linking Policy Network Structure to Policy Outcomes: Evidence from Four Canadian Policy Sectors (1990-2000),” Canadian Journal of Political Science, 35:2, (June 2002), pp. 235-267. Howlett’s work suggests that the community expanded rapidly in the 1990s and that this may be directly linked to the rapid change in policy goals over that period. See Table 1, Chapter Six, for an illustration of Howlett’s data.

II) Industry Changes:

Regardless of growing public hostility to the banks in the 1990s, the post-deregulation period ushered in a wave of mergers and acquisitions, principally by the large chartered banks. The mergers began less than a year after the 1992 legislative changes when the Royal Bank paid \$1.6 billion dollars to acquire Royal Trustco: “. . . the trust company gave Royal access to wealth management, which is another way of saying getting your hands on all of a customer assets, including RRSPs. This [was] hugely attractive to banks because profit margins are much higher than for traditional services.”⁴ Sparked by the attraction of lucrative profits to be made in other sectors, and a competitive race between the banks to acquire subsidiaries before their major competitors could, the pace of merger activity reached a peak in the year prior to the proposed super-mergers between the big banks in 1998.

In 1997, the Royal Bank purchased Canadian investment dealer Richardson Greenshields Limited for \$480 Million. The Royal Bank also acquired all remaining minority shares of its recently purchased subsidiary, RBC Dominion Securities Limited. Its subsidiary, Royal Trust, purchased the institutional and pension custody business of Montreal Trust and the Bank of Nova Scotia. This acquisition garnered Royal Trust \$120 billion in client assets under administration. The Canadian Imperial Bank of Commerce (CIBC) purchased all of the outstanding shares of Oppenheimer Holdings Inc, a US securities firm, for \$493 million. CIBC also purchased Eyres Reed, an Australian brokerage firm, as well as the pension and institutional trust and custody business of Canada Trust. The Bank of Nova Scotia acquired 95 percent of the common shares of

⁴ Anne Kingston, “Stealth Banker,” ROB Magazine, April 1998.

National Trust for \$1.2 billion. Toronto-Dominion Bank (TD) acquired Waterhouse Investor Services, a discount brokerage in the US, for \$726 million. The number of important players in the domestic financial services industry declined sharply as the number of subsidiaries owned by Canada's banks tripled from 1986 to 1996.⁵

Perhaps not surprising given the kind of efficiencies this generated for the banks: the profitability of new product lines; the proliferation of service fees; and the generally rosy economic climate of the period; the waves of mergers produced several years of record-breaking bank profits. In 1997 the net income of Canada's five largest banks was \$7 billion, and by industry standards the return on equity was very high.⁶

Thus, mainly through the acquisition of subsidiary institutions in the other financial sectors, the banks emerged from deregulation larger, and more successful, than ever.⁷ While there were still a large number of deposit-taking institutions in Canada on paper, Canada's five largest banks, the "big banks," had come to dwarf the size of all other competitors, controlling the vast majority of the banking business (see Table 7.1). Deregulation had increased the risks of excessive concentration.⁸ Nothing illustrated this dilemma more clearly for federal banking policymakers than the proposed mergers of Canada's largest banks.

⁵ See Stewart, *Bank Heist*, p. 249. There is a comprehensive list of bank subsidiaries on p. 238.

⁶ Price Waterhouse, *Canadian Banks – Analysis of 1997 Results*, Survey Report, (Price Waterhouse, 1998), p. 8.

⁷ Charles Freedman, "The Canadian Banking System," (Bank of Canada, March 1997), p. 17.

⁸ See Stewart, *Bank Heist*, in appendixes, for data on the banks' standing inside the Canadian industry. Going into the crucial year of 1998, the number of branches and employees had gone down for all five major banks while share price and assets had all been going up. Not surprisingly, all of the banks had been enjoying consistently high returns on equity.

Table 7.1: Deposit-Taking Institutions, by Asset Size (\$ Millions) – 1997-1998

Institution	Year/Assets (\$Millions)
<i>Banks*</i>	<i>1997</i>
Royal Bank	\$244,744
CIBC	\$237,989
Bank of Montreal	\$207,838
Bank of Nova Scotia	\$195,153
Toronto-Dominion Bank	\$163,852
National Bank	\$66,235
Hong Kong Bank of Canada	\$23,910
Laurentian Bank of Canada	\$13,422
Deutsche Bank (Canada)	\$8,727
Citibank (Canada)	\$7,180
Bank of America (Canada)	\$4,990
Société Générale (Canada)	\$4,542
ABN AMRO Bank of Canada	\$3,935
BT Bank of Canada	\$3,763
Bank of Tokyo-Mitsubishi (Canada)	\$3,102
Crédit Lyonnais Canada	\$2,712
Banque Nationale de Paris (Canada)	\$2,606
Union Bank of Switzerland (Canada)	\$2,582
Credit Suisse First Boston Canada	\$2,565
Canadian Western Bank	\$2,023
Banca Commerciale Italiana of Canada	\$1,971
J. P. Morgan Canada	\$1,558
Chase Manhattan Bank of Canada	\$1,323
Republic National Bank of New York (Canada)	\$1,229
Fuji Bank Canada	\$1,041
First Chicago NBD Bank, Canada	\$1,040
Sanwa Bank of Canada	\$955
Swiss Bank Corporation (Canada)	\$930
<i>Credit Unions**</i>	<i>1998</i>
Vancouver City Savings Credit Union	\$5,019
Surrey Metro Savings Credit Union	\$2,162
Richmond Savings Credit Union	\$1,788
Pacific Coast Savings Credit Union	\$1,367
Capital City Savings and Credit Union Ltd.	\$1,013
Niagara Credit Union Ltd.	\$919
Civil Service Cooperative Credit Society Ltd.	\$912
Westminster Savings Credit Union	\$882
First Heritage Savings Credit Union	\$875
HEPCOE Credit Union Ltd.	\$841

*Source: Data drawn from Price Waterhouse, Canadian Banks – Analysis of 1997 Results, Survey Report, (Price Waterhouse, 1998), p. 37.

**Source: Data drawn from Department of Finance Canada, Canada's Credit Unions and Caisses Populaires, available at, http://www.fin.gc.ca/toce/2000/ccu_e.html, July 18, 2002.

III) The Origins of the Merger Proposals – The *MacKay Task Force*:

Putting off serious decisions about further deregulation in 1997, the government established the *Task Force on the Future of the Canadian Financial Services Sector* as a part of a broad policy review process for the next round of *Bank Act* changes. Taking the policy formulation process out of the hands of the Department of Finance which in the past had only privately consulted with the leading firms in the sector, the process was quite different from what had occurred in the 1980s.⁹ The *Task Force*, after some initial personnel changes, was ultimately chaired by Harold MacKay and thus popularly referred to as the “*MacKay Task Force*.” MacKay was given a broad mandate to evaluate the financial services sector as a whole, but in his terms of reference, the government asked him to focus on how the government might:

- Enhance the contribution of the financial services sector to job creation, economic growth and the new knowledge-based economy
- Enhance competition, efficiency and innovation within the sector
- Enhance the international competitiveness of the sector in light of globalisation
- Enhance the ability of the sector to take advantage of changing technology
- Improve the contribution of the sector to the best interest of Canada's consumers

On June 13, 1997 the *Task Force* released a discussion paper which asked for responding submissions from members of the financial services community. The paper

⁹ Non-bank network participants complain that prior to 1997 Department of Finance officials and regulators would not even meet with them to discuss policy changes in the formulation of Finance's papers. Source: Confidential Interviews, 2005.

suggested that globalisation was the most serious problem confronting the industry.¹⁰ Of the 220 responses they received, the most important was from the Canadian Bankers Association (CBA) on October 29. In their submission to the *Task Force* and subsequent hearings, the CBA, and the banks themselves, constantly noted that the WTO and NAFTA were removing barriers to trade in financial services internationally, and that this required domestic deregulation as well as the reduction of remaining regulatory burdens, particularly the remaining restrictions on the range of services they could offer.¹¹ Their submission emphasized globalisation, the trend towards conglomeration elsewhere, and suggested that Canadian banks were facing a surge in competition from larger foreign competitors *inside* the Canadian market:

In the past 18 to 24 months alone, the following banks have received or applied for approval to commence business operations in Canada: ING Bank of Canada (The Netherlands), Citizens Bank (Canada), Wells Fargo Bank (U.S.), Rabobank Canada (The Netherlands), First Nations Bank (Canada), Valley National Bank (U.S.), MBNA Canada Bank (U.S.) and Comerica Bank (U.S.).¹²

The CBA argued that the Department of Finance's announcement in September of 1997 (the proposal which would allow widely held foreign banks to enter the Canadian wholesale banking business directly, rather than through the operation of Schedule II banks), would "result in increased competition in the wholesale market, because foreign

¹⁰ "We no longer have the luxury of dealing with an essentially Canadian industry. Many of the major financial institutions, whether based here or elsewhere, are truly international. This meant that no one nation has the capability to apply meaningful regulation to the entire institution." From Canada, Task Force on the Future of the Canadian Financial Services Sector, The Future Starts Now: A Study of the Financial Services Sector in Canada. (Ottawa: Minister of Supply and Services Canada, 1998e).

¹¹ Ian Roberge, The Internationalization of Public Policy and Multi-level Governance: A Comparison of Financial Services Sector Reform in Canada and France (Doctoral Dissertation. McMaster University, 2004), p. 135.

¹² Canadian Bankers Association, Submission to the Task Force, November 10, 1997, p. 19.

bank branches will rely on the capital base of their considerably capitalized parent rather than on the relatively small capital base of their Canadian subsidiary.”¹³

Facing these threats, the CBA requested that the *MacKay Task Force* propose abolishing the “big shall not buy big” policy which it felt limited the “maneuverability” of Schedule I banks. Given the industry conglomeration that already occurred under the “big shall not buy big” rule, the CBA was speaking directly about mergers between the big banks themselves. Furthermore, the Association argued that the system for approving mergers should be amended so that bank mergers could be judged by the general legislation governing corporate mergers. They would only be reviewed by the Competition Bureau and that Office of the Superintendent of Financial Institutions (OSFI) and subsequent “ministerial reviews” would automatically result in approval for a merger if it satisfied the Competition Bureau.¹⁴ Perhaps anticipating that the greatest opponent to such mergers would be ordinary MPs who might pressure Cabinet to block any attempt to further reduce competition in the sector, the CBA was trying to minimize the role of Parliament and the government in any decision.

The CBA and the individual banks also recommended that the government should further reduce remaining restrictions on the array of services that they would be allowed to offer. They proposed that financial service companies should have the flexibility to pursue their own business strategies, offering whatever services made the most sense to them. Rather than continue to be regulated by the remnants of pillarization, they argued that regulation should be functional: financial services companies should be regulated not based on what sector they were originally in, but rather based on the range of activities in

¹³ Ibid.

¹⁴ Ibid., pp. 54-55.

which they were involved. If a bank offered auto leasing, for example, it should be regulated as a bank but be subject to whatever functional regulations govern automobile leasing. This would provide the industry with flexibility to adopt a range of business strategies.¹⁵

In their submissions to the *MacKay Task Force* and their releases to the media, smaller financial institutions, credit unions, trust companies, small business associations and consumer groups frequently rejected this logic, as they worried that this would simply pave the way for increased conglomeration, with the big banks squeezing out smaller market participants. The Trust Companies Association of Canada (TCAC), the Independent Investment Dealers Association and a number of other non-bank financial services industry groups and firms argued that more effort needed to be made to ensure that there was a healthy second tier of competition for the banks, since the banks had “become too big and threaten[ed] competition.”¹⁶ There was a widespread sense that the process of de-pillarization had consistently favored the banks:

The result has been the creation of a single super-pillar. This, independent dealers believe, has led to a lessening of competition, innovation and efficiency within the financial services sector and higher prices for Canadian consumers, with no discernable benefit for the Canadian economy.¹⁷

Indeed, even extremely wealthy companies like Power Financial Corporation that owned the largest mutual fund company in Canada, Investors Group (along with several insurance companies), argued that banks’ domination of financial services was rapidly

¹⁵ Harvey Schachter, “The Great Debate,” *Canadian Banker*, May/June 1998, Volume 105, Issue 3, p. 18.

¹⁶ For a concise summary of the arguments presented by other financial service providers see Schachter, p. 18.

¹⁷ The Independent Investment Dealers’ Association comments on the Mackay process. Quoted from Schachter, p. 20.

increasing. In response to MacKay's investigation, they presented data suggesting that the banks accounted for a staggering 64 percent of profits by TSE 300 companies between 1992 and 1996.¹⁸ Power Corporation, like some of the other major insurance companies, was not a political lightweight. The company was large and politically well connected, particularly to Finance Minister Paul Martin.

Underlying the concerns of non-bank financial services companies was the common complaint that the real problem was that government policy was allowing the banks into all facets of financial services while maintaining privileges for the banks that insulated them from competition in their core business activities. The insurance industry complained that the wide ownership rules for Schedule I banks acted to prevent new entrants into their industry. The CDIC was another sore spot.¹⁹

While the *Task Force* listened to these arguments, the banks were already formulating their merger proposals. Two events are particularly instructive as to what the banks might have been thinking in the fall of 1997. First, in July, at the request of industry participants, Doug Peters, the Secretary of State for International Financial Institutions, requested a preliminary statement from the *MacKay Task Force* regarding the reform of regulations governing mergers and acquisitions. The major point made by this report was a recommendation that the "big shall not buy big" policy ". . . should not have general application and that any such proposed transactions be reviewed for approval on their merits."²⁰

¹⁸ *Ibid.*, p. 21.

¹⁹ See previous chapter for a discussion of the insurance industries complaints, and their potential political influence in the sector.

²⁰ Price Waterhouse, *Canadian Banks – Analysis of 1997 Results*, p. 3. In fact, the government was sending signals that it felt the same way. Going into the merger process, Jim Peterson, at that time the Chairman of the House of Commons Finance Committee, said that he had no opposition in principle to mergers between banks. See, Stewart, *Bank Heist*, p. 211.

A few months later, on September 26, The Department of Finance released a consultation paper, *Foreign Bank Entry Policy*, in which it laid out its proposals for eased foreign bank access and direct foreign bank branching. Draft legislation on this issue was due in April 1998.²¹ These initiatives were required by commitments made by Canada's trade negotiators. On December 12, the final negotiations on the GATS Agreement on Financial Services were concluded. While the GATS generally promised reduced barriers to foreign banks specifically, Canada had agreed to remove size restrictions on foreign owned Schedule II banks. The Canadian negotiators had also agreed to the creation of some sort of mechanism for direct bank branching for foreign firms wishing to open only smaller operations in Canada.

Those close to the industry felt that this raised the stakes for the policy review process as the banks were worried about increased domestic competition from the larger international banks based in the US, Asia and Europe.²² Indeed there was constant speculation that ING Direct, a subsidiary of the giant Dutch-based bank which had opened up operations in Canada a year earlier, was a sign of things to come. Despite the fact that ING had captured only a small share of the Canadian market while offering favourable rates compared to the banks, many felt that it would provide an example to other foreign banks, particularly those in the US.²³ Though ING was significantly larger than any of the Canadian banks, its Canadian subsidiary operated as a trust company,

²¹ The consultation paper is available on-line at: <http://www.fin.gc.ca/foreign/foreign1-e.html>

²² Stephen Harris, "The Globalization of Finance and the Regulation of the Canadian Financial Services Industry," in G. Bruce Doern et al., *Changing the Rules: Canadian Regulatory Regimes and Institutions*, (University of Toronto Press, 1999), p. 383.

²³ See Sean Silcoff, "No frills. Unbeatable prices. It worked for Wal-Mart. Why can't it work for a bank?" *Canadian Business*, August 1997, Vol. 70, Issue 10, pp. 34-40.

along with the regulatory problems that entailed. The advent of direct foreign bank branching would make it easier for companies like ING to get established in Canada.

IV) The Mergers:

Believing that because of increased international competition, the *MacKay Task Force* would ultimately endorse the idea of mergers between big banks, the Royal Bank and Bank of Montreal hurriedly began negotiations for a merger on December 19. After examining internal company simulations which suggested that the Bank of Montreal (BMO) would be the best partner for his Royal Bank (RBC), John Cleghorn, head of the Royal Bank, went for a short meeting with BMO chairman Matthew Barrett to propose that the two banks should “build a globally-competitive financial institution on a merger of equals.”²⁴

Cleghorn had been trying to remake the image of the Royal Bank. He was notable for his budget consciousness as a bank CEO. Upon taking over RBC, he sold the corporate jet, closed the executive dining room and got rid of the company’s limousines. Flying business class, he traveled to work on Bay Street by subway, despite making millions from the bank. Cleghorn viewed these moves as way to signal an end to the RBC’s stodgy days as a “high-cost” operator.²⁵ His “no frills” economy drive was part of a larger effort to make the bank a more aggressive, risk-taking player in the global financial services industry. For Cleghorn, the merger proposal was simply a continuation of this larger strategy.

²⁴ Anne Kingston, “Stealth Banker,” *ROB Magazine*, April 1998.

²⁵ Harvey Schachter, “Cleghorn and Creative Destruction,” *McGill News Alumni Quarterly*, Summer 1997.

Bank of Montreal head Matthew Barrett cut a somewhat different figure on Bay Street. Having risen from the position of branch teller, Barrett was Canada's most well known banker. Barrett could be relied upon for good quotes as the unofficial "captain" of the Canadian banking industry.²⁶ Barrett was also known to be the most aggressive of the bank heads. In the 1990s he had broken with the anti-competitive traditions of Canadian banking and aggressively tried to lure business away from the other banks, through direct advertising attacks on how they treated their clients. This was not often done in a sector where market shares hardly moved from year to year.

The two chairmen were able to work out a deal quite quickly. In later months, Cleghorn told reporters that he believed that the "planets had lined up" in December of 1997 and that the Government would back his merger proposal.²⁷ Presented with such an unprecedented opportunity to combine forces, Barrett seems to have been unable to refuse a deal. Events unfolded quickly from the early meetings between the chairmen. Five weeks after their evening meeting, on January 23, 1998, Cleghorn and Barrett announced their "merger of equals" between the RBC and BMO to a surprised public. In a joint press conference the two bank chairmen framed the central arguments they would put forward over the next year.

Cleghorn argued that Canadian banks had to respond to the global trend towards conglomeration. Noting that in the three previous years mergers in the US had totaled one trillion dollars, he suggested that "size mattered" in banking circles. The new bank would have \$453 billion in assets. This would make it the tenth largest bank in North

²⁶ The more flamboyant Barrett led a much less budget conscious lifestyle than Cleghorn. Indeed, Barrett's personal life often generated headlines. Reporters covering the merger issue could never seem to avoid mentioning his second marriage to a former model. To many observers, Barrett exemplified the wealth and privilege of the banks.

²⁷ Kingston.

America and the twenty-second largest in the world. Cleghorn argued that it would make it possible for them to compete with their large US competitors and would also make it possible for them to invest in new technologies which would provide their customers with better service and better value.²⁸ The merger might also make the Canadian bank large enough to become a primary organizer of large international syndicated loans, which meant that it would collect extra fees from smaller banks, improving its international position.²⁹

At the merger announcement, Barrett made the bank's key argument supporting mergers in his remarks. He argued that the Canadian financial services market was attractive to foreign competitors. As a result of Canada's previous liberalizations and its recent accession to the WTO agreement on financial services, he argued the banks were facing a "swelling tide of new entrants." The new global "superbanks" identified by Cleghorn, through expansion into the Canadian market, threatened the banks' dominance in key sectors. Carefully noting that the banks accepted the competition, Barrett argued for the need for a strong, world-class "Canadian choice." Indeed Barrett's argument for the merger was simple and provocative: "What we don't plan to be is the corner hardware store, waiting for Home Depot to put us out of business. What we do plan is to give the financial equivalents of Home Depot or Wal-Mart the stiffest competition that we can."³⁰

²⁸ John Cleghorn and Mathew Barrett, "Remarks at the Announcement of the Agreement To a Merger of Equals With the Royal Bank of Canada," Press Release, January 28, 1998, http://www.bmo.com/company_info/speeches/barret/jan2398.html

²⁹ In order to minimize risk, very large international loans are often "syndicated." The largest lead bank makes the loan, but other banks also contribute capital, diversifying the exposure to a failed loan. Smaller banks pay a fee to the largest bank organizing the syndicate for the right to participate. One expert suggested that this was a major motivation behind the merger, as the Canadian banks felt they were losing out on this fee structure because they were smaller than some of the major players in international banking. Source: Confidential Interviews, 2005.

³⁰ Cleghorn and Barrett, "Remarks at the Announcement of the Agreement To a Merger of Equals With the Royal Bank of Canada."

Barrett, like Cleghorn, emphasized that the merger was not simply about entrenching the banks' dominance in the Canadian market; rather, he argued that the new, larger bank would be able to expand its operations internationally, ensuring a strong international presence for Canadian banks. "Like Alcan, Bombardier or Nortel, the new bank will be a Canadian champion abroad. It will have the resources to lead any financial deal large or small."³¹

Cleghorn's comments that day were measured. He would later draw from the more provocative arguments that Barrett provided. Indeed, as opponents to the merger lined up, his arguments became far blunter. Using imagery drawn from warfare, as the bankers were fond of doing, he would refer to the threat of increased competition from the US, and would tell reporters that "We've got to get them in the water before they land on our beach."³² However, reflecting their awareness of public opinion, both bankers' arguments were defensive and nationalistic. The mergers were about protecting the Canadian-owned firms from global competition.

Understandably, given the fact that the industry had not witnessed a merger between two of Canada's big banks in living memory, the merger was big news. The public was shocked and the government seemed to be caught off guard. The news even surprised "Bay Street." While many industry experts and participants had been expecting merger proposals, none thought it would happen so soon. Analysts were surprised not by the banks' desire to merge, but rather by their announced intention to do so prior to the government's approval of the plan.³³ Many assumed that there would have to be a

³¹ Ibid.

³² Kingston.

³³ Kingston.

lengthy dialogue with the government about how a proposed merger would be “handled” prior to any formal announcement.

This seems to have been the prevalent attitude in Ottawa in the hours after Cleghorn and Barrett’s press conference. One official said the news had come “like a bolt from the clear blue sky.”³⁴ According to many sources, Finance Minister Paul Martin was upset by the proposed merger and that the government had not been given more of a “heads-up” on what the banks were doing, and “more importantly he was miffed that the two banks in question jumped the queue on the orderly process of his task-force review.”³⁵ The banks’ plans might affect Martin’s public plans to be Canada’s next Prime Minister. Eager to lure “progressive-liberals” to his leadership campaign it was thought that Martin had been trying to shake his image as a fiscally-conservative supporter of corporate Canada. Given how Canadians felt about the banks, Martin believed that if he accepted the merger, it would only emphasize his perceived problems in any race to replace the prime minister.³⁶

Indeed, Paul Martin’s concerns frame the problems the banks would encounter in the sector after 1997. In the lead up to the merger, the banks were widely known to be highly profitable. At the time of the announced merger both banks were breaking profit records and RBC was the most profitable company in Canada. In 1997 RBC posted a \$1.68 billion profit, while the Bank of Montreal made \$1.31 billion. RBC’s return on shareholder equity was 19.5 percent.³⁷ The public, angered by the proliferation of new service fees and believing that those fees were the basis of the banks’ recent success,

³⁴ Edward Greenspon, “St. Paul among the Philistines,” Report on Business Magazine, March 1998.

³⁵ Ibid.

³⁶ Ibid.

³⁷ Kingston. Returns on equity were often half this size in the global banking industry.

were sceptical that the banks faced impending doom unless they were allowed to merge. Given the public's feelings, any minister that would approve the merger ran the risk of appearing to be too cozy with big business.³⁸

In interviews for this study, officials at the CBA argued that the banks' decision to proceed at that time, and in the way that they did, was poorly thought out. One senior lobbyist, aware of the huge public relations problems the banks had, and the views of many MPs, suggested that he thought that approval for a merger at that time was extremely unlikely.³⁹ Indeed, the CBA was still in the midst of CEO Ray Protti's initiative to improve the banks' relations with MPs. The public relations campaign had been developed in response to the banks' failed efforts to get what they wanted in the 1997 *Bank Act* revisions. The merger proposal would do little to help these efforts.

At a hurriedly organized press conference later in the same day of the banks' announcement, Paul Martin stated that any approval of the merger would have to await a full investigation by both the Competition Bureau and the OSFI as well as the completion of the *MacKay Task Force*; thereby setting the stage for a year long struggle over the merger.

The perceived unpopularity of the RBC/BMO merger was intensified a few months later. Prior to any serious government work on the evaluation of that merger, on April 13, Toronto Dominion (TD) and the Canadian Imperial Bank of Commerce (CIBC) announced similar merger plans. The new bank would have assets worth \$460 billion,

³⁸ Several confidential interviewees have noted that the prime ministerial ambitions of Martin and his successors John Manley and Ralph Goodale are an important consideration in the sector. All three have sought to minimize the appearance of coziness with the banks' public policy demands in light of their own political aspirations. Source: Confidential Interviews, 2005.

³⁹ Source: Confidential Interviews, 2006. One interviewee said he could not believe the banks could be so "dumb" in light of what had been going on over the previous year.

which would have made it the ninth largest bank in North America and the twenty first largest in the world. It would also be slightly larger than the RBC/BMO merged entity. As well, through the merger of their mutual discount brokerage services, TD Green Line Investor Services and CIBC's Investor's Edge, they would become the world's second largest discount brokerage. The second merger proposal only intensified the struggle over the first as, considered jointly, as Martin would insist that they be, the combined proposals would reduce the number of big banks from six to four, with two "super banks" dominating the industry.⁴⁰

While the two banks argued that the move was a response to the same pressures confronting RBC/BMO, many said that they had more "strategic" motives. Experts felt that the approval of two such mergers was unlikely, thus some argued that the second merger was simply a "spoiler" designed to ensure that both mergers were rejected, preventing the RBC/BMO entity from becoming the dominant Canadian bank.⁴¹ Other insiders suggested that the motive for the TD/CIBC merger was more defensive. Either both mergers would be approved and the TD/CIBC marriage would emerge as the largest company, or having raised the stakes, both mergers would be rejected, thereby blocking the surprise proposals from RBC/BMO. TD and CIBC had nothing to lose.⁴²

V) Interpreting the Mergers and the Public Interest:

From April-onwards the arduous process of evaluating the mergers began behind closed doors in Ottawa. Both the Competition Bureau and the OSFI launched detailed

⁴⁰ Source: Confidential Interviews, 2005.

⁴¹ When interviewed, one bank official argued that this was the case. Source: Confidential Interviews, 2006.

⁴² Source: Confidential Interviews, 2005.

examinations. However, outside these processes there was also public evaluation of the mergers. Both in the press and before the various committees and task forces that would examine the issue, the four involved banks, the CBA, and other supporters would argue that the mergers were in the “public interest.” Industry insiders expected that despite the initial unpopularity of the mergers, ultimately they would receive government approval. Cleghorn publicly suggested his complete confidence throughout the review process. In a lengthy interview in the April issue of the *Globe and Mail’s Report on Business*, Cleghorn suggested that the merger was expected to “win government and regulatory approval.”⁴³ Cleghorn was optimistic that the banks’ case for mergers was compelling: “We’re regarded as arrogant and standoffish and not in touch with what Canadians want. If we can get our day in court, we can convince Canadians it’s in their interest in the long run. If we can’t, we don’t deserve it.”⁴⁴

There were factors working in the banks’ favour as well. It was the case that the mergers did seem to jibe with the general deregulatory trajectory of government policy and regulators’ consistent disregard for the “big shall not buy big” policy since the 1980s adoption of the universal banking paradigm. The banks’ arguments that the increased cost of new technologies and the efficiencies that could be gained by economies of scale would put them in a better position to compete globally were often endorsed by the various investigations into the industry. Indeed, the *MacKay Task Force* was largely sympathetic. Furthermore, the banks had a great deal of political influence. Aside from being the dominant players in a crucial economic sector; and therefore, a constituency that any government would be loath to ignore, the banks were quite simply some of

⁴³ Kingston.

⁴⁴ Ibid.

Canada's largest and richest companies. In the past they had always managed to dominate federal policy in the area.

However, recognizing their image problems, the banks made a concerted effort to improve their relationship with elected officials. As noted, in 1997 they developed a strategy to increase their influence with local MPs through the efforts of local branch management. In addition, they made large direct contributions to party finances generally and to the governing Liberals in particular (See Table 3). According to Elections Canada's disclosure of political party contributions for 1997, Canada's major banks accounted for a significant portion of campaign finance as the Liberals received abnormally large donations from major financial service companies (see Table 7.2 below). In fact over the period there was an attempt to obscure this relationship as the banks' securities subsidiaries often made donations that equaled those coming from the much larger parent bank, hiding the size of the banks' political donations to casual observers. Based on factors like these some experts predicted that, despite the political unpopularity of the mergers, they would be approved.⁴⁵

⁴⁵ One provincial official said that after receiving a briefing from Department of Finance staff on the issue, he thought the deals were going to be approved. Source: Confidential Interviews, 2006.

Table 7.2: Financial Service Company Donations to the Liberal Party (1997)

Banks and their leading subsidiaries donated, respectively:

Bank Of Nova Scotia & Scotia McLeod	\$231,672.45
Bank of Montreal & Nesbitt Burns Inc.	\$221,342.22
CIBC & CIBC Wood Gundy Securities	\$198,580.84
Royal Bank & RBC Dominion Securities	\$194,869.58
Toronto-Dominion Bank & TD Securities	\$186,207.71
Banque Nationale du Canada	\$82,102.62
Canadian Bankers Association	\$8,854.81
Canadian Western Bank	\$2,000.00

Other important financial service companies donated, respectively:

BCE Inc.	\$79,006.78
Midland Walwyn	\$78,605.68
Merrill Lynch Canada Inc.	\$54,813.96
First Marathon Securities Limited	\$34,073.03
Montréal Trust	\$34,039.68
Canadian Automobile Dealers Association	\$32,173.13
Power Corporation of Canada	\$31,000.00
Great West Life Assurance Co	\$29,621.40
Manufacturers Life Insurance Company	\$22,606.30
London Life Insurance Company	\$20,116.58
Sun Life Assurance Company of Canada	\$20,000.00
Canada Trustco Mortgage Company	\$12,239.44
Canada Life Assurance Company	\$10,693.58
Crown Life Insurance Company	\$10,000.00
Dominion of Canada General Insurance Co.	\$9,356.30
Credit Union Central of B.C.	\$3,416.90
Credit Union Central of Canada	\$550.00

Dwarfed by the large donations made by Canadian Banks, foreign financial service providers donated, respectively:

AMEX Canada Inc	\$3,785.40
Hong Kong Bank of Canada	\$300.00
Bank of America Canada	\$103.54

Source: Data compiled from Elections Canada, "Registered Political Parties' Fiscal Period Returns for 1997," available at <http://www.elections.ca>

Despite the grounds for optimism, however, the banks faced a serious challenge from the outset. The mergers clearly threatened to upset the policy overhaul of the sector, and perhaps, Paul Martin's plans to become Prime Minister. However, they also posed serious questions of public policy for the government concerning how the industry

should be regulated in the future. Furthermore, the government would have to consider these issues amid considerable public controversy as, from the outset, a large array of organizations and competing firms began to exert pressure, both public and private, on the government to reject the mergers. Small business groups, consumer organizations, the opposition parties in Parliament, provincial governments and many industry participants in the financial services sector all campaigned fiercely against the mergers throughout 1998. Trust companies, competing securities dealers, credit unions, other banks, as well as large and influential financial services companies like Power Corporation, all opposed the mergers. This array of “anti bank” interests ultimately challenged both the style of policymaking in the sector and the paradigmatic assumptions of universal banking.

For example, early in the process the Canadian Centre for Policy Alternatives (CCPA), a prominent think tank, came out against the mergers. On April 30, Murray Dobbin released his analysis of the problems posed by the merger proposals. Noting how the banks suggested that the mergers were essential to their international competitiveness:

Canadians are being told to support these mergers so that “our” banks can be competitive with the big global players, as if they were a Canadian Olympic team. But Canada is a country, not a cheerleader for megabanks, and as such it is made up of many diverse interests. And on balance, most of these interests will be damaged by the mergers.”⁴⁶

The Centre for Policy Alternatives, expressing the fears of a host of societal interests, argued that as a result of inevitable branch closures as the firms integrated their operations for greater efficiency, there would be thousands of job losses, thousands of rural communities would lose competition for their financial services, and millions of

⁴⁶ Murray Dobbin, “Are the bank mergers good for the country?”
<http://www.policyalternatives.ca/bc/opinion12.html>, 21/11/01.

Canadians would be left with fewer options for borrowing. Given the widespread dissatisfaction with increased service charges and record profits for the banks, the CCPA's arguments represented a general feeling that the mergers would really only further privilege the banks, at the expense of almost everyone else.

Perhaps striking the chord that resonated most clearly with the Canadian public, Dobbin also argued:

But beyond these economic and financial consequences, the merger controversy reveals the enormous political arrogance of these behemoths. So confident that their political power is greater than the democratic authority of the Canadian government, they simply pronounce the new reality in the midst of a parliamentary review of banking regulations. This is a deliberate attempt to pre-determine government policy.⁴⁷

The fact that the banks were "jumping the queue" and effectively dictating the agenda of regulatory reform was perceived as manifestly unfair.

The Canadian Community Reinvestment Coalition (CCRC), an "anti-bank" NGO with considerable expertise on the nature of modern banking reached similar conclusions to the CCPA.⁴⁸ The CCRC noted that the two "superbanks" would control over 70 percent of banking assets, a level of concentration higher than in any other G-7 country. "Each bank would be twice as large as the next largest bank in Canada."⁴⁹ More importantly, the CCRC challenged the banks' central claim that foreign banks' intrusion into the Canadian market necessitated mergers. Aside from the continued restrictions that limited the entry of foreign banks into Canada, even after the GATS agreement, the

⁴⁷ Dobbin, "Are the bank mergers good for the country?"

⁴⁸ The CCRC, though a coalition of consumer groups, was run out of the Democracy Watch offices in Ottawa. Headed by Duff Conacher, a long time participant in the sector and critic of the inadequacies of the regulatory system, Conacher and Democracy Watch remain an influential source of critical information on the banks practices and arguments for policy change.

⁴⁹ CCRC, "Ending Power Without Accountability: Making Banks in Canada Better Before They Get Bigger," Summary of CCRC Position Paper #6, May 1998, <http://www.cancrc.org/english/Sumpp6.html>, 6/12/02

cost of opening new branches was still prohibitive. The number of foreign banks doing business in Canada had actually declined since 1987.⁵⁰

While groups like the CCPA and CCRC might almost be expected to oppose bank mergers, opposition also came from business groups like the Canadian Federation of Independent Business (CFIB), led by Catherine Swift. Swift would emerge as a major thorn in the Banks' side during the review process. Indeed CFIB had been persistently appearing before parliamentary committees since the 1980s any time financial services regulation was at issue. CFIB wanted the government to increase the pool of financing available to small businesses. The CFIB questioned the degree to which mergers would only reduce the access of small businesses to a competitive market for financial services, particularly in smaller centres. After evaluating the proposals, the CFIB suggested that it was "imperative" for the interests of small business that parliamentarians block the merger proposals.⁵¹ Political constituencies like the CFIB were much harder for Liberal MPs to ignore. They represented the small business people who often formed the backbone of local riding organizations. The CFIB's efforts to oppose the mergers in 1998 undoubtedly placed pressure on many government MPs to question the merger proposals.

While supporters of the merger proposals saw opponent's arguments as little more than unfair "bank bashing," these arguments raised serious questions of public policy for the government. The anti-competitive impact of the mergers in terms of branch closings and the availability of credit were particularly important considerations and would be addressed in the Competition Bureau's review of the proposals. Indeed, polemics aside,

⁵⁰ CCRC, "Ending Power Without Accountability."

⁵¹ Canadian Federation of Independent Business, "Mega Banks: Issues for All Canadians to Consider on Bank Mergers," <http://www.cfib.ca/research/businfo/min0091.asp>, 6/11/03

the opinion of the financial markets themselves on the super merger proposals was clear. Announcements of mergers initially drove the stock prices of the banks upwards as investors believed that the ensuing increase in market power would allow the new banks to set artificially high prices, not because it made the banks more efficient or globally competitive. Ramon Baltazor and Michael Santos illustrate this through an analysis of patterns in bank share prices through 1998.⁵² Interestingly their analysis also reveals that investors did not perceive a serious threat from foreign penetration in the Canadian market. Baltazor and Santos argue that these findings were consistent with other, similar mergers in which prices inevitably went up.

Some experts on banking also argued that the merger proposals potentially created the conditions for reckless bank behavior. Bob Jenness, a senior research associate at Informetrica Ltd, and former Senior Research Director at the Economic Council of Canada, argued this in a Monthly Economic Review article. Bank profits are closely tied to macroeconomic policy. Low interest rates, provided inflation is also low, produce higher bank profits. There was a risk that the merged banks, with increased power in relation to the government, might force it to adopt inappropriate macro-economic policies in order to shield themselves from the mistakes of “aggressive” overseas lending that globalisation engenders. Rather than being prudent, the banks, secure in their ability to pressure the government to change policies, might also themselves pursue inappropriate business opportunities.⁵³

⁵² See, Ramon Baltazor and Michael Santos, “The Benefits of Banking Mega Mergers: Event Study Evidence from the 1998 Failed Mega Merger Attempts in Canada,” Canadian Journal of Administrative Sciences, 2003, 20(3), pp. 196-208.

⁵³ Bob Jenness, “Current Issues in Canadian Banking”, Monthly Economic Review, Number 3, October 26, 1998.

While the merging banks were the most vocal supporters of the merger proposals, they also received the endorsement of a number of other groups. For example, in the middle of July, the Fraser Institute, the Vancouver-based right of centre think tank, released the results of its survey of senior investment managers' attitudes towards financial sector consolidation. The Institute argued that its results showed that market participants favored accelerated deregulation and the approval of the bank mergers.⁵⁴ The Fraser Institute survey posed the problem for the Finance Minister all too starkly. While people in the financial services sector tended to favour the approval of the mergers, 88 percent of them also rated the Finance Minister as doing a good job in his portfolio.⁵⁵ The crux of the problem was that one of Martin's most carefully cultivated constituencies, the Canadian corporate community, and in particular, financial market heavyweights, wanted the mergers to go ahead. The problem was, the rest of the country did not.

One of the most important figures in the public debates about the mergers was Scotiabank Chairman Peter Godsoe. As the head of the only major bank to not have a merger partner, Godsoe had strong reasons to oppose the proposed mergers; however, the fact that he was the head of a bank also lent his analysis a great deal of credibility. While many felt that the mergers could spell a "death blow" to Scotiabank, which was already perceived as a technologically-challenged weak player amongst the big five banks, Godsoe emerged as a communications nightmare for the merging banks. Constantly speaking against government approval of the mergers, in the view of the other banks, he used deliberately loaded, provocative language to raise public opposition to the merger.

⁵⁴ Fraser Institute, "Bank Mergers Necessary: Investment Managers," Press Release, July 14, 1988.

⁵⁵ Ibid.

Godsoe would speak of the potential “superbanks” as “awesome centres of power” which would make the financial services market “completely anticompetitive;” that the mergers were “absolutely dynamiting our banking system.”⁵⁶

More problematic for its competitors was Scotiabank’s challenge to some of the logic used by the pro-merger banks. Scotiabank, despite being smaller than the other banks, had the most international orientation of the big five. Scotiabank had 20,000 employees outside of Canada.⁵⁷ In a general sense Scotiabank’s criticisms of the mergers might have been the most damaging to the pro-merger lobby. Pro-merger forces could say little in response. BMO’s Barrett, speaking before committee hearings evaluating the mergers, argued that Godsoe was concerned only that the post-merger banks would be more competitive than Scotiabank and therefore threatened its business.⁵⁸ The problem for Barrett and his allies was that this spoke directly to the concerns of many merger opponents: that the result of the mergers would be a reduction of competition in the marketplace. Barrett was saying, “Don’t listen to Scotiabank because the two superbanks are going to squeeze them out as well.” To many, this was exactly the problem with the merger proposals.

Godsoe was lending a great deal of credibility to “bank bashing” populists, and ultimately, undermining the case for mergers. The opposition of small business groups, non-bank financial service providers, and one of the large banks itself buttressed the complaints levied against the banks by consumer groups. Indeed it must be noted that this rare public fracture between the banks over policy in the sector was a crucial aspect in the story. At precisely the same moment that small business groups and NGOs were

⁵⁶ Trevor Cole, “Waiting for Godsoe” Report on Business Magazine, September 1998.

⁵⁷ Ibid.

⁵⁸ Ibid.

trying to gain access to the policy network, the banks were divided. The dispute between Godsoe and his colleagues also weakened the CBA's ability to speak collectively for "the banks," undermining its centrality in the associational system.

In any event, there can be little doubt which side was winning the rhetorical war for public opinion. Most Canadians opposed the mergers. As was illustrated in Chapter Six, the EKOS public opinion survey work done on banking and in the various public consultations occurring throughout 1998, including the BC Government's *Task Force on Bank Mergers* and the *Ianno Task force*, the public felt that the banks were already too powerful, too privileged and were doing a bad job of serving consumer needs.⁵⁹

VI) Evaluating the Mergers – the Public Policy Process:

While the public controversy and debate about the mergers continued into the fall of 1998, in early September the results of the series of government evaluations of the mergers and the *MacKay Task Force Report* were released, and the ensuing parliamentary responses began to appear. On September 14, the *MacKay Task Force* released its report. The report made a host of complex recommendations regarding the future of the industry in Canada. In the short term however, the important point was that, by focusing mainly on the challenges of globalisation, the *Task Force* recommended virtually everything that the banks had been asking for. It endorsed the CBA's recommendation that the "big should not buy big" rule should be abandoned, suggesting that, in theory, the big banks should be allowed to merge. This fit well within the broader thrust of the Report which embraced more rapid deregulation of the industry. The *Task*

⁵⁹ For the *Ianno Task Force* final report. See The National Liberal Caucus Task Force on the Future of the Financial Services Sector, *A Balance of Interests – Access and Fairness for Canadians in the 21st Century*, November 1998. <http://sen.parl.gc.ca/sjoyal/e/features/caucus.html>

Force also supported the CBA's demands that financial services companies should be allowed to offer a full range of services, recommending that the banks should be allowed to provide automobile leasing and insurance, lucrative sectors from which they were still excluded.⁶⁰ The report was a major victory for the banks.⁶¹

Subsequent "interpretation" of the Report focused on these aspects. TD Bank Financial Group Chairman and CEO, A. Charles Baillie, applauded the conclusions of the *MacKay Task Force*. "In particular, we applaud their recommendation that the "big shall not buy big" policy be dropped, allowing for mergers among large institutions. The recommendation on mergers is one in which all Canadians can have confidence as the Task Force membership represents constituencies as diverse as Canada itself."⁶² Arguing that it would take as long as three years for TD and CIBC to fully integrate their operations, Baillie emphasized that the *Task Force* report, by highlighting speed of change occurring in the sector, supported the need for a quick approval of the merger proposals. Baillie also thanked the *Task Force* for supporting the banks argument that that they should be allowed to offer their consumers automobile leasing and insurance.

On September 29, in its submission to the Senate Standing Senate Committee on Banking, Trade and Commerce, *Preliminary Response to the MacKay Task Force*, the CBA also formally endorsed the *MacKay* proposals and the general deregulatory spirit of the report. They supported the *Task Force's* notion that all federally-regulated financial

⁶⁰ Canadian Bankers Association, "CBA's Preliminary Response to the MacKay Task Force Report – Submitted to the Standing Senate Committee on Banking Trade and Commerce," http://www.cba.ca/eng/CBA_on_the_Issues/Submissions/980929-a.htm

⁶¹ See Roberge, p. 123 for discussion. The *MacKay Task Force* Report focused mainly on the problems of increasing global competitiveness and domestic competition. These topics of concern tended to favour the banks' agenda at the expense of the concerns being forwarded by small business and consumer groups.

⁶² "TD Bank Applauds MacKay Task Force Recommendation on Mergers, Says Decision Needed Sooner Not Later," TD Press Release, September 16, 1998.

institutions should be able, via a holding company model, to offer wider ranges of services through the creation or purchase of subsidiaries. They also supported the *Task Force's* recommendation for more competition in the automobile leasing sector.

Not surprisingly, given the position of Scotiabank the CBA made little mention of mergers and the *MacKay* recommendation of an end to the “big shall not buy big” rule. Instead they noted that “. . . there is a divergence of views within our membership on how the financial services sector should evolve, and we trust that the Committee will hear from our members on the matter.”⁶³ Raymond Protti, the head of the CBA would joke of his position on the mergers in his public comments after the *Mackay Report* that:

Harold MacKay . . . said of the mergers that his report provides a flashing yellow light. Matthew Barrett, Chairman of the Bank of Montreal . . . suggested that the MacKay report provides a green light for mergers. Peter Godsoe, CEO of Scotiabank . . . said of the mergers that whatever the *MacKay* report says, the mergers deserve a red light. Well, I happen to work for both Messrs. Barrett and Godsoe . . . I've told them and I'm telling you – I'm colour blind!⁶⁴

In a speech to the C.D. Howe Institute in early October, TD's Baillie outlined his views on the choice presented by the *MacKay Task force*. Arguing that the *Task Force* presented a “balanced approach, with no clear winners or losers” he suggested that it laid out two possible trajectories for the Canadian financial services sector, one in which Canada would be “at the table” as a major financial centre and one in which Canada would be excluded from the table and instead face the prospect of seeing its domestic financial services companies “dwindle” in the face of foreign competition. The path to the first option was simple for Baillie, let the mergers go ahead. This would ensure that

⁶³ Canadian Bankers Association, “CBA's Preliminary Response to the MacKay Task Force Report”

⁶⁴ Canadian Bankers Association Speeches, “The MacKay Report and Beyond,
http://www.cba.ca/eng/media_Centre/Speeches/981119-a.htm

Canadian financial companies had the kind of customer base necessary to invest in the new technologies required to compete with the emerging US superbanks. It would also “. . . cement Toronto as a thriving financial centre with banks that are sufficiently large not to be take-over targets.”⁶⁵ For Baillie this was a crucial rebuttal to the concept that mergers would lead to massive job losses, as he argued that “Canadian ownership of global concerns means, ultimately, keeping more jobs in Canada.”⁶⁶ According to Baillie, the alternative was to reject the mergers and embrace a “catastrophic” decline of the Canadian financial services industry.

The arguments that Baillie and the other bank chairman were making in support of the mergers received a second, more lukewarm, endorsement in early October. Although of a much lower profile than the *MacKay Report*, the Senate Standing Committee on Banking, Trade and Commerce released a report on its Comparative Study of Financial Regulatory Regimes. The report, which summarized what the committee had been told in its investigation of the regulation of financial services markets in the US, Australia and New Zealand, had attempted to directly assess whether “bigger was better” in the industry. While the committee concluded that there was little evidence to support the claim that the global success of banks required that they be big domestically, they did emphasize that industry leaders in other countries had told them that “medium sized” firms were likely to face “difficult and growing problems in obtaining operational

⁶⁵ A. Charles Baillie, “Why Bank Mergers are in the National Interest,” TD Financial Group Speeches, <http://www.td.com/communicate/speeches/14oct98.htm>

⁶⁶ Ibid. Several studies had come out since the merger announcements that suggested that one major effect of the pacts would be major job losses. See for example, Stephen McBride, “The Employment Impact of the Proposed Bank Mergers,” Report prepared for the British Columbia Task Force on the Bank Mergers, (September, 1998).

efficiencies” in the future.⁶⁷ Also, they noted in their findings that a large domestic bank was essential to the success of a country’s multinational corporations: “having a domestic bank that is a global player may ensure a reliable source of capital on a large scale for multinational companies based in Canada.”⁶⁸ While the Senate’s study made little impact in the public’s consciousness it was illustrative of the fact that outside of the public glare, the Senate Committee, which would conduct hearings and release a report in response to the *MacKay Task force* as the first step towards new legislation, was relatively sympathetic to the banks’ agenda.

Opposition in the House of Commons:

Despite these important endorsements of the banks’ policy demands, opinion was moving a different direction in the House of Commons. On November 4, Tony Ianno, a backbench Liberal MP from Ontario who was particularly concerned with the problems small business faced in dealing with the banks, released his own “Task Force” report on the mergers.⁶⁹ The “Ianno Report” was drawn up by an *ad hoc* parliamentary committee that conducted its own hearings on the merger proposals when it became apparent that the Commons Finance Committee was not going to do so.⁷⁰ The hearings, seen as a kind of unfair show trial by the banks, focused on submissions from groups like the Canadian Federation of Independent Business. The final report was signed by fifty Liberal MPs and four Senators. It recommended that the Finance Minister reject the mergers. The

⁶⁷ Canada, Senate, Standing Senate Committee on Banking, Trade and Commerce, Comparative Study of Financial Regulatory Regimes, (1998), <http://www.parl.gc.ca/36/1parlbus/commbus/senate/com-e/rep-e/report15-cov-e.htm>

⁶⁸ Ibid.

⁶⁹ The National Liberal Caucus Task Force on the Future of the Financial Services Sector, A Balance of Interests.

⁷⁰ It has been suggested that Jim Peterson, at that time the Chairman of the House of Commons Finance Committee, was supportive of the merger proposals. Source: Confidential Interviews, 2006.

report was careful to suggest that its recommendations were not “bank bashing.” “There is persuasive evidence that the proposed mergers would be likely to have very adverse consequences for the Canadian public interests.”⁷¹ Ianno and his colleagues concluded that the mergers would lead to large scale job losses, branch closures, reduce consumer choice while driving banking costs up, and make it harder for small business to get financing. Furthermore, Ianno told the press that the banks had “. . . never presented a clearly defined and persuasively documented a case as Canadians were reasonably entitled to expect,” in support of their merger plans.⁷²

The Report did not stop its analysis with the merger issue, it also touched on a number of other bank regulatory concerns which had been popular in Parliament for some time. Jumping ahead of the formal legislative response to the *MacKay* recommendations, Ianno and his fellow MPs also recommended that Paul Martin should also:

- Say “no” to letting the banks sell insurance out of their branches
- Say “no” to letting banks provide auto leases
- Place limits on branch closures
- Encourage the banks to increase lending to small business
- Encourage more foreign competition in the Canadian market⁷³

⁷¹ Les Whittington and Laura Eggerston, “Liberal Caucus Says No To Piggy Bank Mergers: Ball In Paul Martin’s Court,” *Toronto Star* Ottawa Bureau, <http://www.flipside.org/vol1/nov98/n98w1013.htm>

⁷² Ibid.

⁷³ It is interesting to note that “Bill C-8,” the subsequent legislation in response to the review conducted by the *MacKay Task Force*, endorsed almost all of the Ianno Report’s recommendations, and broke with the *MacKay* recommendations on a number of important items, such as allowing the banks to sell insurance. See Chapter Eight.

Ianno's report generated a great deal of public interest as it was very unusual for a committee of government backbenchers to put this kind of public pressure on the government. MPs were very frustrated with their exclusion from policymaking and were attempting to insert themselves more directly.⁷⁴

The response from the banks was hostile. David Moorcroft, vice president of the Royal Bank, playing the nationalism card, as the banks were increasingly fond of doing, argued that saying "no" to mergers, but "yes" to foreign banks setting up their own branches in Canada gave foreign banks an advantage: "I would imagine today in Boston and Delaware and San Francisco there are smiling faces and parties being held. Because they will be able to expand and grow in our country. We're not being given the same right to grow and expand and take them on as competitors."⁷⁵ CIBC president Holger Kluge was more measured, saying that Ianno's report was only one of several government reports that Paul Martin would have to take into consideration, "We've had one report which is the *MacKay Taskforce* report indicating mergers is a legitimate banking strategy and we've had one report now saying no. So I believe it's one-one."⁷⁶

The CBA, given the split in its ranks over the mergers, limited its analysis to the non-merger related items in the Ianno Report. The CBA argued that unlike the *MacKay Report* which had suggested movement to more competition and choice in financial services, as illustrated by their support for allowing the banks to get into the automobile leasing business, "This report seems to favor on-going protection of special interests."⁷⁷

⁷⁴ Source: Confidential Interviews, 2005. Indeed, Ianno was clearly working with considerable backing inside the Liberal caucus. Despite his actions, he subsequently became a minister in Martin's first cabinet.

⁷⁵ Quoted from "Merger Mania," CBC, <http://www.cbc.ca/national/pgminfo/banks2/update.html>

⁷⁶ Ibid.

⁷⁷ Whittington and Eggerston.

The banks were not alone in this view as other network participants appear to have resented the Ianno Task Force's intrusion into the sector on behalf of these other industry interests.⁷⁸

Others in the financial industry, most importantly, insurance brokers and automobile dealers applauded the report. Richard Gauthier, president of the Canadian Automobile Dealers Association labeled it, "a victory for Main Street over Bay Street."⁷⁹ Indeed, the response by those opposed to the mergers was celebratory. The Council of Canadians argued that the banks had been given the opportunity in the Ianno hearings to justify why the mergers were necessary and that they had failed to do that. Peter Bleyer, the Executive Director argued that "The whole discussion about bank mergers is – or should be – a non starter. The real discussion that needs to take place is about how to make banks more accountable to the public through better regulation. The banks hijacked that discussion earlier this year when they announced their proposed mergers."⁸⁰

More importantly, the report emphasized the political problems posed by the mergers. For example, even the opposition Reform Party, aware of the public's anti-merger sentiments, which Ianno had tapped into, began to suggest a "middle way" strategy. Ironically Reform's stance was the one the government would eventually embrace. Reform Party critic Dick Harris, uncomfortable with the anti-business overtones of the report, suggested that the government should simply place a moratorium on the mergers until there was a policy process in place to deal with the them.⁸¹ The immediate problem for the government was even more pronounced. Regardless of what

⁷⁸ For example, an OSFI official referred to Ianno as a "blockhead" who did not understand modern banking. Source: Confidential Interviews, 2006.

⁷⁹ Whittington and Eggerston.

⁸⁰ Council of Canadians, <http://www.canadians.org/campaigns/campaigns-bankmedia06.html>.

⁸¹ Whittington and Eggerston.

happened in either of the parliamentary committees that were reviewing the *MacKay* recommendations, or at OSFI and the Competition Bureau, one third of the government's sitting members had signed a report calling for a rejection of the mergers. This could only increase Paul Martin's discomfort over the issue. Regardless of how he might personally feel about the banks' proposals, it was becoming politically impossible to endorse them, even if he wanted to.⁸² Lorne Nystrom, the NDP finance critic concluded at the time simply that "The mergers are dead."⁸³

In effect, the *ad hoc* Ianno committee had expanded parliamentary oversight of the sector. MPs had directly reviewed the merger proposals and rejected them. This was a privilege which Parliament had legally surrendered in the 1910 *Bank Act*. Before 1910 it required an act of Parliament for two banks to merge. After, it was up to the Minister of Finance.⁸⁴ Having removed Parliament from the process, after 1910, the number of banks dwindled. The events of 1998 reflected a re-assertion of Parliament's direct role in regulating levels of competition in the sector. Of course, legally, Paul Martin could have ignored the Ianno Report since no vote was required in the House to approve the mergers, and therefore Ianno and his 50 members were not needed, but in practice this was politically risky, particularly for someone who wanted to become Prime Minister. Indeed in response to the unpopularity of the mergers earlier in the summer, Martin tried to orchestrate an informal deal that would reduce opposition, a strategy that had worked in

⁸² Martin declined to be interviewed for this study. As already mentioned, many suggest that he was personally hostile to the mergers, and to the banks, given his relationship with the Desmarais family's Power Corporation and his previous experiences with the banks. Others, both publicly and in the confidential interviews for this study suggest he was privately supportive of the mergers had they not been so politically unpopular. In the end, the Ianno report may have made his own attitude a moot point. If Martin wanted to be Prime Minister he could not approve the mergers.

⁸³ Quoted from Whittington and Eggerston.

⁸⁴ James Darroch, "Global Competitiveness and Public Policy: The Case of the Canadian Multinational Banks," *Business History*, 34:3 (July 1992), p. 157.

the past when Parliament had been hostile to the banks. In private meetings with consumer and small business groups, Martin asked if they would consider changing their position on mergers if he put in place a temporary guarantee against branch closings and moved to regulate service fees.⁸⁵ The anti-bank constituencies rejected the overtures.

Meanwhile, the banks' public relations problems continued. While stock prices slumped in late 1998, the banks continued to produce record profits. On November 20, the RBC announced a 9 percent increase in earnings over the previous year as total profits reached \$1.8 billion for the 1998 fiscal year.⁸⁶ TD also announced another record year of profitability. Despite the inherent bad publicity of these kinds of numbers, the banks continued to argue that their mergers were necessary to stave off increased foreign competition.

In response to the public's hostility, a week earlier the banks had launched a new public relations campaign. RBC and BMO released a collection of "promises" to the public and to their customers if the merger were allowed to go ahead. They promised that the new bank would cut service charges by ten percent, loan \$40 billion to small business, double the current level, have more staffed branches, and not close branches in small towns.⁸⁷ As part of this campaign, Matthew Barrett promised that the new RBC/BMO Bank would open a separate small business bank at some time in the future. However a sceptical press corps noted that this seemed little more than a "flavour of the week" as Barrett never offered any serious proposal as to how this would be done. While the effectiveness of this belated public relations campaign might be set to one side, what could not be ignored was that it would ultimately be precisely these kind of issues, the

⁸⁵ Source: Confidential Interviews, 2005.

⁸⁶ "Merger Mania," CBC, <http://www.cbc.ca/national/pgminfo/banks2/update.html>

⁸⁷ Ibid. Matthew Barrett emerged as the major spokesperson for the banks' new public relations campaign.

probable effect of branch closing and reduced competition in the market that were being exhaustively analyzed by the Competition Bureau through the summer and fall of 1998, which would decide the outcome.

In anticipation of the public release of the OSFI and Competition Bureau reports, which would theoretically determine the outcome of the banks' merger proposals, on December 4 the Council of Canadians launched a "National Week of Action in Opposition to Bank Mergers." This ended the almost year-long lobbying process in which business groups like the Canadian Federation of Independent Business, citizens' organizations like the Council of Canadians, and industry lobbies like the CBA had all dutifully reported before hearings to voice their position on the mergers and other contentions issues. Throughout the fall while the banks had been dealing with the Competition Bureau and OSFI investigations of their proposed mergers, both the Standing Senate Committee on Banking Trade and Commerce, and the Commons Standing Committee on Finance had conducted hearings in response to the findings of the *MacKay Report*. None of these inquiries, with the exception of the Ianno Task Force, was designed to directly address the specific merger proposals. They were part of the larger on-going policy review triggered by the *MacKay Task Force*. However, all served as *ad hoc* forums in which proponents and opponents of the mergers made their cases. As such, the two parliamentary committees became venues in which the two sides tried to convince the committee to recommend acceptance or rejection of the mergers in the hopes of pressuring Paul Martin in his final decision. Parliament was emerging as the centre of policymaking in the sector in a way that simply had not occurred in the past.

In December, during the Council of Canadians “National Week of Action” both parliamentary committees released their reports.⁸⁸ In the end, both reports were careful to support the idea that mergers could be allowed in theory, but that these specific proposals could not be judged prior to the release of the Competition Bureau and OSFI reports. However, the Commons Committee argued that while mergers could be allowed, there should be a clearer process in place for evaluating their impact before government approval was granted. In effect, the position of the Commons Finance Committee was that while they had no opposition in principle to proposals for mergers they wanted a regularized system by which they would be given a role in evaluating the proposals.⁸⁹ However, all four opposition parties released dissenting opinions in the report, much of which expressed opposition to the mergers and support for new regulations of bank practices.

The Regulators’ Reports:

Within days of the Parliamentary Committee Reports, on December 10, the OSFI report to Paul Martin was publicly released. The OSFI report concluded that there were reasons to be concerned about the impact of the mergers for the Canadian financial market. Given its historically-limited mandate, OSFI had been instructed by Martin to investigate two prudential questions regarding the mergers:

- 1) If the merger proposal were to be allowed, would there be any adverse impact on the financial viability, safety, and soundness of either merged bank?

⁸⁸ Canada, Standing Committee on Finance, The Future Starts Now – A Study on the Financial Services Sector in Canada, December 1998, and Canada, Standing Senate Committee on Banking Trade and Commerce, A Blueprint for Change – Response to the Report of the Task Force on the Future of the Canadian Financial Services Sector, December 1998.

⁸⁹ It should also be noted that when they limited their analysis to this point they were already aware that the Competition Bureau was going to reject these mergers. Source: Confidential Interviews, 2006.

- 2) If the merger proposals were to be allowed and one of the merged banks was to experience serious financial problems, would it be harder to deal with the problem than if the banks had not merged?

In order to assess the impact of the mergers, OSFI combined an analysis of the current financial situation and risk profiles of the banks with the existing literature on the likely effects of mergers.⁹⁰ They also consulted with other national regulators with merger experience. OSFI's investigation was limited by the fact that there was little evidence of past experience with such "mergers of equals" either in Canada or internationally. It also only took into consideration the merger proposals as they were currently structured and did not consider possible modifications. Lastly, OSFI argued that it was difficult to judge the level of risk engendered by the mergers until the process of merging actually began, as many of the risks of mergers would arise out of the process itself.

Despite these qualifications, OSFI concluded that it was unable to find prudential reasons why the Finance Minister should not consider the mergers. It was not clear as to whether the merged banks would be more or less "sound" than their predecessors. It should be remembered, however, that OSFI had always seemed to subscribe to the view that "bigger was better" when it came to the safety of an institution.

On the second question, whether the mergers would make it more difficult to deal with a possible failure of one of the new banks, OSFI reached the obvious conclusion that it would. Their report noted that all the same mechanisms would exist for assisting a bank facing a collapse, ". . . but, given the relative size of the institution in relation to

⁹⁰ Office of the Superintendent of Financial Institutions, Proposed Mergers between the Royal Bank of Canada and the Bank of Montreal, and the Canadian Imperial Bank of Commerce and the Toronto-Dominion Bank - Report to the Minister of Finance, December 10, 1998.

potential buyers and investors . . . a “least cost” resolution may be more difficult to achieve.”⁹¹ Essentially, OSFI said that the banks were not likely to run into more serious threats of problems as a result of the mergers, but that if they did, it would be harder for the government to manage the process of rescuing the bank. OSFI hinted that such rescues would inevitably involve further difficult public policy questions as it was likely that only some sort of international partner would have the ability to buy out a troubled Canadian post-merger “superbank.”⁹² OSFI was careful to say that those kind of “downstream” concerns were for the Minister to worry about, suggesting that ultimately, the “prudential” concerns of OSFI were secondary to the policy concerns of the Minister.

The following day the Competition Bureau’s report to Paul Martin was released to the public. The Competition Bureau was not normally part of the financial services policy network. Previously it had not been called on to investigate competitive concerns, such as during the dissolution of the troubled trust companies earlier in the decade. The Bureau is part of the Department of Industry Canada and is headed by a Commissioner of Competition. The Bureau is guided by the overarching assumption that competition is inherently good for both consumers and for the Canadian economy. As such, the mandate of the Bureau is to prevent business from combining or otherwise acting in a way that limits competition and thereby creates economic inefficiency. This involves both the ongoing oversight of business practices in some industries as well as detailed investigations into proposed mergers. In carrying out its mandate the Bureau enforces the rules of the Federal *Competition Act*. In the case of the bank mergers, the bureau was also guided by a set of *Merger Enforcement Guidelines* which lay out specifically how it

⁹¹ Ibid.

⁹² Ibid.

should evaluate the likely effects of a large merger on levels of competition.

Furthermore, the Bureau is guided by sector-specific legislation, like the *Bank Act* in the case of mergers or anti-competitive practices involving banks.

Under the existing legislation, if the Commissioner found that there were problems with a proposed merger, the Bureau had the authority to demand remedies through a competition tribunal. Essentially they could inhibit the merger or demand changes to the merger proposals to limit their effects on competition. However, in the case of a merger between entities regulated by the *Bank Act*, the process was more immediately political. In the case of a merger between two or more of the banks, the merger requires the ultimate approval of the Minister of Finance. Indeed, the Minister has authority under Section 94 of the *Competition Act* to set aside the normal process if they had ruled in favour of a merger between banks. Furthermore, neither the *Bank Act*, nor the *Competition Act*, spells out how the Commissioner and the Finance Minister should interact in evaluating a bank merger. Thus, while the Competition Bureau was required to evaluate the proposed mergers between Canada's largest banks, it was not straightforward what role its investigation would play in approving or disallowing such mergers.⁹³ In fact, the Martin chose to view the Competition Bureau's investigation of the mergers as a recommendation, which he had to weigh in making his final decision.

At the time, the Commissioner of the Competition Bureau was Konrad von Finckenstein. A veteran civil servant, von Finckenstein had faced a number of difficult tasks since taking charge of the Bureau in 1997. Globalisation and technological change had fostered an environment of increasing economic concentration, and the Competition

⁹³ See Competition Bureau, "The Merger Enforcement Guidelines as Applied to a Bank Merger," Competition Bureau, January 2003, pp. 42-43.

Bureau had been forced to make increasingly difficult decisions regarding mergers between firms in economically important and politically sensitive sectors like air transport and banking.

After its investigation, the Bureau argued that the mergers would undermine competition. According to von Finckenstein, the review of the mergers had taken so long because of their complexity as they were the largest ever considered by the Bureau, and because of the timing of the *MacKay Task Force Report*.⁹⁴ Indeed, the investigation was substantially different from the one conducted by OSFI. The Competition Bureau was not limited to considering the viability of the merged financial institutions or the risks that they might pose to the solvency of the Canadian financial services industry. Rather, the Competition Bureau's task was to evaluate whether or not the mergers would reduce competition for consumers of bank services. While this would seem to imply that the Bureau would pose a harder test for the mergers than OSFI, the *Competition Act* outlined that in cases where the resulting efficiencies of a merger outweighed declines in competition, the Bureau could allow a merger to proceed.⁹⁵

The Competition Bureau's investigation, which was based on a well-established set of measures for industry competitiveness, led the Bureau to the conclusion that if the two mergers went ahead at the same time, and it was impossible to judge the competitive impact of one without considering the impact of the other, this would result in a "substantial" reduction of competition "... that would cause higher prices and lower

⁹⁴ Konrad von Finckenstein, Competition Bureau, December 11, 1998, <http://www.competitionbureau.gc.ca>

⁹⁵ Ibid.

levels of service and choice for several key banking services in Canada.”⁹⁶ In particular, the Bureau argued that competition for basic banking services would be drastically affected. Given the legacy of de-pillarization, securities dealing and the credit card business would also see reduced competition. While the Bureau’s report conceded that technological change did increase the possibility for further competition to the banks and more choices for consumers in the future, “these are unlikely to mitigate the anti-competitive impact of the merger in the next two years.”⁹⁷ In fact, one of the most important conclusions reached by the Bureau was that in the wake of the mergers, it was not clear there would be any effective competition remaining to the two superbanks. They noted many of the new entrants in the market were extremely small. ING Direct was often cited as the principle threat to the big banks’ competitiveness in a global market. However, despite offering very favourable terms to customers, ING had only managed to capture 0.2% of total consumer deposits in the 15 months prior to the report.⁹⁸

More ominously, the Bureau questioned how the remaining smaller banks and credit unions would be able to compete. Noting the cost efficiencies of the new superbanks, the Bureau suggested that even the Bank of Nova Scotia, which was huge in relation to most smaller institutions, but would be less than half the size of either merged bank, would be “. . . at a significant cost disadvantage and would not be able to compete

⁹⁶ Ibid. Some insiders suggested that this was in fact a “soft” way of presenting the situation. The suggestion is that one merger may have been “legal,” but both mergers considered jointly simply could not pass the regulations the Competition Bureau was mandated to enforce. It is an interesting “what if?” to suggest that had the mergers been judged individually in the “first in, first out” order they were submitted, the RBC/BMO merger might have been approved and the TD/CIBC merger rejected. Source: Confidential Interviews, 2005. These arguments however, underplay the degree to which the Minister can influence Competition Bureau rulings. Others said simply, if the Finance Minister had wanted the mergers approved the Bureau’s report would have approved them.

⁹⁷ von Finkenstein..

⁹⁸ Ibid.

effectively unless it also merged with another major bank.”⁹⁹ In short, the Bureau confirmed what analysts and pundits in the financial services industry had been saying about the heads of those financial institutions that opposed the mergers; that they were “dead men walking.” It confirmed some of the worst fears of merger opponents, that rather than ending up with two super banks and a host of smaller traditional and new competitors, Canada might end up with only two big banks.

The report challenged the findings of the *MacKay Report*. In response to the *Mackay Task Force’s* recommendations to increase competition in banking, von Finckenstein suggested that the new competitors who MacKay assumed would challenge the domination of the big banks in Canada would not arrive soon enough to mitigate the effects of these mergers.¹⁰⁰ Essentially the Bureau agreed with *MacKay* in theory, but argued that it was too soon to allow this kind of concentration. The Bureau’s findings were a major defeat for the banks.

VII) The Merger Decision

On December 14, Paul Martin announced to the public that given the reports that he had received, it was not possible for the proposed mergers to go forward at that time. The banks had known that this would be the case for several weeks. While the public had waited for the release of the various reports to emerge one by one, on November 29, RBC Chairman John Cleghorn was invited to a private breakfast at Paul Martin’s home in Montreal to discuss the mergers. Martin told Cleghorn that the mergers were going to be

⁹⁹ Ibid.

¹⁰⁰ Ibid. In its analysis, the Competition Bureau was limited to examining the effects of mergers on market competitiveness over a two-year time frame. This short horizon meant that they simply could not consider the longer term impact of changing technology.

rejected. Cleghorn had expected that even if the government rejected the mergers that there would be some sort of process left open by which they could alter the proposals for further consideration.¹⁰¹ This would not be the case. In the short term, the mergers between RBC/BMO and CIBC/TD were rejected. Martin had decided that the mergers were unacceptable at that time, and instead would have to await a lengthy legislative overhaul of Canada's banking regulations which was due in response to the *MacKay* Report. Martin promised that that overhaul would include new guidelines to govern the process for evaluating large mergers in the banking sector.

The press labeled the decision a “resounding defeat” for the banks. Indeed the banks made this clear in their reaction to the decision. One particular sore point was that the Competition Bureau had not allowed them to alter their proposed mergers for further consideration. Konrad von Finckenstein had publicly declared that the banks would have to wait until the Competition Bureau’s final ruling before discussing alterations to their proposals. However, when the Bureau released its report, von Finckenstein suggested that the banks could have thought about altering the proposals, but that they never did so.¹⁰² The banks viewed von Finckenstein’s actions as a “clean kill,” an attempt to ensure that Paul Martin, under pressure from his own caucus, would have the ammunition he needed to reject the merger; however, they were unwilling to dispute in public the way the merger proposals were handled by the Bureau since they were likely to have new

¹⁰¹ *Maclean's*, “Bitterness on Bay Street,” Dec 28, 1998, Vol. 111, Issue 52, pp. 70-74.

¹⁰² *Ibid.*

proposals before it again in the not too distant future.¹⁰³ The CBA remains upset to this day that the banks were not given a chance to alter their proposal, and date this as one of the best examples of the encroaching politicisation of the sector.¹⁰⁴

In fact, the Bureau found, based on their detailed geographic analysis of local branches, that there would have to be a series of requirements imposed upon the banks in order to limit decreases in local competition. Hypothetically, had the Competition Bureau process allowed the banks to modify their proposals in response to anti-competitive concerns, they might have agreed to divest themselves of product lines or branches in areas where industry concentration would become too high. For example, they might agree to sell some branches to competitors in rural areas prior to their merging into a single institution in order to ensure that small town Canadians still had a choice in basic banking services. However, such a compromise would undermine the efficiencies generated by the mergers. This thereby eliminated the only exception to the bureau mandate to reject mergers which reduced competition: that if they increased “efficiency” they might be accepted. In any event, the banks were not given the choice to do so.

Behind the scenes, Canada’s big banks were outraged. Bank heads complained privately to reporters that there had been too much parliamentary interference in reviewing their merger proposals. While some suggested doom for Canada’s banks and

¹⁰³ Ibid. Many question the degree to which the minister responsible for the sector is able to determine the outcome of the Competition Bureau investigation. In the 1999 Air Canada acquisition of Canadian Airlines, Konrad von Finckenstein, despite his own public comments criticizing the lack of competitiveness in the airline industry, approved the merger of the two airlines under political pressure from transport minister David Collenette. Analysts noted that the difference in the two cases, despite the perceived independence of the Competition Bureau, really seemed to turn on the attitude of the Minister: “In the bank case, Finance Minister Paul Martin showed no enthusiasm for the merger plans of four of the Big Five players. As if on cue, the Competition Bureau found the deals anticompetitive. While this may have been the case, the banks were given no opportunity to eliminate the anticompetitive elements. What Martin wanted, Martin got.” See, Eric Reguly, “The Missing Invisible Hand,” *Time Canada*, 05/21/2001, Vol. 157, Issue 20, p. 40.

¹⁰⁴ Source: Confidential Interviews, 2006.

that they were unlikely to survive in the future, others were even more strident. One senior banker told a reporter that the decision was like “living in Indonesia,” that by rejecting the mergers, the Canadian government was “headed for dictatorship.”¹⁰⁵ Rhetoric aside, the process certainly did not resemble the esoteric politics of a decade earlier.

In fact, bank lobbyists complained that in Martin’s announcement of the “no” decision to the House of Commons, his speech about the future of the sector drew far more from the language and analysis of the Ianno Report than the *MacKay Task Force*. For example, Martin suggested that the mergers had the potential to create an “unacceptable concentration of power,” terminology which resonated with anti-bank groups and the public, but which did not appear anywhere in the official reports and investigations of the mergers.¹⁰⁶ The concern for the industry was that if the Ianno recommendations framed the subsequent legislative response to the *MacKay Report*, then the banks may have lost more than just the right to go ahead with their mergers in 1998.

Opponents of the mergers, on the other hand, were quick to celebrate Martin’s decision. Canadian Federation of Independent Business’s Catherine Swift called Martin’s announcement a defeat for the banks but a victory for small business.¹⁰⁷ The Council of Canadians was also quick to call the rejection of the mergers a victory. However, Peter Bleyer, the Council’s Executive Director, also worried that the rejection of the mergers provided the banks with a justification for a program of branch closings and service reductions. Bleyer argued that the banks, by hijacking the policy review process over bank regulation and turning it into a narrow debate over mergers, had laid

¹⁰⁵ Kimberley Noble, “Bitterness on Bay Street,” *Macleans*, Vol 111, Issue 52, Dec 28, 1998, p. 70.

¹⁰⁶ Source: Confidential Interviews, 2006.

¹⁰⁷ <http://www.cfib.ca/nomergers/info/5039.asp>

the groundwork for them to be able to blame service reductions on increased competition and their inability to use mergers to respond to that challenge.¹⁰⁸ Indeed there seemed to be a consensus on Bay Street that with the rejection of the mergers, the banks would aggressively pursue other strategies to increase competitiveness, through cost-cutting measures such as vastly reducing the number of existing branches. Bleyer also argued that Canadians needed to worry about the long term as well: “The Finance Minister’s decision today leaves open the possibility that he intends to pursue further deregulation of the financial services sector.”¹⁰⁹ Bleyer, like many of the other opponents of the mergers worried that the decision was only a temporary setback in the government’s steady progression towards allowing further pro-bank industry concentration and deregulation.

The government’s statements clearly indicated an intention to increase the level of competition for banking services as soon as possible. Most importantly, Martin had promised to table legislation as soon as February 1999 that would make it easier for foreign banks to expand their branch banking operations in Canada: “Under the proposed changes, a foreign bank could establish branches in Canada without establishing a Canadian subsidiary.”¹¹⁰ The government was also considering giving credit unions the option of forming co-operative banks and making other regulatory changes that would make them more “dynamic” and “competitive.”

Bleyer may have been correct: the government’s response to the mergers was not entirely clear-cut. When Paul Martin informed the banks that their mergers could not go ahead as proposed at that time, he argued there was no policy to reject the principle that

¹⁰⁸ Council of Canadians, “Rejection of Bank Mergers a Victory, But Banks’ Earlier Threats a Serious Worry,” <http://www.canadians.org/campaigns/campaigns-bankmedia11.html>

¹⁰⁹ Ibid.

¹¹⁰ MacLean’s, “Bitterness on Bay Street,” pp. 70-74.

the banks could merge; rather, the government intended to design a more transparent process for evaluating mergers pending the creation of a comprehensive package of reforms for the industry. Thus, the Government did not so much say “no,” as “maybe soon,” to the mergers.¹¹¹ In fact despite the general celebration of Martin’s decision by anti-bank groups, the Centre for Policy Alternatives concluded that the decision was not really a “no” at all, but that “In effect, Martin has told the banks to regroup, re-grease their public relations machinery and then make him an offer he can’t refuse.”¹¹²

VIII) Conclusions:

The events of 1998 opened the private club of the financial services policy network to many new participants. “Anti-bank” groups, long opponents of the way in which the banks had turned the process of de-pillarization to their advantage, acting in conjunction with other large financial service providers (including both the influential insurance industry as well as one of the banks) and the general hostility to the banks from the Canadian public, were given a unique opportunity to turn Parliament into the key site of struggle for policymaking in the sector. Under the existing political conditions the banks’ proposed mergers had been poorly timed.¹¹³ The merger banks seemed unaware of how many enemies they had, and how restive MPs had become to assert their role in regulating the sector. Certainly this was the opinion of the CBA. The fact that enforcing the “big shall not buy big” guideline had been left to the Minister, rather than a regulatory agency, meant that even ordinary backbenchers, like Tony Ianno, had a means to

¹¹¹ David Robinson, “No Mergers? Don’t Bank on it,” Canadian Centre for Policy Alternatives, Press Release, December 13, 1998. <http://www.policyalternatives.ca>

¹¹² Ibid.

¹¹³ A member of the *BC Task Force* reviewing the mergers said the banks simply seemed to have “dropped the ball.” They seemed unprepared to make the case that mergers were necessary in an environment in which many groups had reasons to oppose their demands. Source: Confidential Interviews, 2006.

challenge potential government support for the banks, by making the Finance Minister's position uncomfortable.

The informal alliance between many MPs and groups like the Confederation of Independent Business, representatives of smaller firms in the industry, a variety of NGOs, and some powerful financial services companies like Power Corporation and the Bank of Nova Scotia, undermined the normal esoteric politics of the sector. The banks simply were unable to work out policy with the Minister and senior officials regardless of whatever sympathy those individuals might have had for them. For example, they were not allowed to privately negotiate with Competition Bureau on how they might satisfy the agency. More ominously for the banks and the future of esoteric politics, having gained a powerful foothold in the network, it was not clear that the new participants would leave any time soon. Opposition to the mergers had strengthened existing demands that the government not give additional powers to the banks and that there needed to be new regulatory initiatives to address consumer and small business complaints.

**CHAPTER 8: “PARLIAMENT AND DOMESTIC
POLITICS RESURGENT - THE NEW
POLITICS OF FINANCIAL SERVICES IN
CANADA”**

"Permit me to issue and control the money of a nation and I care not who makes its laws."

Mayer Amschel Rothschild (1790)

"The money power preys upon the nation in times of peace and conspires against it in times of adversity. It is more despotic than monarchy, more insolent than autocracy, more selfish than bureaucracy. It denounces, as public enemies, all who question its methods or throw light upon its crimes."

Abraham Lincoln (1861)

I) Introduction:

Paul Martin's decision to block the banks "super merger" proposals of 1998 did not resolve the remaining post de-pillarization policy questions in the sector. Instead, the policy review process continued as a legislative response to the *Mackay Task Force* proposals was still due. This process, long drawn out, would ultimately produce "Bill C-8" - *An Act to Establish the Financial Consumer Agency of Canada, and to Amend Certain Acts in Relation to Financial Institutions*, the most complex piece of legislation ever passed by Parliament. In this process, new policy goals replaced the policy network's earlier obsession with producing a small number of globally competitive and Canadian-owned "universal banks." Since 1998, reflecting the depth of anti-bank views expressed during the merger review process, the government has committed itself to expanding the domestic competition facing the big banks. The government also introduced measures to expand international competition by relaxing rules on foreign entry, and responded to the array of complaints raised by consumer and small business groups by introducing new regulatory initiatives. Finally, the government has established a formal "merger review process" which gives Parliament a direct role in evaluating

mergers between Canada's largest financial service providers. These developments cannot be understood through the lens of "esoteric politics." In policy terms, the banks have lost control of the agenda and have been unable to "get their way," as was the case in the deregulatory period of the 1980s and early 1990s. At that time, armed with the assumptions and logic of "globalisation" and a closed policy community, observers could paint a relatively clear picture of how they believed the decade would unfold. Canada's banks would be allowed to rapidly expand into all financial services sectors through aggressive takeover activities. Since 1998 the direction of policy has become a more complex and more immediately political question.

A number of studies note that during the events surrounding the banks' 1998 merger proposals, "politics" played a far larger role in policy outcomes than was normally the case in this sector. Michael Howlett points to a "spike" in the size of the financial services policy network in this period as the number of groups attempting to influence federal policy grew substantially.¹ Adam Tickell suggests that the banks' defeat on the merger question was a product of their own political naivety: they misread the scope and scale of opposition to their agenda in the sector.² Indeed, one should note that divisions between the banks themselves, and their inability to present a united front on the mergers issue, also hurt their agenda. However it is also the case that Parliament's reassertion of the right to review bank mergers, a power it had surrendered in 1910 when approval of such mergers was placed in the hands of the Finance Minister, played a key

¹ Michael Howlett, "Do Networks Matter? Linking Policy Network Structure to Policy Outcomes: Evidence From Four Canadian Policy Sectors 1990-2000," in Canadian Journal of Political Science 35:2 2002 pp. 235-268.

² See Adam Tickell, "Global Rhetorics, National Politics: Pursuing Bank Mergers in Canada," Antipode, 32:2, 2000, pp. 152-175.

role in upsetting the path of deregulation in the sector.³ While the events of 1998 have been well-documented, the point here is that the new, post-esoteric politics of the sector have persisted. Any review of developments since 1998 illustrates a degree of confusion about the direction of policy, as different network participants pursue their often competing agendas. Despite the logic of globalisation, politics continues to “matter” in setting the agenda in this sector.

II) The Aftermath of the “Mergers Decision”:

In the months immediately following the merger decision, the government made several deregulatory changes in the financial services industry. In February 1999, new legislation (which had been promised in 1997) was introduced to allow foreign banks to establish branches directly in Canada: *The Foreign Bank Entry Bill*. The previous year, the *MacKay Task Force* had recommended that the government should allow foreign banks easier access to the Canadian market by offering them the right to directly branch in Canada, or at least to operate through separately incorporated subsidiaries. The legislation, introduced by Secretary of State for International Financial Institutions Jim Peterson, promised to “. . . give foreign banks greater flexibility in structuring their Canadian operations and remove unnecessary regulatory obstacles to more effective competition from foreign banks.”⁴ At that time, foreign banks that wished to offer banking services in Canada were still required to establish separate Schedule II subsidiaries subject to the full range of banking regulations. The rules had acted to

³ Russell Williams (2004), “Mergers if Necessary, but not Necessarily Mergers: Competition and Consolidation at Canada’s ‘Big Banks,’” in Robert Campbell, Leslie Pal and Michael Howlett eds., *The Real Worlds of Canadian Politics, Cases in Process and Public Policy*, Fourth Edition, (Toronto: Broadview Press, 2004), pp. 155-214.

⁴ Department of Finance, Canada, News Release, Ottawa, February 11, 1999, 99-016, p. 1.

impede foreign bank entry into Canada, particularly commercial banks that were not interested in offering retail deposits.⁵

Under the new legislation, foreign banks would have the option of establishing two kinds of branches. They could establish full service lending branches that were not subject to the same regulations as Canadian banks, provided they were only to accept deposits of more than \$150,000 dollars. Alternatively, they could establish “lending branches” which could not accept any deposits except from other financial institutions. In either case, since they were not taking normal retail deposits, they were not subject to the same restrictive rules on new banks that would otherwise apply. Foreign banks would still have the option to establish retail deposit-taking institutions, but this would be subject to the existing restrictions in the *Bank Act*. The rules offered foreign banks a wider range of options for establishing themselves in the Canadian market. The government argued that this was a way in which competition for the big banks could be increased.⁶ However, the proposals were also a product Canada’s participation in international trade negotiations aimed at reducing exactly these kinds of barriers to entry in the financial services sector. A month later, in March 1999, Canada’s long-negotiated obligations under the WTO GATS Agreement on Financial Services came into force: Canada had committed to creating a mechanism for allowing this kind of limited, direct bank branching for foreign firms.

More importantly, the Federal Government also prepared legislation to allow mutual insurance companies to demutualize. This raised the possibility of more rapid

⁵ Ibid.

⁶ Ibid., p. 2.

ownership changes in the industry.⁷ The policy was a long awaited response to complaints from the insurance industry that many of the large mutual insurance firms were unable to take advantage of the post-1992 deregulatory environment because of the restrictions that mutualization had placed on their ability to participate in mergers and takeovers in the industry. By allowing these firms to demutualize, the government placed them in a better position to try to become diversified financial service providers. The idea was that demutualized insurance companies, with newfound abilities to raise investment funds, would potentially be able to also acquire deposit-taking subsidiaries (small banks or one of the remaining trust companies) and become a source of competition to the big banks. Theoretically, demutualization also raised the long term possibility of bank takeovers of the major insurance companies. However, the legislation restricted the banks' rights to take control of a demutualized firm until after 2006. The government would later informally extend the restriction to 2007. According to bank officials the government subsequently extended it to 2010.⁸

Expanded market access for foreign firms and demutualization were both means to increase domestic competition for the banks. Unlike past symbolic initiatives in this

⁷ Mutualized insurance companies are owned by their policy-holding clients. Demutualization involved assigning each of those clients an appropriate number of shares in the company (given the size of their policies). Those clients then had the option to sell those shares to any potential investor. Thus the firm became a publicly-traded company. Demutualization represented "... a massive redistribution of wealth," as millions of Canadians stood to receive company stock which would rapidly go up in value. See Mark Daniels, "The Future of the Canadian Financial Services Sector – A Life and Health Insurance Industry Perspective," *Vital Speeches of the Day*, 04/01/99, Vol 65, Issue 12, pp. 364-370. Indeed many policy holders sold their shares for two to three times their original assigned value.

⁸ Source: Confidential Interviews, 2006. No legislation was passed extending the time restriction. Instead the government informed the industry that this was the case. Since a merger of this scale would require Competition Bureau, OSFI and ministerial approval in any event, a bank official said that no one "was holding their breath" that such a merger would be allowed until the government goes on record that they are lifting the restriction.

area, there was no *quid pro quo* for the banks. They received nothing in the way of expanded powers in the spring of 1999.

III) Paul Martin's "New Policy Framework" – The Response to the *MacKay Task Force*

In June, Paul Martin announced the larger "New Policy Framework" for reforming the regulation of the financial services sector which he had promised to do when he rejected the 1998 mergers.⁹ Announcing his proposals, Martin argued that globalisation and technological change in the financial services sector required a change in the basic principles that governed financial service sector regulation. Based on the prior two years of consultations with the industry in the *MacKay Task Force* and the subsequent parliamentary inquiries, Martin argued that major reforms were needed to ensure an "efficient" and "competitive" financial services sector. Consistent with the spirit of the *Mackay Task Force's* recommendations, Martin announced that the Government intended to "decrease the regulatory burden" in the industry. The Government would allow financial service sector companies to adopt a holding company approach (reminiscent of the Green Paper proposals of 1986), in which they could place some of their activities outside the regulatory regime for their core business activities. For example, banks would be allowed to shift their credit card services outside their banking activities through the operation of a subsidiary thereby lessening the regulatory burdens they faced in those activities. The government would also allow the emergence of "strategic alliances and joint ventures." Traditionally banks had been precluded from forming alliances which would result in any one shareholder controlling more than ten

⁹ Paul Martin, "Reforming Canada's Financial Services Sector – a Framework for the Future," Department of Finance, June 25, 1999.

percent of a bank's voting shares. To allow banks the flexibility to find new partners, the government suggested that this threshold would be raised to 20 percent for voting shares and 30 percent for non-voting shares. The government was careful to note it would still be vigilant to ensure that no individual shareholder could gain control of a bank. Martin also vaguely promised that the government would consider the possibility of reducing capital taxes to increase the international competitiveness of the industry, but noted this was complicated by the fact that jurisdiction over capital taxes was shared with the provinces.

Despite the deregulatory thrust of these proposals, the more tangible aspects of Martin's framework were a different matter. Much of his "New Framework" responded to the anti-bank arguments of the insurance industry and the positions put forward by the Ianno Report the previous fall.¹⁰ Indeed, bowing to pressure from the large automakers and insurance firms, Martin's proposals suggested that legislation would continue to restrict banks from directly selling insurance or offering auto leasing. This was a major defeat for the banks' demands for further deregulation and also a major rejection of the *Mackay* recommendations.¹¹ While Martin and the Department of Finance were formulating the "New Framework" announcement, the banks had asked for a meeting to discuss the insurance issue. Wishing to avoid a repeat of the events that led to the 1997 White Paper, in which Martin publicly announced a rejection of the banks' request to sell insurance in branch, prior to formulating the *Bank Act* revisions, the banks again asked Martin to carry through on earlier government promises to complete the process of de-

¹⁰ Tony Ianno, *The National Liberal Caucus Task Force on the Future of the Financial Services Sector. A Balance of Interests – Access and Fairness for Canadians in the 21st Century*, November 1998. <http://sen.parl.gc.ca/sjoyal/e/features/caucus.html>

¹¹ CBC, *Merger Mania – Paul Martin's Policy*, <http://www.tv.cbc.ca/national/pgminfo/banks2/report.html>

pillarization. The *Mackay Task Force* had lent their arguments additional credibility. Nonetheless, Martin informed the banks that they “did not have the votes” in the House of Commons to get movement on the issue. Martin told them that if they wanted to sell insurance in branch they needed to get the support of Parliament.¹²

Instead, responding to the level of parliamentary antipathy towards industry, Martin’s proposals suggested a number of regulatory reforms. For example, on conglomeration, the government proposed the creation of a “Merger Review Process,” designed to “increase transparency and public participation.” Under this process banks would be potentially allowed to merge with one another. However, they would have to fulfill several additional reporting obligations to make this possible. Large financial services companies would be required to prepare a “Public Interest Impact Assessment” for review by the House of Commons Standing Committee on Finance. This assessment was intended to formalize the process that emerged in 1998 when the Ianno Task Force created its *ad hoc* review of the bank mergers. The proposal meant that Parliament would have a direct say in approving or disallowing large mergers. Potential merger participants would also continue to be required to go through reviews by OSFI and the Competition Bureau. The proposed framework suggested that regulatory agencies’ reports would be completed prior to the Finance Committee’s review of the merger proposal.¹³ Based on the evaluation of the Committee, the Finance Minister would still have the authority to approve or reject any merger, but responding to the banks’ complaints about the Competition Bureau’s failure to allow them to modify their 1998

¹² Source: Confidential Interviews, 2006. A member of the CBA, present at the meeting, suggested that this symbolized the new political environment in which the banks found themselves- that they were now required to lobby individual members, rather than to simply deal with the Finance Minister.

¹³ Martin, “Reforming Canada’s Financial Services Sector,” p. 6.

proposals, banks would now be given the opportunity to make modifications to their proposals before seeking final government approval.

Martin's framework also announced that the government would make regulatory changes designed to increase the size of "a healthy second tier of deposit-taking institutions" which could compete with large banks in regional and local markets. This was to be accomplished by reducing the complex ownership restrictions for new banks, allowing insurance companies to demutualize, which had actually already been approved by Parliament earlier in the year, and approving a request from the credit unions, via the Credit Union Central of Canada, that they be allowed to establish their own national cooperative banks.

More importantly, reflecting the recommendations of the Ianno Task Force and the decade of complaints that Parliament had heard about the banks' consumer practices, the government also promised to implement new measures aimed at consumer protection, and measures designed to limit the ability of deposit-taking institutions to close branches without advance notice from the firm. Martin also proposed the creation of a "Financial Consumer Agency," which would have oversight to ensure the new consumer protection legislation was being adhered to within the industry. In particular, it would address long-standing concerns about tied selling. Closely associated with this was a proposal to create a *public* Canadian Financial Services Ombudsman, something NGOs and anti-bank activists like Duff Conacher had long advocated.¹⁴ Under the proposals, the banks would also have to offer bank accounts to everyone, regardless of whether they were

¹⁴ The Ianno Report had also called for a government ombudsman for the industry.

employed. Many of these proposals had been discussed in Ottawa for over a decade, but the banks had always managed to block any government initiatives.¹⁵

CBA head Ray Protti publicly welcomed many of Martin's recommendations but expressed the banks' massive disappointment that aspects of the *MacKay Report* which would have benefited the banks were not going to be acted on by the government due to continuing anti-bank sentiment in Ottawa. The CBA welcomed the *Task Force's* recommendation that the banks be allowed into the insurance and auto leasing businesses: "We find it hard to understand why the government has rejected the task force's recommendation."¹⁶ While the banks complained that the government was dragging its feet on *MacKay Report* recommendations supportive of deregulation, anti-bank groups, not satisfied with the scale of the government's reversal, negatively framed the report to the public as "potentially re-opening the door to bank mergers." The policymaking environment was still "highly politicized." In any event, as Protti pointed out, nothing could really occur until the proposed framework became policy and the legislation itself could not be expected anytime soon.¹⁷

Bill C-8 Process:

The framework announced by Martin, itself a product of two years of lobbying by both the banks and the array of interests that had been involved in the previous year's

¹⁵ For example, in response to demands in the early 1990s for a government funded financial services ombudsman, the banks had created their own industry supported office which maintained a very low profile.

¹⁶ Canadian Bankers Association, "Banks Reviewing Martin's Financial Reform Paper," News Release, June 25, 1999. Privately, the CBA admits that the failure on the insurance issue was the bitterest aspect of the Martin proposals. While the CBA thought the formation of new regulatory rules and agencies was "unnecessary bureaucracy," they had been expecting the right to sell insurance in branch for almost a decade and felt like past promises were being broken. Source: Confidential Interviews, 2006. Apparently the banks had lost interest in the auto leasing business so the government's refusal to allow them into that sector meant little.

¹⁷ CBC, [Merger Mania – Paul Martin's Policy](http://www.tv.cbc.ca/national/pgminfo/banks2/report.html), <http://www.tv.cbc.ca/national/pgminfo/banks2/report.html>

mergers debate, set in motion the legislative process that would eventually lead to Bill C-8 - *An Act to Establish the Financial Consumer Agency of Canada, and to Amend Certain Acts in Relation to Financial Institution*. It was introduced initially in June of 2000 as bill C-38, however, as one of the largest bills ever to pass through Parliament, progress was slow and the legislation died on the Order Paper in November due to the General Election. In February 2001, Bill C-8 was introduced. It was a repeat of Bill C-38 and passed through Parliament with little controversy. While lobbying had been fierce between 1997 and 2000 with the public hearings of the *MacKay Task Force* and the many subsequent parliamentary inquiries, but once the legislation had been tabled in 2000, activity in the sector died down as it was simply a waiting game to see when it might come into effect.¹⁸

However, the process that led to the final legislation revealed a confused set of competing policy demands, and a wide array of actors. Harris in particular notes that the process was far more “politicized” than any in the past:

The decennial revisions to the *Bank Act* traditionally pitted industry participants against one another to protect turf and perceived property rights. This was the case in the 1960s and 1970s, when the trust and mortgage loan industry was making inroads into core banking. However, the policy discourse was located within the realm of the expert policy community. It was not a matter in which ordinary citizens took great interest. The important *Bank Act* amendments in 1992, a watershed of structural change in the industry, only represented a struggle among directly affected interest groups. Individuals were not really earnest participants in the process. The policy process, the policy discourse since 1992, however, has shifted significantly. The policy community has expanded beyond the cadre of experts. It now encompasses provincial governments, municipal governments, consumers, academics, party caucuses, the mass communications industry, small and medium sized

¹⁸ Source: Confidential Interviews, 2005. A consumer lobbyist suggested that once the Martin Framework was tabled as legislation it was unlikely that the government would change their mind on any of the substantive issues that were symbolically important for political reasons.

enterprises, peak industry associations and the labour unions. One can reasonably ask why this change has occurred?¹⁹

The expanded number of participants in the Bill C-8 process was a product of both the wide ranging and *public* nature of the consultations involved in the process and the degree to which Members of Parliament took seriously the concerns of new network participants eager to influence the agenda.²⁰

While many of those involved found the process to be collaborative, lacking the acrimony of the debate over mergers,²¹ there were substantial disagreements over policy. It might be safer to say that participants were pleased with the depth and intensity of the consultation which led to the legislation, something that was very different from the past.²² This level of public consultation is “. . . now an un-mistakable feature of the Canadian scene.”²³

MPs, while at times openly hostile to the banks, paid particular attention to two sets of groups, consumer and small business organizations on the one hand, and the insurance industry on the other. Throughout the process:

The most dramatic change in the Canadian policy process has to be the involvement of consumer groups in the actor constellation and not solely in the attentive public, something that was unthinkable just a short while

¹⁹ Stephen Harris, “Financial Sector Reform in Canada: Interests and the Policy Process,” Canadian Journal of Political Science, March 2004, p. 177. Harris argues that the source of this politicisation was largely “partisan,” that Paul Martin and the rest of his Cabinet were hostile to the banks. However, this ignores both the expanded array of interests in the sector following deregulation and the institutional encroachment of the House of Commons. It also misconstrues Martin’s own attitude to the banks.

²⁰ Unlike the Department of Finance papers that had preceded policy change in the deregulatory period of the 1980s and early 1990s, there had been two full years of public consultation, task force reports and parliamentary committee reports *prior* to the release of the government’s position in Martin’s “New Framework.” It was then fully another year, once again dominated by intense lobbying and public posturing amongst participants, before the government put its legislative proposals before the House.

²¹ See Ian Roberge, The Internationalization of Public Policy and Multi-level Governance: A Comparison of Financial Services Sector Reform in Canada and France, (Doctoral Dissertation, McMaster University, 2004), p. 127.

²² Source: Confidential Interviews, 2005.

²³ Roberge, pp. 105-106.

ago. These groups, whose powers should not be overstated and which are often disorganized and lacking in resources, have managed to become a noticeable actor in financial services sector policymaking.²⁴

Ian Roberge notes that network participants, including the banks themselves, increasingly respected the knowledge base and contribution of these groups.²⁵ However, representatives of consumer and small business groups suggest that they continued to receive “frosty” receptions from the relevant state agencies, particularly the Department of Finance. Officials did not share their policy concerns around consumer protection, small business lending and domestic competition. Instead it was the particularly attentive role of parliamentarians that garnered them access to policy.²⁶

It is also important to recognize the influence of the insurance sector, perhaps the most important “anti-bank” constituency. It had been assumed that, when the next round of deregulation occurred, banks would be allowed to offer a full array of insurance products directly. This threatened the existing firms in the industry. Even under the existing limitations, banks had managed to capture as much as ten percent of the insurance market prior to Bill C-8.²⁷ The position of major insurance firms throughout the policy review process leading to Bill C-8 was unequivocal: hold the line on any advances in banks powers in the insurance sector. For example, Mark Daniels, President of Canadian Life and Health Insurance Inc., drawing on the same anti-deregulation arguments that had been around for over a decade, suggested that until effective measures could be put in place to control tied selling, the abuse of personal information by banks for insurance sales, and bank branch’s staff’s lack of “proficiency” standards in selling

²⁴ Ibid., p. 147.

²⁵ Ibid., p. 148.

²⁶ Source: Confidential Interviews, 2005.

²⁷ See Mark Daniels, “The Future of the Canadian Financial Services Sector – A Life and Health Insurance Industry Perspective,” *Vital Speeches of the Day*, 04/01/99, Vol 65, Issue 12, pp. 364-370.

insurance, the government should take no steps allowing the banks to further intrude into the industry.²⁸ The Insurance Bureau of Canada argued that allowing banks to sell insurance in branch would ultimately drive small insurance providers out of the industry, limit competition and reduce financial service jobs in rural areas.²⁹ These were all arguments to which MPs were sensitive.

The insurance industry also continued to complain that it could not gain access to the banks' core business activities to compete with them. The *MacKay Report* had suggested that the largest insurance companies were the most likely source of competition for the banks. Indeed, the insurance industry was in a particularly fortuitous position to benefit from tight government budgets, reduced social expenditure and demographic changes. These factors promised to increase Canadian's demands for the industry's products as they were the principal providers of RRSPs, RRIFs, private pension plans, and private health insurance.³⁰ However, whether or not insurance firms provided competition to the banks depended on whether they took advantage of deregulation to diversify into the other industry pillars. This is why the *Task Force* and the government had supported demutualization. However, even after demutualization, insurance companies could still not take savings deposits. This made it hard for them to emerge as "one stop shopping" financial centres. While they could legally issue debit and credit cards, the banks' control of the Interac system prevented them from competing effectively in providing those kinds of services. Daniels argued:

In a nutshell, the essence of our position in talks with the government and in submissions to the *MacKay Task Force* and the Parliamentary

²⁸ *Ibid.*, pp. 364-370.

²⁹ "Canada Insurance Groups hit bank sales plan" *American Banker*, 09/21/98, Vol. 163, Issue 180, p. 6.

³⁰ See Daniels, pp. 364-370.

Committees studying the *Task Force* recommendations is this: Get the playing field leveled so we can effectively use the broad business powers that we were given in 1992. Once that happens, then we can talk about further expanding bank powers, including insurance powers.³¹

Behind these policy positions the insurance industry and its local dealers were recognized as a more effective lobby than the banks, particularly in terms of their relationship with individual Members of Parliament.³² While the banks rejected many of the claims of the insurance industry and labeled them as the “special interest demands for protection,” they had very little hope of changing the governments’ position on in branch insurance sales once Martin had announced his position in the “New Framework.”³³

Insurance providers, small business organizations and even consumer groups all influenced Bill C-8, making it a complex and contradictory piece of legislation. Indeed, interpretation of the legislation has often been contradictory, as “bank opponents” have emphasized the deregulatory aspects of the package, while the banks and their advocates have tended to see the legislation as a substantial increase in regulatory oversight.

IV) Bill C-8 – Interpreting the Legislation:

Bill C-8, *An Act to Establish the Financial Consumer Agency of Canada, and to Amend Certain Acts in Relation to Financial Institutions* (Royal Assent, June 14, 2001) was broadly reflective of Martin’s “New Framework.”

³¹ Ibid., pp. 364-370.

³² Both the confidential interviews for this study and the analysis of others have suggested that this was an important factor. While the insurance firms themselves lobbied senior government officials and benefited from close ties to key policymakers, the associations representing the local dealers focused on lobbying MPs about their concerns. As Roberge notes, the level of anti-bank sentiment in Parliament after 1998 undoubtedly helped their efforts. See, Roberge, p. 132.

³³ Martin had told the banks to go and “get the votes,” but they could not do so in the environment they found themselves in. Source: Confidential Interviews, 2006.

In terms of domestic competition, consistent with the *MacKay* and Ianno Task Force proposals, the Bill modified ownership restrictions to make it easier to start new banks. “Small” banks with less than a billion in equity could be now be “closely held” – meaning one shareholder could own a majority of voting shares, although 35 percent of shares must be publicly held. Banks larger than this still had to be widely held, though single shareholder limits were raised from 10 to 20 percent. Furthermore, with special approval from the Minister of Finance, this could be raised to 30 percent on an *ad hoc* basis, provided a portion of that was non-voting shares.

The existing big banks also benefited from new ownership rules. As promised, banks were allowed to organize themselves under a holding company model. Effectively this reduces capital requirements for banks on some of their operations as product lines transferred to the holding company do not require the normal levels of capital adequacy to which bank’s deposit and lending activities are subject.³⁴ According to Roberge, although the CBA had sought this in its public submissions, the real impetus came from the Quebec-based *National* and *Laurentian* Banks, which, uniquely in Canada, faced competition from *Desjardins*. Regulated by Quebec, *Desjardins* already had these privileges. Federal legislation was intended to close this gap for federal institutions.³⁵

The Bill also reduced ownership restrictions on the types of businesses banks could own and invest in, something that had always been tightly regulated. Insiders thought that this new “permitted-investment regime” might have long term

³⁴ See “Interpreting Bill C-38 – Interview with Ray Protti,” *Canadian Banker*, Third Quarter 2000, Vol. 107, Issue 3, p. 21.

³⁵ Roberge, p. 129.

implications.³⁶ Some speculated that the banks were particularly interested in acquiring stakes in e-commerce firms, given the increasing importance of electronic banking.³⁷ The Bill also attempted to reduce regulatory barriers on cooperatives/credit unions cross-provincial boundary activity, by expanding Federal jurisdiction over those industries.

The government set new rules to “discipline” OSFI, requiring that they speed up their approvals process and their industry investigations. Interestingly, the legislation also increased the range of “ministerial approvals” giving the Finance Minister more discretionary regulatory power to override or supersede OSFI.³⁸

While all of these provisions were deregulatory and kept with the policy pattern established by de-pillarization (though many of the changes benefited potential bank competitors rather than the banks), much of the remainder of Bill C-8 was not.

First, the legislation held the line on further desegmentation. Despite heavy lobbying by the banks, the government stuck to Martin’s promise to the insurance industry by not allowing the banks into the insurance and auto leasing sectors, something the banks decried as “anti-consumer.”³⁹ While this was a blow to the banks, there was also concern over the additional regulatory requirements entailed by the legislation. Indeed much of Bill C-8 was taken up with the new domestic regulatory apparatus and requirements, a surprising development given the thrust of policy change in the 1980s and 1990s.

³⁶ Source: Confidential Interviews, 2005. See also “Interpreting Bill C-38 – Interview with Ray Protti,” (2000), p. 21.

³⁷ Peter Diekmeyer, “Banking in the era of Reform,” *CMA Management*, April 2002, Vol. 75. Issue 2, p. 54-55.

³⁸ Roberge argues that this was an attempt to discipline OSFI for dragging out the approval process for foreign bank licenses – something foreign banks had complained about during the consultations. See Roberge, p. 131.

³⁹ See, “Interpreting Bill C-38 – Interview with Ray Protti,” (2000), p. 21

Bill C-8 also established the Financial Consumer Association of Canada (FCAC) which took consumer-issue-monitoring responsibilities from OSFI. OSFI had never been particularly interested in this kind of consumer protection which was never part of its explicit mandate. The formation of the FCAC was a direct response to parliamentary demands and the complaints of consumer organizations like the Canadian Community Re-investment Coalition (CCRC).⁴⁰ The FCAC was be charged with ensuring bank compliance to all regulations governing banks' consumer practices, including new provisions regarding tied selling that were contained in the legislation. In the past, during the proliferation of services fees in the late 1980s and early 1990s the banks had ignored rules governing the process of imposing such fees. Banks were required to notify customers of fee changes, but there had been no agency to complain to (see Chapter Five). The FCAC was designed to address precisely these kinds of concerns. The legislation also reformed the industry ombudsman in direct response to consumer groups' and MPs' complaints that the system established in 1996 by the banks was little more than an "industry puppet."⁴¹ The Bill also had provisions inhibiting branch closures, increased disclosure requirements, and access to low-fee banking. Banks were also now required to fill out a yearly public "accountability statement," which was commonly

⁴⁰ Source: Confidential Interviews, 2006. One expert from the banking industry suggested that the banks had been wrong to lobby against the FCAC as, over the long run, it might serve their interests by supplanting the role Parliament was playing in dealing with consumer complaints. Perhaps this would reduce MPs' dissatisfaction with the banks.

⁴¹ Roberge, p. 130, and, Canada, Parliament, House Standing Committee on Finance, 1998c and 2000.

required in other countries.⁴² The banks saw all of these initiatives as an additional level of unnecessary bureaucracy that could have been left for market forces to address.⁴³

While these new “consumer protection” initiatives often received less attention in the press coverage of the Bill’s provisions,⁴⁴ they were nonetheless important changes. At the very least they signaled a shift in policy emphasis. Indeed, the banks saw these measures as particularly problematic given the fact that the government had not expanded their in-house business powers. They argued that given the Interac machines, internet and phone banking, fewer and fewer people were using branches for banking services. “The main reason people go into a branch now is to seek advice. Increasingly, the reason you have a branch is to provide far more sophisticated financial advice and financial planning than banks used to provide.”⁴⁵ The legislation restricted the banks’ right to close branches and rationalize services, but also did not expand the range of advice that banks could provide in their branches. The banks’ position had been that if they were going to be forced to keep branches open they needed to be able to provide a wider array of financial services that made branches an asset, such as auto leasing and insurance. The government said “no.”

Technically, Bill C-8 did not deal with the most controversial issue, mergers. However, in press releases included in annexes to the legislation, the government announced the establishment of the merger review process. This process, while

⁴² Anti-bank constituencies had complained bitterly that under US law Canadian banks were required, based on their operations there, to file public accountability statements each year to describe how their activities conformed to mandated regulatory goals. The banks had long refused to do the same thing in Canada. Bill C-8 required them to do so. This requirement for ongoing public reporting was seen as an important step towards more industry transparency. Source: Confidential Interviews, 2005.

⁴³ Source: Confidential Interviews, 2005 and 2006.

⁴⁴ Diekmeyer, “Banking in the era of reform,” pp. 54-55.

⁴⁵ Ray Protti, CBA head, quoted from, “Interpreting Bill C-38 – Interview with Ray Protti,” Canadian Banker, Third Quarter 2000, Vol. 107, Issue 3, p. 21.

recognizing the legal right of banks to merge, required that any such proposal would have to be evaluated by OSFI, the Competition Bureau and by Parliament. Both the House of Commons Standing Committee on Finance and the Standing Senate Committee on Banking, Trade and Commerce would conduct reviews of the banks' proposals to judge whether they were in the "public's interest." This was consistent with the spirit of the proposals that Martin had outlined in his "New Framework" in 1999, but it fell somewhat short of "streamlining" the merger review process, something the government had promised the banks when they rejected the 1998 merger proposals. Bill C-8 left it an open political question as to how Parliament would interpret the "public interest" in mergers. For the banks this raised the spectre of another *ad hoc* process in which the banks' business strategies would be treated as a political football. Indeed, the banks' supporters made this point publicly. The Fraser Institute dismissed the framework as having ignored the "new realities" of the banking industry, and instead, imposing outdated and unfair parliamentary oversight over the business decisions of industry participants.⁴⁶ Ray Protti, the CEO of the CBA, was most blunt about the insertion of a formal role for Parliament in regulating the sector, and the overall spirit of Bill C-8:

We didn't have a merger review process before and now we'll have one. The government is acknowledging mergers are a legitimate business option that ought to be available to major banking institutions in this country. The process is cumbersome, however, and the involvement of Parliament in it is, as far as I know, unprecedented. None of the major Western countries has directly elected bodies specifically involved in the bank merger review process.⁴⁷

⁴⁶ Jason Clemens, "Financial Services Reform is Politicized and Dated" Fraser Institute, Canada News Wire, <http://www.newswire.ca/releases/july2001/16/c2287.html>

⁴⁷ Quoted from, "Interpreting Bill C-38 – Interview with Ray Protti," p. 21.

Furthermore, the legislation did formally include provisions which precluded bank takeovers of demutualized insurance companies until after 2006. The provision was intended to head off serious conglomeration between the two sets of firms.⁴⁸

While those involved in lobbying the government have different interpretations of how (re)regulatory Bill C-8 was, the safest conclusion that can be reached about the legislation and the overall process is that domestic politics drove the agenda. While discourse about globalisation persists in the sector, indeed it continues to define many of the perceived policy problems. “The policy process for Bill C-8 demonstrates that states retain policymaking autonomy within the context of the internationalization of public policy. Many of the issues studied during this period cannot be traced to any international imperatives.”⁴⁹ The big banks and their supporters continued to deploy globalisation rhetorically to advance their interests in policymaking. However, if anything, the Bill C-8 process illustrates that many domestic actors have gained influence in the sector, producing a more diverse set of policy demands.⁵⁰ In the process:

Banks thought they were over-burdened with regulations and wanted a framework that would allow them to internationalize further; consumer groups sought a policy that would render banks more accountable; insurance firms thought the playing field was uneven and wanted more competitive balance between them and the banks. Greater efficiency and competition were the words of the day, but all actors had different views on how to achieve the perfect equilibrium. By opening up the policy process, there now appeared a multiplicity of policy concerns. The government, thus sought to elaborate a policy that would ‘satisfice’ the majority of actors.⁵¹

⁴⁸ This restriction was subsequently extended by the government. Some suggest that it now runs until at least 2010. Source: Confidential Interviews, 2006.

⁴⁹ Roberge, p. 149.

⁵⁰ Some “anti-bank’ groups tried to explicitly counter the globalisation argument, often emphasizing the latitude which the Canadian government had in making policy, despite market pressures and international treaty obligations. See Roberge, p. 135.

⁵¹ Roberge, p. 149.

Furthermore, there is little doubt that Parliament's role in influencing the final legislation was larger than during the deregulatory period. It was ultimately Parliament that was most steadfast in stopping further deregulation to the benefit of the banks, such as in branch insurance sales, preventing bank mergers, and in responding to concerns about the inadequacies of the regulatory structure in regards to consumer protection.⁵² Under pressure on these questions, the government rejected the spirit of the *Mackay Task Force* proposals which would have given the banks much of what they wanted. Instead it responded to longstanding parliamentary concerns. As a result the policy consensus in support of universal banking, deregulation, and conglomeration that had dominated events since the 1980s has come under serious strain.

V) The Mergers Question:

The changed trajectory of policy in the sector evidenced by Bill C-8 can also be illustrated by the subsequent handling of other merger proposals from the banks. Essentially the question remains highly politicized and the government has publicly rejected even considering a series of merger proposals that would raise similar issues to those of 1998. While the government has not halted conglomeration in the sector, consideration of mergers between big banks, and between big banks and large insurance companies has been a "non starter" in Ottawa for six years, regardless of changes in cabinet personnel.

⁵² It was on these questions that Parliament's influence was most clear. See for example, Roberge, p. 147. Indeed, Parliament had been demanding regulatory reform for consumer protection since the 1980s, while the Department of Finance and OSFI felt that these initiatives were unnecessary.

While the government was hammering out the Bill C-8 proposals, there was considerable debate about what the process for reviewing mergers should look like. This was understandable, since throughout the process the industry had made it clear that new proposals were pending, and the rules themselves therefore would have an immediate impact on whether or not mergers would be approved. The *MacKay Task Force* had suggested that OSFI be given the power to monitor and regulate competition in the industry. However, MPs were not willing to give up their new role in the sector.

Initially, the government proposed giving the House of Commons Finance Committee sole power to review bank mergers.⁵³ The Senate, and the Senate Committee for Banking fought this, claiming that they had more “historical expertise” in overseeing the sector through their *Bank Act Reviews*. Indeed individual Senators felt they had more insight on the sector than MPs.⁵⁴ However, their desire to be involved was not politically neutral, as they were also more sympathetic to the banks’ claims that the crucial policy goal should be to ensure the global competitiveness of Canada’s banking “national champions.”⁵⁵ The Senate, somewhat ironically, either wanted Parliament as a whole taken out of the review process, since MPs “politicized” necessary domestic adjustment or, if Parliament was to review mergers, that the Senate should also be involved. Indeed, the Senate ultimately threatened to stall the final reading of Bill C-8, leading Jim Peterson, the Secretary of State for Financial Institutions to relent and gave the Senate the right to also review merger proposals. As a result of the guidelines attached to Bill C-8,

⁵³ See Harris, “Financial Sector Reform in Canada,” p. 174. Bill C-38, which died on the order paper, had left the Senate out of the process of reviewing mergers. See Library of Parliament, Legislative Summaries, Bill C-8, *An Act to Establish the Financial Consumer Agency of Canada, and to Amend Certain Acts in Relation to Financial Institutions*, p. 24. The Senate was only added in the final stages of passing Bill C-8 when it threatened to block the legislation if it was not included in the process.

⁵⁴ Source: Confidential Interviews, 2005.

⁵⁵ Harris, “Financial Sector Reform in Canada,” pp. 174-175.

mergers between large financial service providers in Canada are now subject to explicitly political reviews rather than being left in the hands of regulators. Harris argues that this perpetuated the problems that banks encountered in 1998 when their proposals were politically rejected long before they were given a chance to remedy problems identified by the Competition Bureau.⁵⁶

Despite questions left unresolved by the long-awaited provisions of Bill C-8, such as how Parliament might interpret the “public interest” in a merger, many insiders felt that a new round of merger proposals was inevitable in the wake of the Toronto Dominion/Canada Trust merger.

The TD-Canada Trust Merger:

The successful merger of Toronto Dominion with Canada Trust was the one notable exception to anti-merger sentiment in Ottawa. This requires some explanation. Even this successful merger reveals how much “politics matters” in the sector, as the merger was approved only because it was conceptually different from mergers between banks, something the merger’s architects successfully played on in their more subtle lobbying.

Even before Martin announced his “New Framework” response to the events of 1998, and some claim even before the 1998 TD/CIBC merger was formally rejected, Charles Baillie, the head of TD, had approached Canada Trust with a takeover proposal. This proposed formation of TD-Canada Trust was publicly announced in August of 1999. The announcement was controversial as in effect it would “kill” the last of Canada’s large trust companies. Anticipating anti-bank constituencies’ likely linkage of this merger,

⁵⁶ Ibid.

which, if accepted, would be the largest merger in the Canadian industry's history, to the events of the preceding year, Baillie suggest that it did not involve the same questions and should be treated differently. He argued that because the *Mackay Report* had now been issued and the government had responded with its legislative proposals, there was no reason to continue to stall developments in the sector. Also, because there would still be five major banks if this merger was accepted this should alleviate most of the competition concerns raised by the previous proposals. Because the merger was not between two of the big banks, the anti-competitive impact of the merger was vastly reduced. Neither the Competition Bureau or OSFI could argue that the effective "status quo" of this proposal threatened the safety and soundness of the industry.⁵⁷

Baillie was also careful to try to head off any of the general anti-bank rhetoric that had hindered the banks' earlier merger proposals. Indeed, Baillie argued that far from this being a process by which one of Canada's hated "big banks" closed down a more customer, and small business, friendly competitor, this merger offered TD the chance to learn from Canada Trust how to better service the needs of their own customers. Baillie stated TD would be adopting Canada Trust's philosophy of expanded customer service, longer business hours, and overall "retail service model." He also argued that job losses from the merger would be limited.

Baillie was optimistic that the merger would be approved. Furthermore, because Canada Trust was not a "bank," the Government promised Baillie that the merger

⁵⁷ For an overview of the bank's arguments see Noble et al., "Going Green," *Maclean's*, 08/16/99, Vol. 112 Issue 33, p. 40. The merger would vault TD from Canada's 5th biggest bank to its 3rd largest. Baillie had argued that it would also solidify the bank's foundation for expansion into the United States.

proposal would not be subject to the same level of public review.⁵⁸ This in itself is illustrative of something lost in other analyses of this sector in recent years. While Harris suggests that ultimately the government was “anti-bank” and therefore opposed to mergers, the government actually went out of its way to approve the TD/CT pact. It was able to do this because the merger received less public scrutiny and hostility than did mergers between banks. The government was hardly “anti-merger.” It was simply averse to offending its own backbenchers, other constituencies in the sector, and the public at large.

Canada Trust’s CEO, Edmund Clark was a useful ally in Ottawa. Before joining the financial services industry, Clark had been known in the business community as “Red Ed” for his role in designing the National Energy Policy for Pierre Trudeau. Behind the scenes, Clark handled the merger process in Ottawa. Of his relationship with the Department of Finance he boasted, “I still have a lot of friends up there. The feeling is that this deal would not have been allowed to go on as far as it has if Mr. Martin didn’t want it to go ahead. If Mr. Martin was generally opposed to it, that message would have been given.”⁵⁹

Many of the organizations that had played a role in the defeat of the previous merger proposals weighed in on this issue as well; however, recognizing the altered politics of the sector, the bank adopted a fundamentally different approach to the entire process of getting government approval:

⁵⁸ Ibid. Insiders have said that CT was not a bank and therefore the merger was seen as conceptually different from those of 1998. Source: Confidential Interviews, 2006. Indeed, the same government had had already overseen and supported bank takeovers of all the other major trust companies.

⁵⁹ Noble et al., p. 40.

. . . TD has gone to great lengths to make sure that Ottawa was kept in the loop; thereby, it hopes, heading-off political opposition. Baillie and his executives met with Martin two weeks before the deal was announced to outline their plans, and also met in advance with Liberal MPs from London Ont., to offer assurances that the city where Canada Trust was born would not lose any of its 2,000 jobs. One Martin advisor suggested that the meetings have been crucial; by getting MPs on side, the TD hopes to avoid the sort of backlash that helped sink the 1998 bank mergers.⁶⁰

Indeed TD and Canada Trust had also informed the government of their plans long before they were announced to the public. Some insiders have suggested Ottawa knew of the deal a full six months before it was made public – which would mean that the deal was in the works prior to the rejection of TD’s merger with CIBC.⁶¹

As a result, the government, prepared with the “heads up” they had been given about this merger, treated it as it had earlier smaller mergers in the industry. Despite the fact that Canada Trust was a large company, it was not one of the “big banks,” meaning that in Paul Martin’s interpretation, the merger did not violate the “big shall not buy big” principle and would not have to await the new merger evaluation framework.⁶² Rather, it would be evaluated by the Competition Bureau. The Finance Minister would approve or reject the merger when he had that report in hand.

In marked contrast to the 1998 mergers, the TD/Canada Trust merger proceeded with little controversy. Parliamentary business on reforming the financial services sector was not dominated by the merger. Indeed, there were no public hearings conducted in regards to the merger. The Competition Bureau was left to evaluate it on its own merits. Furthermore, unlike 1998, the companies were given the opportunity to modify their

⁶⁰ Ibid.

⁶¹ Canadian Press, “TD Bank, Canada Trust Closer to completion after share purchase recommended by board”, 01/10/2000.

⁶² Bank takeovers of the largest trust companies were already an accepted practice, given the events of the early 1990s. Conceptually the Canada Trust case was no different than the Royal Trust case.

proposal to satisfy anti-competitive concerns raised by the Competition Bureau. It was a continuing sore spot in relations between the government and the banks that they had not been given the same right in 1998. Not surprising, given the government's attitude towards this merger and the much smaller impact it would have on levels of competition, the Competition Bureau eventually approved the merger.⁶³

The Bureau noted that Canada Trust was a "regional player" with its operations concentrated in areas like Southern Ontario and British Columbia where there were generally higher numbers of competitors to begin with. They found there was very little overlap in the products and services offered by the two companies other than basic branch banking and credit cards. Their investigation found the merger would reduce competition in only three of the 74 local markets in which the two companies competed, and that unless Canada Trust was divested of its MasterCard portfolio, there would be significantly reduced competition in the sector. Thus the major exception the Bureau imposed was that TD was required to sell off CT's Mastercard business to another company. TD willingly agreed to the exceptions. Jim Peterson, drawing on Charles Baillie's arguments in support of the merger the previous year, pointed out in his statement that this merger would, ". . . mean that TD customers will enjoy longer and more flexible bank branch service hours in keeping with Canada Trust practice."⁶⁴

While the TD/CT merger had generally been under the radar of Canadian public opinion compared to the big merger proposals, the response to the government's endorsement of the merger from many groups active in the policy network was largely negative. Catherine Swift, the president of the Canadian Federation of Independent

⁶³ Competition Bureau, <http://strategis.ic.gc.ca/ssg/ct01687e.html>, p. 6.

⁶⁴ Department of Finance, "Federal Government Approves Acquisition of Canada Trust by The Toronto Dominion Bank," <http://www.fin.gc.ca/newsoo/oo-oo6e.html>.

Business argued the deal was a blow to small and medium business. The CFIB had opposed the banks' merger proposals of the previous year, and "... those concerns are equally valid today. This deal marks the demise of the Trust industry, which was the best opportunity to develop a strong second tier of banking in Canada. This decision will have a negative impact on consumer choice."⁶⁵ The CFIB was particularly upset that unlike the earlier merger proposals there had been no public consultation in the merger review process. They worried that this set the precedent for another round of big bank mergers which could be reviewed "behind closed doors."⁶⁶ Such concerns proved unfounded.

Indeed, many saw the merger as an illustration that major bank mergers were going to be approved in the not too distant future. Observers argued that Canadians had had more time to get used to the idea that one of their banks might disappear.⁶⁷ Also, as the TD/Canada Trust merger had shown, the banks had grown more sensitive to the more open and transparent policy network in which they were operating.⁶⁸ More importantly, the potential competition from new market participants had been legislatively expanded and there were early indications this was resulting in expanded market shares, particularly from foreign financial service providers.⁶⁹ Most importantly, the government was sending clear signals through their new legislation that although mergers would be difficult they were not out of the question.⁷⁰

⁶⁵ CFIB, "CFIB's Response to the Federal Government Approval of the Acquisition of Canada Trust by the Toronto-Dominion Bank", <http://www.newswire.ca/releases/January2000/31/c4451.html>.

⁶⁶ Ibid.

⁶⁷ Derek DeCloet, "Warm, cuddly bank mergers," *Canadian Business*, 05/29/2000, Vol. 73, p. 29.

⁶⁸ Williams, "Mergers if Necessary, but not Necessarily Mergers," pp. 155-214.

⁶⁹ DeCloet (2000) p. 30. ING Direct in particular has emerged as a growing competitor in the sector since 2000. MBNA was also cited. See, Peter Diekmeyer, "Bank Mergers – The Second Round", *CMA Management*, September 2001, Vol. 75, Issue 6, pp. 52-53.

⁷⁰ DeCloet, p. 28.

A New Round of Bank Mergers?

Throughout 2001 and 2002, the heads of all the major banks continued to speak in favour of mergers and suggested they were awaiting the ground rules for how their proposals would be evaluated.⁷¹ In April, Peter Godsoe, head of Scotiabank and one of the strongest opponents of the 1998 mergers, reversed his position. TD-Canada Trust's Baillie had earlier argued that a further wave of proposed consolidations was inevitable – Canada's six banks needed to be joined into three, or “face extinction.”⁷² Baillie had suggested formal merger proposals could be expected within a year or two. In response, in a speech to the Canadian Club in Montreal, Godsoe suggested that some form of consolidation was inevitable, either in the form of bank mergers or through bank acquisitions of the major insurance companies.⁷³ The following day, Gord Nixon, the incoming head of the Royal Bank, announced his bank was anticipating another round of consolidation and that he was personally preparing for all eventualities.⁷⁴

Industry analysts argued that there was simply too much “potential value for shareholders” in mergers between banks for the issue to go away. Said one reporter covering the financial services industry:

Having learned the hard way, the banks will likely work closer – through informal negotiations – with the regulatory bodies and the Canadian Government. But the approval process will be a long, drawn out affair Public opinion – although more attuned to the competitive challenges facing Canadian banks that it was in 1998 – could shift at any time.

⁷¹ See for example, Canadian Press, “Bank mergers critical to Canadian economy's future: TD Chairman says,” 02/26/2001 and Canadian Press, “Banks must do a better job of explaining merits of bank mergers: CIBC chief,” 02/26/2001.

⁷² Canadian Press, “Scotiabank chairman says mergers coming among Canada's banks,” 04/09/2001.

⁷³ *Ibid.*

⁷⁴ Canadian Press, “Royal's new CEO says bank is covering its options when it comes to mergers,” 04/10/2001.

Politics being what they are, this could force the government to stop an unpopular proposal.⁷⁵

It was widely expected that small business and consumer groups would again play a role in opposing any future merger proposals, attempting to mobilize parliamentary opposition.

As it turned out, the banks were unwilling to subject themselves to the politics of the issue, refusing to go through the merger review process, as they did not know how Parliament would define the “public interest” in a merger review.⁷⁶ Instead, they approached the government directly trying to gain cabinet support for their proposals before taking any public actions.

Two substantial mergers which would have required special government approval were put forward in 2002. First, Manulife Financial, one of Canada’s larger non-bank financial services companies proposed to the government that it be allowed to take over CIBC in a deal that would have made the new company the largest bank in Canada with assets of \$433 billion. However, the new Finance Minister, John Manley, effectively rejected the deal by informing them he would not ignore rules which currently prohibit banks from merging with Canada’s largest insurance companies.⁷⁷ It was suggested immediately that Manley’s political ambitions to be Prime Minister, much like Paul Martin’s, had got in the way of the proposal. Competing with front-runner Martin in the race to replace Jean Chrétien, it was felt that whatever sympathy Manley might have for the merger, that it was, “. . . hard to run for the hearts and minds of Main street Canada

⁷⁵ Diekmeyer, “Bank Mergers – The Second Round,” pp. 52-53.

⁷⁶ David Boraks, “Another Blocked Merger Nudges Canada’s Big 5 Towards the States,” American Banker, 11/1/2002, Vol. 167, Issue 210, p. 1.

⁷⁷ Globe and Mail, “Manulife tried to buy CIBC,” January 24, 2003.

once you've become tarred as the champion of Bay Street.”⁷⁸ While Manulife had been considering taking over a bank since at least 1994, the point was that the new rules explicitly prohibited this merger. Effectively, restrictions on mergers between banks and other FSPs were tighter than they had been in the past.

Even in the case of bank to bank mergers which were allowed in theory, Manley was unprepared to push any proposal forward. At the same time as the Manulife/CIBC proposal was floated, Scotiabank proposed a tentative takeover of the Bank of Montreal. Again, the deal never became public as either John Manley rejected the proposal behind closed doors, the PM overrode a favourable Manley and blocked the proposal, or, in the process of discussing the deal, the banks asked the Minister to more clearly define what challenges the parliamentary review of merger proposals would entail.⁷⁹ Whatever transpired, the result was that, at the banks' request, the Finance Minister asked both the Standing Senate Committee on Banking, Trade and Commerce and the Commons Finance Committee to hold hearings and prepare a report clarifying the merger policy.⁸⁰

The banks felt that the process set out by Bill C-8 the previous year was still too vague and too political and that there needed to be a clearer sense of how Parliament

⁷⁸ Maclean's, "Manulife's D'Alessandro stands out in a crowd," 1/27/2003, Vol. 116, Issue 4, p. 15.

⁷⁹ It is not clear whether Manley was personally opposed to putting the proposed merger through the review process (which technically he could have done), opposed to the merger itself, or if it was the Prime Minister that rejected the deal. According to Senator Leo Kolber, Manley was prepared to support the merger, but had it quashed by the PMO. Kolber claims, Peter Godsoe, who he describes as a "well-connected" Liberal, wanted to handle the lobbying of the PM himself and this apparently failed. See Simon Tuck, "Manley backed bank merger," Globe and Mail – ROB, October 30, 2003, p. B1. Press accounts with "insiders'" attributions suggested that Prime Minister Jean Chrétien opposed the deal, closing the door to any consideration of these types of merger proposals until there was a new government. Indeed, this account rings true as officials at the two banks complained that they had been "led on" by a Manley promise that their proposals might receive serious consideration, but that the PM simply refused. See Boraks, pp. 1-2. The question does seem a bit "moot" in any event as bank officials and representatives at the CBA believe that the proposals were going nowhere as Chrétien had made it clear that there would be no serious moves on the issue until after he retired. Source: Confidential Interviews, 2006.

⁸⁰ Keith Kalawsky, "Lift Veil on Bank Deals, Urges Nixon," Financial Post, November 20, 2002, p. 1.

would evaluate the banks' "Public Interest Impact Assessments" and the "public interest" in the mergers generally. John Hunkin, the new chairman and CEO of CIBC, along with the other bank chairmen, told the committee investigations that mergers were necessary for the viability of Canada's banks: "A lot of us think about mergers a lot . . . [but] I would have a great deal of difficulty under present circumstances recommending to my board that we move ahead with [a merger]." ⁸¹

In fact, the banks had new allies in the hearings. Joe Oliver, the head of the Investment Dealers Association told the House of Commons Finance Committee hearings that while his industry was increasingly dominated by the banks, allowing mergers would spur the growth of new smaller firms which would benefit small business. ⁸² The hearings put the issue to the government: While there was a growing resignation on Bay Street to the inevitability of mergers in a globalising financial services sector, the mergers would be too difficult under the current "politicized" process. The banks wanted the evaluation of any merger proposals to be "depoliticized," they wished to take Parliament out of the process as Parliament was the principle vehicle by which opposing interests were pressuring the government. ⁸³ The banks' position was clear: Parliament was politically

⁸¹ James Baxter, "No mergers in works, banker says," Vancouver Sun, Tuesday, November 26, 2002, p. C3.

⁸² Globe and Mail, "Size matters in banking, IDA says," February 4, 2003.

⁸³ Gordon Nixon, the new RBC head, made the banks' arguments in a measured way in the March 2003 issue of Policy Options. Nixon said that the lack of clarity and predictability in the merger review process were not in the public interest – that the uncertainty was standing in the way of merger proposals and was therefore "disruptive to employees, clients and investors." Nixon, remembering the events of 1998, argued that as the current situation stood, merger proposals ". . . run the risk of being embroiled in a politically charged process. This would not be in anyone's interest, and is not conducive to the establishment of good public policy." See, Gordon Nixon, "Canada Needs a Clear and Timely Merger Review Process," Policy Options, March 2003, p. 19.

interfering in the normal business decisions of the sector and that the banks would prefer to work with lower profile regulators who would produce more “predictable” decisions.⁸⁴

The Senate Committee’s report was released in December of 2002. Perhaps not surprising, given its generally “warmer” relationship with the banks, the report was a “ringing endorsement” of the banks’ position.⁸⁵ Having been shunned by the ministers, who refused to attend the Senate hearings, the Senate Committee recommended the government further deregulate barriers to new competitors in the industry. More importantly, the Committee, “. . . urged the government to get out of the bank merger process as much as possible. The finance minister . . . should only turn down a request if there are strong and unusual reasons.”⁸⁶ Indeed the committee recommended there be no Parliamentary review of merger proposals, that they should be left up to the Competition Bureau and OSFI, and that legislation that which would make this clearly the case should be passed before summer.⁸⁷

The “Barnes Report” and the Status of the Mergers Question:

The House of Commons Finance Committee took much longer to assess its position on the merger review process. In the process of preparing the *Barnes Report*,

⁸⁴ Speaking to reporters in London, where he had recently become CEO of Barclays PLC after stepping down as head of BMO, Matthew Barrett was more direct. Barrett said of the rejected BMO-Scotiabank Merger, that Canadian politicians were “marginalizing” Canada’s banks by “blocking consolidation.” Barrett said that the government’s opposition was “purely political and not about concentration.” See Paul Waldie, “Barrett blasts Ottawa on blocking banks,” *Globe and Mail*, November 6, 2002, pg. B1. Barrett had left BMO two months after the failure of his merger proposal with the Royal Bank in 1998.

⁸⁵ While Manley called for committee investigations into the merger guidelines, neither he nor the Junior Minister agreed to testify at the Senate hearings. See, Simon Tuck, “Manley backed bank merger,” *Globe and Mail – ROB*, October 30, 2003, p. B1. While Senators complained about being “stiffed” by the ministers, many believe that Manley avoided the hearings because he did not want to “take the heat” from the pro-merger Senate committee for having killed the merger proposal. Source: Confidential Interviews, 2005.

⁸⁶ *Globe and Mail*, “More Competition in Banking Urged,” December 13, 2002.

⁸⁷ Canada, Standing Senate Committee on Banking, Trade and Commerce, *Competition in the Public Interest: Large Bank Mergers in Canada*, December 2002.

named after Committee Chair Sue Barnes, the committee was subjected to the usual views on the matter. While the banks complained that the process was too political and too uncertain, and was blocking necessary industry reform, opponents were critical of this view.

For example, in the Commons Finance Committee hearings, Doug Peters, a former TD Chief Economist and Liberal Cabinet Minister from 1993 to 1997, dismissed the Senate Banking Committee report as a “charade” that ignored the problem of declining levels of domestic competition.⁸⁸ Peters argued that Parliament should stand fast against further consolidation and was particularly critical of how past large mergers had increased service costs and decreased service levels to consumers.⁸⁹ Indeed the Barnes consultations revealed deep divisions about what the criteria for evaluating mergers should be, as a wide array of interest groups tried to influence policy. David Moorcroft, the Senior VP of Corporate Communications at RBC, complained about many of the groups’ agendas. In particular he suggested that restrictions on branch closing should “absolutely not” be included in the process, despite the fact that it was a “hot button” issue for MPs and consumer groups.⁹⁰ While small business and consumer groups all publicly lobbied the committee not to make it easier for banks to merge, behind the scenes many of the larger insurance firms did the same. They did not want banks to get the right to merge while they were precluded from taking over one of the banks themselves.⁹¹

⁸⁸ See Thomas Watson, *Canadian Business*, 3/3/2003, Vol. 76, Issue 4. p. 29.

⁸⁹ See Ryan Starr’s coverage of the hearings, in *Canadian Business*, 3/3/2003, Vol. 76, Issue 4, p. 30.

⁹⁰ Watson, p. 29.

⁹¹ Source: Confidential Interviews, 2006.

At the end of March 2003, the Commons Finance Committee released its views.⁹²

The report was a major blow to any would-be mergers and major restatement of some of the new policy goals Parliament wished to pursue. Predictably, this ran counter to the goals of the banks and many of the recommendations of the *MacKay Task Force*. First and foremost, the *Barnes Report* argued that there should be no major change in the existing principles of the merger review policy – that there should still be a parliamentary committee review of any merger proposals of banks with over \$5 billion in equity. The report was not simply “status quo,” however. It went on to clarify the meaning of the Public Impact Assessment that the merging banks would have to present to the parliamentary committees and thereby clarified the “public interest.” The report argued banks would have to provide evidence that:

- The merger would result in no less than the existing range of services to all Canadians.
- The merger would increase access to capital for small and medium sized business.
- The merger would ensure services to rural and remote communities.
- The merger would minimize job losses.
- The merger would benefit the domestic market and increase international competitiveness.

These were all “red flags” to the banks that mergers were not likely to be accepted.

Furthermore, as the press noted in the days following the release of the report, at the time, the Government viewed this as the first step in yet another piece of legislation to clarify the rules for mergers, meaning that it would be inappropriate to even consider a merger under the existing law until newer, clearer legislation was created.⁹³

⁹² Canada, Standing Committee on Finance, Large Bank Mergers in Canada: Safeguarding the Public Interest for Canadians and Canadian Business, March 2003.

⁹³ Sean Pasternak and Sandra Cordon, “Commons report halts bank mergers,” Vancouver Sun, March 28, 2003, p. D3.

Bank supporters were upset by the report. David Bond, the retired Chief Economist of HSBC prepared a C.D. Howe Institute study on the mergers question. The report suggested that the House committee's study conveyed:

. . . the impression that responding to special interests is more important than enabling the banking subsector to prosper in a rapidly changing world. The government's response is similar in tone . . . it would appear that only the most desperate of bank CEO's would ever attempt a merger because of the various hurdles⁹⁴

Bond's study reiterated what the banks had been saying for two years:

On the face of it both committees espoused the belief that mergers are a legitimate business strategy. The Commons committee, however, unlike its counterpart in the Senate, recommended for itself an integral part in reviewing any merger proposal, supposedly with the objective of protecting the public's interest. This process makes merging a political lottery, not a business strategy.⁹⁵

Bank of Canada Governor David Dodge intervened in the subsequent debate about the merger review process. Dodge also rejected the position of the Commons Committee. In December he held a news conference to outline his views. He argued that Canada's banking industry was falling behind in the efficiency race as other deregulated jurisdictions were showing a more permissive attitude towards consolidation both within and across industry sectors. "To stay competitive in this environment, Canada's financial system must also constantly increase its efficiency . . . the status quo won't cut it."⁹⁶ Dodge suggested that the evidence around the world shows that size does matter in

⁹⁴ David Bond, "Bank Mergers – Why we need them, How to get them – Background", CD Howe Institute, No. 74, September 2003, www.cdhowe.org, p. 2.

⁹⁵ Ibid.

⁹⁶ Quoted from, "Bank of Canada's Dodge muses on merits of bank mergers," CBC News, December 09, 2004, <http://www.cbc.ca/story/business/national/2004/12/09/dodge-120904.html>

generating the industry efficiencies necessary in Canada. Anti-bank merger groups were impeding the success of the industry.⁹⁷

Given the “uncertainty” of the merger review process, no merger announcements were expected after the *Barnes Report*, but they remain very much on the “policy horizon” as long as the banks continue to want them. Indeed, it was thought that much of the uncertainty would be resolved when the Federal Liberal leadership race was resolved. According to industry insiders, merger proposals between big banks are inevitable. Finance Minister John Manley, at the time, still a candidate to replace Jean Chrétien, released an informal “timeline” for considering another round of mergers. Manley suggested that the government would accept proposals, pending the fine-tuning of the government review process, after September 30, 2004. Manley told the banks that there would be no “first come first served” process; that instead, banks would have a 60 day period in the fall of 2004 to all put their proposals on the table so they could be jointly considered.⁹⁸

Arguably, joint consideration of multiple mergers ensures that none were likely to be approved and that this was really a stalling tactic by the government which did not want to deal with such an unpopular issue.⁹⁹ Both Manley and his successor, Ralph Goodale, insisted on joint consideration of any proposals. Given the ruling of the Competition Bureau in 1998, it seems possible that one merger between two big banks could be legal, but several at the same time would have too drastic an effect on

⁹⁷ Interviews with Bank of Canada officials suggest serious concerns about the global competitiveness of the industry in recent years. One official suggested that regulations preventing firms from making business strategy-driven decisions, such as obstacles to mergers, would only harm the industry in the long term. Source: Confidential Interviews, 2005.

⁹⁸ Sinclair Stewart, “Bank bidding wars expected,” *Globe and Mail*, June 25, 2003, p. B1.

⁹⁹ Source: Confidential Interviews, 2006.

competition. Therefore, proponents of mergers want a “first in first out” system in which the first merger proposed is considered on its own merits. Such a system however, creates considerable mistrust amongst the banks as they fear that some amongst them may make a deal with the cabinet to “get in first.” To protect against this, they advocate joint consideration of multiple proposals, which ironically reduces the prospects for mergers.¹⁰⁰

In any event, these questions were rendered moot in the June 28, 2004 Federal Election. Paul Martin’s failure to win a majority government effectively killed any consideration of mergers between big banks and any large scale conglomeration in the industry. In the absence of clear executive dominance, given the attitude of many MPs and the continued influence of the anti-bank constituencies in the policy network, it is extremely unlikely that any big decisions on the regulation of the sector will be made in the near future. In fact despite repeated financial press headlines in 2005-2006 announcing new political sympathy for the banks’ merger demands, the situation in the House of Commons ensures that nothing will be done. Stephen Harper’s new minority government has also made it clear that no decisive action will be taken on these issues anytime soon.¹⁰¹

Bank officials note that effectively, the barriers on bank/bank and bank/insurance company mergers serves to lock in the basic structure of the Canadian financial services market, without an explicit policy that this is the case.¹⁰² Depending on where the line is drawn on size, until restrictions on mergers are lifted and because foreign takeovers are effectively barred, Canada will continue to have five large banks and three large

¹⁰⁰ Source: Confidential Interviews, 2005 and 2006.

¹⁰¹ Source: Confidential Interviews, 2006.

¹⁰² Source: Confidential Interviews, 2006.

insurance companies. In other jurisdictions like Australia the government has explicitly passed legislation stabilizing the number of domestic industry participants as a response to the trade offs between global and domestic competitiveness. In Canada this has effectively occurred as a by-product of anti-bank sentiment inside the financial services policy network.

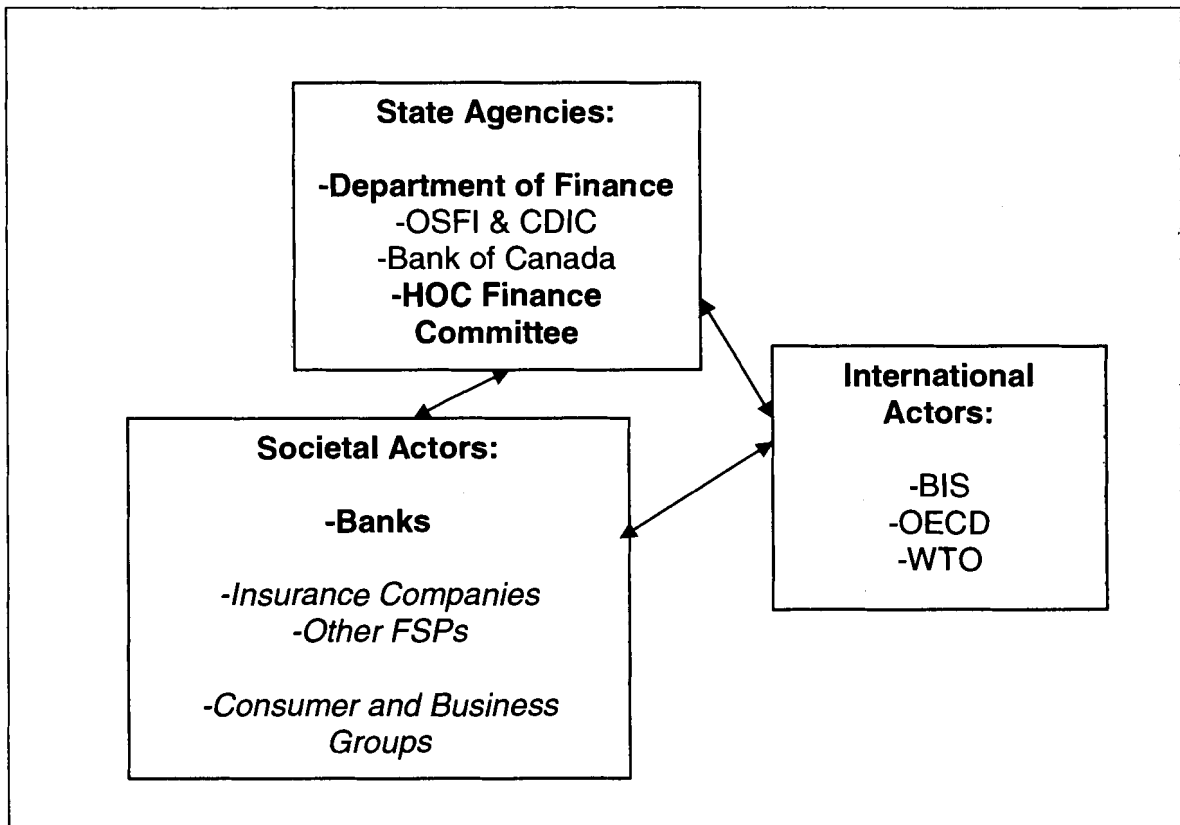
VI) Conclusions- The Open “Issue Network,” Parliament and “Anti-bank” Groups (1997-2004):

Since 1998, the banks’ efforts to restart the process of deregulation and conglomeration have been inhibited by a number of factors. First, the popular political rhetoric of globalisation has become far less effective in driving policy towards further deregulation and liberalization. There remains little evidence of foreign penetration into an industry which was said to be threatened through the entire decade of the 1990s. If the “sky is no longer falling,” the range of possible policy outcomes may be much larger. Indeed, one of the banks’ biggest problems in this respect is that they continue to report extremely high profits, even in comparison to their major international competitors.¹⁰³ Closely related, widespread anti-bank sentiment is persistent and unpredictable and many industry associations and groups which are eager to influence government policy continue to use these sentiments to undermine the banks’ influence. As the *Barnes Report* illustrates, many of the arguments used to counter the banks agenda in 1998 remain of central concern to MPs. Finally, the reforms of Bill C-8, *An Act to Establish the Financial Consumer Agency of Canada, and to Amend Certain Acts in Relation to*

¹⁰³ A study released by Boston Consulting Group on May 10, 2005, suggests that over the last five years Canada’s banks had the highest average annual shareholder returns in global rankings (averaging 23.3 percent per year). This rate was more than double that posted by US banks. See Sinclair Stewart, “Banks top Global Rankings” *Globe and Mail*, May 10, 2005.

Financial Institution (2001), have increased Parliament's oversight of the industry, particularly in regards to mergers between large financial service providers. This means that "anti-bank" groups continue to have the opportunity to exact some sort of control over the industry. The policy network is much larger than in the 1980s and the process of policy reform far more public, meaning that the banks face more scrutiny than in the past (see Figure 8.1)

Figure 8.1: The Canadian Financial Services Network – Open Issue Network Period (1998-2004)



Network Structure:

Revisiting Coleman's "esoteric politics" map of the Canadian financial services network clearly shows there have been some major changes since the deregulatory period. Firstly, the relevant parliamentary committees must be included in the policy network. They have played a key role in defining the rules governing industry conglomeration and the legislative priorities for Bill C-8, very unlike the deregulatory period where Parliament was largely left out of policy formulation. In recent years much of the policy impetus has been coming from Parliament. The House of Commons Finance Committee in particular has had an expanded impact on policy formulation. This is most clear in the areas where Bill C-8 ignored the *MacKay* recommendations, instead focusing on issues of consumer interest. It is also the case that Parliament now has a formalized regulatory role in overseeing mergers. Thus the confusion emerging from the deregulatory period as to who would enforce the "big shall not buy big" standard has been resolved. It will be Parliament.

At the same time, the range of societal actors that have an influence over policy has also expanded. Where once the banks had privileged and virtually exclusive access to influence at the federal level, the insurance industry as well as small business groups and consumer organizations have become recognized players in policymaking. Indeed given policy outcomes, it would seem that they have achieved considerable influence. The head of one of the prominent consumer organizations suggested that the group had achieved about 75 percent of what they wanted in terms of new regulatory apparatus in Bill C-8, noting the establishment of the FCAC, the ombudsman and the new regulatory requirements. They were confident that they could finish the job in the next substantive

round of *Bank Act* revisions.¹⁰⁴ Certainly, the banks can hardly be said to have achieved 75 percent of their goals in recent years. The Independent Investment Dealers Association, other insurance lobbies and the major insurance firms themselves have had a large influence on outcomes. The Canadian Confederation of Independent Business, the Consumers Association of Canada and the Canadian Community Reinvestment Coalition have also influenced events.

Network Structure and Policy Change:

The result is that a range of other concerns have entered the policy debate, although since the groups have competing agendas, often in a confusing manner. New policy goals include increasing competition for banking services, increasing consumer protection and holding the line on further conglomeration amongst the largest industry players.

All of the major policy initiatives since 1998 illustrate the impact of these goals. Bill C-8, for example, the legislative response to the *Mackay Task Force*, largely held the line on further bank demands for expanded powers. This was a major setback for the banks. Similarly, reversing almost two decades of wholesale deregulation, the legislation established several new agencies and guidelines designed to increase transparency in banking and improve accountability to consumers and small business. As well, a series of initiatives, such as demutualization and relaxed rules of entry have at least theoretically increased the likelihood that a second tier of domestic competitors will survive in Canada. Finally, the House of Commons Finance Committee has formalized

¹⁰⁴ Source: Confidential Interviews, 2005.

its role in overseeing conglomeration in the sector, which has effectively killed serious consideration of large mergers in the industry.

Policy outcomes in recent years have become much less predictable due to the breakdown of the traditionally closed policy community of this sector. This is very unlike the situation in the early 1990s. At that time, armed with the assumptions and logic of “globalisation” and an extremely closed policy community, observers could paint a relatively clear picture of how the decade would unfold. Canada’s banks would be allowed to rapidly expand into all financial services sectors through aggressive takeover activities. This has not turned out to be the case. The larger number of network participants, many of them pursuing fundamentally different goals from the banks, and the increased role of Parliament in influencing the direction of policy (or at the very least in stalling reform) all suggest a more open issue network than was the case in the past.

By drawing our attention to the macro-institutional policy subsystem setting, networks analysis provides us with useful hypotheses about whether this network was likely to open or close and whether or not policy change was likely. While globalisation has certainly had an impact on the industry, its impact is not simply unidirectional, by solidifying the traditional esoteric politics of the sector. Instead, mediated through deregulation and its institutional impact, globalisation has arguably led to a more “politicized” policy sector than in the past, as Parliament and daily partisan struggles have a much larger role in affecting policy outcomes. De-pillarization, the initial response to the perceived challenges of globalisation, brought previously discrete policy subsystems together in an environment of weak state agencies, and it increased the role

for Parliament. Deregulation created conditions for an expanded policy network and a great deal more conflict over policy. This was a surprising and unexpected result.

Consistent with much recent scholarship on this question, this result suggests that globalisation will produce different policy outcomes in different national settings because they have different institutions. Given the insights of network analysis which explores the role of institutional settings within a policy specific domain, responses to globalisation may also vary within a national setting depending on sector-specific institutional arrangements. Thus, as Daugbjerg and Marsh argue, networks analysis can provide predictions about the likely changes in network shape and therefore the likelihood of policy change, when it considers both macro level considerations, like globalisation, along with intervening policy subsystem institutional arrangements.¹⁰⁵ Such an approach has a great deal to offer globalisation scholarship generally.

One of the most interesting lessons that can be drawn from this case is that globalisation and debate about globalisation played a major, if indirect role in policymaking in the deregulatory period, particularly in how it “framed” the understanding of major policy problems. But most analysts have to concede that in recent years global factors have played a more limited role. Domestic politics has been crucial to major policy decisions since 1997. The financial services sector has entered a period of re-politicisation and re-regulation.

¹⁰⁵ Carsten Daugbjerg and David Marsh. “Explaining policy outcomes: integrating the policy network approach with macro-level and micro-level analysis,” In D. Marsh ed., Comparing Policy Networks, (Philadelphia: Open University Press, 1998), pp. 51-71.

**CHAPTER 9: CONCLUSIONS: THE LESSONS OF
CANADIAN FINANCIAL SERVICES
REFORM FOR A “SOCIAL SCIENCE OF
GLOBALISATION”**

“The crisis of Canada today is the combination of economic problems facing us and the increasing impotency of governments that lack either the will or the resources to do much about it.”

Angus Reid

“Men stumble over the truth from time to time, but most pick themselves up and hurry off as if nothing happened.”

Sir Winston Churchill

I) Introduction – The Political Dilemmas of Financial Services:

In the summer of 2005 new Finance Minister Ralph Goodale asked the various opposition party critics in the House of Commons to help him “advance” policymaking in the financial services sector. In particular, Goodale sought an agreement from the other parties on the development of new “ministerial guidelines” for reviewing mergers between large financial service providers that would ease the merger review process.¹ These guidelines were to be agreed upon prior to the start of the scheduled *Bank Act Review*, due in 2006-2007.² Goodale’s initiative was thought to be “impossible” by MPs given the hostility to proposals for consolidation amongst Canada’s banks in the House of Commons and within the Canadian public. Opposition critics of the Liberal minority government responded by suggesting that they would continue to assert Parliament’s role in the sector, in regards to both the *Bank Act Review* and to overseeing the guidelines for

¹ See for example, Alexander Panetta, “Bank Merger Issue Resurfaces,” [Globe and Mail.com](#), Monday July 25, 2005.

² At the same time, Goodale also restarted the Federal Government’s efforts to set national standards in the securities industry, either through a national regulator, through federal intervention, or harmonized provincial rules. At the time of writing, the Finance Minister, under the urging of Bank of Canada Governor David Dodge, who had expressed concern over the international image of Canada’s securities industry, was trying to revive efforts by calling for a national Ministers meeting on the topic. See Steven Chase, “Goodale seeks watchdog meeting,” [Globeandmail.com](#), Wednesday, July 13, 2005. Efforts had stalled in the fall of 2004, when Ontario refused to accept the “passport” harmonization plan, seeing it as an inadequate improvement on national regulation.

reviewing mergers. Many saw Goodale's proposal as disingenuous since the government had little appetite for a fight with Parliament over the issue, particularly given its tenuous hold on office throughout the summer.³

Behind the scenes the banks continued to press for the right to merge. Indeed, in 2005 it was public knowledge that mergers between banks were going to continue to be proposed. Merrill Lynch Canada Inc. has been offering portfolio advice to clients on the basis of which banks are likely to merge over the next few years. The expectation is that a merger announcement will drive stock value up making the correct bank stock a good investment.⁴ The banks also continue to insist that the process of desegmentation started by the 1987 "little bang" and stalled by Bill C-8 (*An Act to Establish the Financial Consumer Agency of Canada, and to Amend Certain Acts in Relation to Financial Institutions*, the 2001 legislation which comprehensively overhauled industry regulation) should be completed, particularly with respect to the limitations on their right to sell insurance "in branch."

Goodale was the third straight Finance Minister to be hemmed in by the politics of the financial services sector. Like the others, he was caught between Canada's traditionally politically-powerful banks who were eager for consolidation and further deregulation on the one hand, and Members of Parliament sceptical of the banks "needs" given intensified global competition. Previous Finance Ministers Paul Martin and John Manley had "dodged" making direct decisions on approvals of the banks' demands, allowing Parliament to effectively tie their hands on such politically charged questions. Parliamentary hostility to potential mergers and to further deregulation in the interests of

³ Source: Confidential Interviews, 2005.

⁴ Alan Robinson, "Bank mergers seen doubtful without majority government," *Globe and Mail*, March 30, 2005. Merrill Lynch's "favourite" merger is a Bank of Nova Scotia/CIBC match.

the big banks remains an effective roadblock in the sector, at least until an election resolves the current minority government impasse.⁵

Many expected that the Government's position on the mergers question would soon change. John Manley, Jean Chrétien's last Finance Minister, seemed to be less supportive of the banks' merger plans. Under his leadership, the Department of Finance leaked reports challenging the banks' case for mergers. However, it was widely believed that a Martin majority government might ultimately have been "merger friendly."⁶ Many, including the banks, believed that once Paul Martin was installed as Prime Minister supported by a comfortable majority in the House, he would re-open the window for the banks. A shrewder, more carefully-managed public relations campaign by the banks, in combination with a Prime Minister who would rein in political opposition to the mergers and leave the process of reviewing the banks' proposals in the hands of the Competition Bureau and OSFI would be just what the banks needed. As the Canada Trust/TD merger illustrated, the government can make it relatively easy for big merger proposals to succeed provided the banks get the process right.

Martin was never put in the position of deciding as his government was defeated in 2006. Similar speculation began immediately on how Stephen Harper's Conservative minority Government and new Finance Minister Jim Flaherty might handle the banks' demands in the sector. In the fall of 2005, the outgoing Liberal government effectively passed decision-making to the Conservatives by starting the legislatively-required *Bank*

⁵ By the end of the summer of 2005, Goodale announced any work on financial services and bank mergers would have to wait once again, as the minority government resulting from the 2004 election was too "fractious" to deal with such a topic. Goodale complained that the other parties were likely to engage in "partisan maneuvering." See, Jacqueline Thorpe, "Bank merger debate may have to wait, Goodale suggests," *Vancouver Sun*, June 22, 2005, p. D9. Opposition critics from both sides attacked the government's indecision and for not moving to "resolve the question once and for all."

⁶ Sinclair Stewart, "Martin seen as merger friendly," *Globe and Mail*, Friday June 13, 2003, p. B3.

Act review, in which a new *Bank Act* must be passed by October 24, 2006 in order for the banks to continue to be allowed to do business. Even if there are no serious changes made to the *Bank Act*, “enabling” legislation must still be passed. While it is possible to get this deadline extended for a short period, eventually the government must “sign off” on the 2006 *Bank Act*. This means that if they want to make substantive changes prior to the next round of revisions in 2011, they must do so within the year.

Given this situation, the banks have heavily lobbied the Conservatives to advance their demands. Publicly, the banks continue to demand the right to pursue mergers.⁷ They also want the right to sell insurance in branch and to be able to use their existing client information for marketing that insurance. The banks argue that the remaining pillar restrictions make little regulatory sense given the way the domestic financial services markets have changed. In interviews, bank officials note that when one of their customers is in a bank and asks about buying insurance, the bank can do nothing in branch. However, they can hand the customer a pamphlet which instructs them basically to go home and buy insurance from the bank online or by phone.⁸ In fact, in some larger centres, RBC has begun to open separate “insurance branches” next door to its bank branches. The insurance branches, run by the bank’s insurance subsidiary, can sell the full range of insurance products. Legally they could also offer banking services.⁹

While some press accounts suggested that the incoming Conservative Government was more sympathetic to the banks’ demands, the government made it

⁷ See Globe and Mail, “Banks want ban lifted,” Thursday, February 02, 2006, www.globeandmail.com.

⁸ While the banks think this is a ridiculous restriction which serves no purpose, it is important to note that it does preclude tied selling.

⁹ A former OSFI official said that the banks could really push this issue through some minor ownership changes. If the banks’ insurance holding company bought out the parent bank, the bank’s branches, under the current legislation, would suddenly be allowed to sell insurance. Source: Confidential Interview, 2006. The official suggested that RBC “insurance branches” were part of a longer term strategy to make the existing legislation appear irrelevant so that the government would relent.

immediately clear that approving bank mergers was not on its agenda.¹⁰ While the former Conservative finance critic, Monte Solberg, had publicly promised to “depoliticize” the financial services sector,¹¹ he was passed over for cabinet post in favour of Jim Flaherty. In private, Flaherty told the CBA and the banks that they should expect little.¹² Publicly, Flaherty suggested that if the banks were interested in mergers they could bring the issue up with parliamentary committees conducting their parliamentary reviews of the *Bank Act*.¹³

The banks responded by suggesting that they would focus their lobbying efforts instead on removing the obstacles in the *Bank Act* to in branch insurance sales.¹⁴ Despite the public demands however, bank insiders expected the 2006 *Bank Act* revisions to be an abbreviated process and had little optimism that the government would make any big decisions given the limited time frame. Lobbyists privately suggest that their relationship with most Conservative MPs is not much different than with the Liberals. One official said that since most conservative MPs are from “rural” Canada, and they are even more sympathetic to the existing insurance dealers than the Liberals were.¹⁵ More to the point, while it is probably too early to know what direction the Conservatives might move over the long term, bank executives and officials at the CBA have already acknowledged that

¹⁰ See, Brian Laghi, “Bank mergers left off Tory Agenda,” *Globe and Mail*, 05/04/06, globeandmail.com, or, *Globe and Mail*, “Banks want ban lifted,” Thursday, February 02, 2006, www.globeandmail.com.

¹¹ There had been a fair bit of Conservative criticism of the Liberals’ “political interference” in the sector over the last few years.

¹² Source Confidential Interviews, 2006.

¹³ Laghi.

¹⁴ Ibid. A CBA official said that, by necessity, the banks had to push the insurance issue, particularly in light of the clear barriers to any change on the mergers question - they hoped they could link the two issues for strategic reasons, advancing one at the expense of the other. Source: Confidential Interviews, 2006.

¹⁵ Source; Confidential Interviews, 2006.

the minority government outcome of the election meant that mergers and the insurance sales were probably “dead issues.”

The important point to note in all of this, however, is that *these things matter*. Despite the assumption of the esoteric politics framework, big decisions regarding the future of the financial services sector in Canada remain very much within the preserve of Parliament and day to day Canadian politics. Gone are the days when ministers, working privately with regulators and bank chairmen, agreed to the banks’ demands for policy change. The partisan composition of Parliament, the specific Finance Minister, and the attitudes of various House of Commons committees are all crucial to predicting policy outcomes.

Bank officials complain that this new environment has made the task of influencing policy “infinitely more complicated” than was the case in the “old politics” of one stop shopping when the banks could deal directly with the Minister and the Department of Finance.¹⁶ The CBA, responding to the challenges of trying to “get the votes” in the House of Commons to support their policy demands, has gone so far as to send staff to Washington to learn how their counterparts in the US attempt to influence Congress, in the more “open” US system. Regulatory officials who have been active in the sector for years complain that the basic “problem” in the sector right now is that it is being run by “. . . a bunch of rather uneducated politicians who whip the banks, because it is always good politics.”¹⁷ The banks themselves complain that they have been cheated by the promises of deregulation. One suggested that the banks had “placed their bets” on growth in the domestic market following de-pillarization, but that the full

¹⁶ Source: Confidential Interviews, 2006.

¹⁷ Source: Confidential Interviews, 2006.

fruition of domestic conglomeration has been denied in the end because of the political environment in Ottawa.¹⁸ What does all this mean?

There has been a tendency to assume that the politics of financial services in Canada has involved a trade off between *needed* industry restructuring as a result of globalisation (domestic deregulation and conglomeration) and a partisan backlash against the big banks which has simply delayed the inevitable. This has certainly been the position taken by a number of the “think tank” studies of the sector conducted by the C.D. Howe and Fraser Institutes. It is also central to Stephen Harris’ analysis.

Harris suggests that, unlike the Mulroney era, the lack of Liberal Party caucus support for the positions put forward by the banks has stalled reform. The lack of Liberal support is inseparable from the broader antipathy of Canadians for the banks. This hostility “. . . resonated with the caucus and provided a good reason to delay purposeful action in a policy area likely to yield negative externalities for the minister and the government. This pattern of inaction in regard to financial sector policy continues to the present day.”¹⁹ For Harris, the banks’ own success and profitability has allowed politicians, eager to advance their own interests, to cynically redirect policymaking in this area for political benefit rather than respond to the sector’s “real problems.” In short, “Financial sector policy in Canada was inadequately informed of developments in global finance and the dynamics of its business environment and was at odds with the policies in most OECD countries.”²⁰

¹⁸ Source: Confidential Interviews, 2006.

¹⁹ Stephen Harris, “Financial Sector Reform in Canada: Interests and the Policy Process,” Canadian Journal of Political Science, March 2004, p. 162.

²⁰ Ibid.

For Harris, rent seeking particularistic interests have simply had more influence over policy in Canada than has been the case in other countries. He maps out a public choice approach which suggests that the government's foot dragging has been fueled by the economic self-interest of the banks' competitors who do not wish to see the expansion of the banks' powers to compete. Ironically, Harris notes that one of the implications is that it has made political oversight of the industry more important than might have been expected in the era of globalisation.²¹ Harris suggests that the only way to bring the policy agenda back in line with the realities of globalisation is to restore the policymaking capacity of Department of Finance that had "hollowed out" over the 1990s.²² Finance should have more "real" expertise about what is going on in the sector, presumably restoring the balance to the situation in the 1980s when Finance negotiated policy outcomes with the banks, largely to the exclusion of Parliament.

Such an account is inadequate. There is little evidence that the "irrational politics" of the sector in Canada, insufficiently attuned to the logic of globalisation and global competition, has in any way harmed the sector. In fact, the record-breaking profitability of the big banks suggests the opposite.²³ Despite the banks' prognosis of doom for the Canadian industry in the absence of even greater domestic economies of scale, thus far the early years of the 21st century have been phenomenally profitable. Canadian banks give their shareholders the best rate of return of any banks in the world, a remarkable 2.5 times better than banks in the US.²⁴ In a study released by the Boston

²¹ Ibid., p. 167.

²² Ibid., p. 179.

²³ All five big banks' profits were up again in 2005. See Tavia Grant, "Scotiabank Profit Rises," globeandmail.com, Tuesday, March 1, 2005. TD's quarterly net profit increases by another record breaking 22% in the spring of 2005. See, TD online or Globe and Mail, May 26, 2005.

²⁴ See, Sinclair Stewart, "Banks top Global Rankings," Globe and Mail, May 10, 2005.

Consulting Group, examining banks' global competitiveness, the Canadian industry emerged on top. Between 2000 and 2004, the average rate of return on equity for Canada's big banks was 17.3 percent per year.

The bottom line however, is that the loss of control of the policy agenda by Canada's big banks is historically unprecedented, contradicts IPE scholarship assumptions of how globalisation was likely to affect state autonomy in the sector, and contradicts existing public policy analysis of the Canadian sector.

II) Interpreting the Findings:

This dissertation has argued that while it was logical to assume that globalisation might have further entrenched the esoteric politics of the sector in the post-Mulroney era, the public's increasing use of financial services, combined with growing hostility to the banks' domination of the industry produced a backlash and re-politicisation of the sector from 1998 to the present. The way in which deregulation unfolded in Canada did not produce a decrease in public and state oversight of the industry, but instead stimulated demands for closer public scrutiny. While global markets and political pressure played a role in driving reform in the Canadian financial services industry, understanding how those pressures have translated into policy requires much closer attention to domestic politics. A number of broad conclusions can be drawn.

a) IPE and Domestic Politics:

First, the "internationalization and domestic politics" literature in IPE is clearly headed down the "right path" by trying to combine global level variables with domestic institutional and political analysis. First wave globalisation scholarship which suggested

a mono-causal explanation for domestic policy change cannot account for the politics of this sector in Canada. As Ian Roberge suggests, “hyperglobalization” arguments simply do not work in this case.²⁵ Arguments that global market integration inevitably constrain policy autonomy and produce convergence around deregulation and liberalization at the national level invariably emphasize sectors like financial services. However, the evidence presented here suggests that domestic politics still has pervasive influence on policy outcomes.

Globalisation initially further-entrenched esoteric politics and supported the transition to a deregulated universal banking environment in Canada with widespread industry conglomeration. But later a broader and more open politics has emerged. This change was produced by interaction between changing domestic interests and existing institutions. Thus if we really wish to understand the sector-by-sector specifics of globalisation, we need to move beyond crude generalizations and draw more directly on insights and models drawn from public policy. The policy networks framework drawn from Coleman’s work is a useful way to capture how globalisation can alter the domestic politics of a sector in unpredictable ways.

While “second wave” globalisation studies have suggested that domestic institutions mitigated the effects of globalisation and that domestic partisan politics matter,²⁶ this study moves one step further. Here the argument is not simply that domestic politics matter, but that an assessment of policy domain-specific institutional

²⁵ Ian Roberge, The Internationalization of Public Policy and Multi-level Governance: A Comparison of Financial Services Sector Reform in Canada and France, (Doctoral Dissertation. McMaster University, 2004), p. 203.

²⁶ For example, Geoffrey Garrett and Peter Lange (1996) showed that partisan political leanings continued to have a predictive role on the kinds of macro economic policy choices states make. Geoffrey Garrett and Peter Lange, “Internationalization, Institutions and Political Change,” in Keohane and Milner, eds., Internationalization and Domestic Politics, (New York: Cambridge University Press, 1996), pp. 48-75.

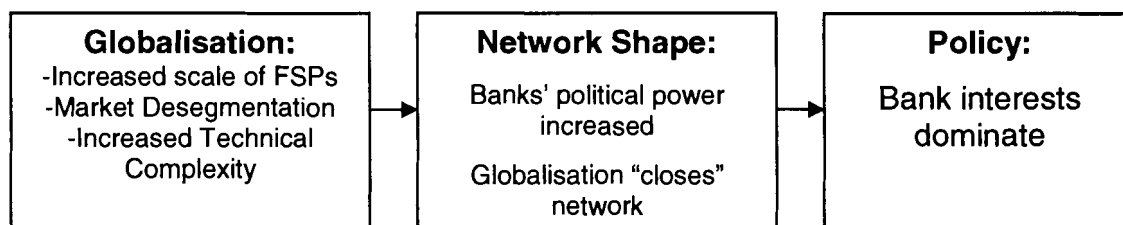
settings can help predict the areas in which domestic politics is likely to matter. Through attention to policy networks, their “macro institutional” settings, and the likelihood that network shape may change in response to globalisation, scholars of IPE will be better able to predict areas in which globalisation might have a large effect on domestic politics, and areas where domestic politics and domestic state capacity may actually be stimulated by globalisation. Networks analysis offers essential insights to both Canadian political economy approaches to globalisation and its impact on domestic policy choices, as well as the more “mainstream” IPE literature which has recognized the need for domestic political models to improve analysis.²⁷

b) Policy Networks and Financial Services Reform:

Much like mainstream IPE literature, the existing public policy scholarship on the Canadian financial services sector suggested that globalisation of financial services markets was likely to significantly constrain domestic policy autonomy. Coleman’s analysis suggested that globalisation, by increasing the scale of financial service providers, by facilitating market desegmentation, and by increasing the technical complexity of the sector, would entrench the dominance of Canada’s federally-regulated “big banks” in the policy network. The existing esoteric politics of the sector, where policymaking was informally negotiated between the banks and the key state agencies, would be further entrenched in a closed policy community that would produce predictable policy outcomes reflective of the demands of the banks (see Figure 9.1).

²⁷ See respectively, Grace Skogstad, “Globalization and Public Policy: Situating Canadian Analyses,” Canadian Journal of Political Science, XXXIII:4, December, 2000, pp. 805-828 and Andrew Maravcsik, “Taking Preference Seriously: a Liberal Theory of International Politics,” International Organization, 51, Autumn, 1997, pp. 513-53.

Figure 9.1: Coleman’s Hypothesis – Globalisation and “Esoteric Politics” in Canada



Drawing on historical institutionalism and networks analysis, Coleman’s model suggests that we examine the market power of financial service providers, the associational system and the particular national policy network. Assessing these factors in the Canadian case led Coleman to predict that policymaking would be largely reactive to the political pressure of Canada’s banks. Furthermore, globalisation would entrench this situation. There is a great deal of merit in this analysis. However, events since 1998 have actually shown a “re-politicisation” of the sector, as “politics matter” more now in policymaking than in the past.

The esoteric politics argument assumed that the sector had an extremely closed policy network, in which finance officials worked closely with large FSP, principally the big banks, in managing policy to the exclusion of other interests. It assumed that globalisation, by increasing the power of the banks in the Canadian setting, and by increasing the technical complexity, would entrench this dynamic, albeit it in a “new esoteric” politics where the public may well expect a more formalized policy process.

However, the esoteric politics analysis involved two oversights in the Canadian case, which contributed to the breakdown in esoteric politics. Firstly, Parliament and

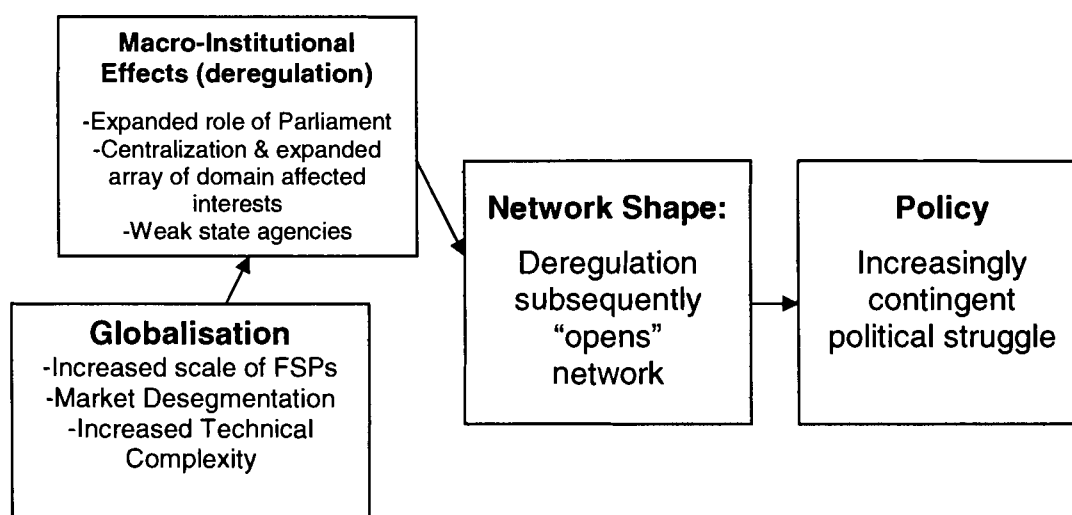
parliamentary committees have become an important part of the policy network. The government's failure during the deregulatory process to create a comprehensive industry regulator or even an industry ombudsman meant that issues of industry competition and concentration and business practices, such as service fees, remained "residually" the responsibility of Parliament to oversee.

Against a backdrop of widespread hostility to the big banks' growing domination of the financial services industry, the residual role of Parliament has provided a point of entry in the policy network for "anti-bank" groups. The overwhelming public controversy about the banks' 1998 merger proposals provided a historic opportunity for these groups to challenge the dominant policy paradigm and stop the process of industry conglomeration. The subsequent institutionalization of this dynamic through Bill C-8 has expanded Parliament's ongoing oversight of such matters and dramatically altered the shape of the policy network. The policy network is wider and more contested than the esoteric politics analysis suggested in 1996. This has served for the last nine years to stall any further consideration of mergers between big banks and between banks and insurance companies. No change in this dynamic can be expected in the immediate future.

Second, and relatedly, the precipitous collapsing of several policy subsystems into one during the deregulatory period ensured that there were new actors and interests demanding access to policymaking. Groups representing the insurance industry, provincial deposit-taking institutions, provincially regulated securities dealers, and small businesses and consumers, all sought access to the new federal "financial services policy network." The combination of centralization of the policy sector inherent to de-

pillarization, the increased role of Parliament, and the existing weakness of state agencies all created conditions under which the network would expand. Ironically, while events of the deregulatory period were ostensibly responses to “globalisation,” over the long term they have served increase the importance of domestic politics (see Figure 9.2).

Figure 9.2: Deregulation and the “Issue Network”



Many aspects of Coleman’s analysis remain valid. Most notably, policymaking remains reactive, as state capacity to create anticipatory policy changes is limited. Nevertheless, the policy network is wider than the esoteric politics argument assumed and this has had a crucial impact on policy outcomes. As was illustrated in Chapters Seven and Eight, policy outcomes in the sector have become increasingly unpredictable and are frequently not reflective of the interests of the big banks.

c) Understanding “Globalisation:”

The findings also suggest a great deal about how globalisation should be integrated into networks analysis. Factors associated with globalisation prompted the era of regulatory reform, contributing to domestic shifts in the existing policy paradigm. In the Canadian case this led to an erosion of support for the system of pillarization. But globalisation’s impact has been largely “discursive.” “Analysis” of globalisation has played a role in ideological debate about how the sector should be regulated, but it has played little role in altering the shape of the Canadian financial services industry. Banks argued that “globalisation” required that Canada have larger diversified banks to ensure its status as a major financial centre. These arguments influenced policymakers, but as time has gone on and little evidence has emerged suggesting a widespread foreign assault on the Canadian marketplace, anti-bank groups have succeeded in shifting debate back to concerns about the level of domestic competition.

Political efforts at globalisation, trade agreements, and international regulatory cooperation have played little role in directly exposing Canada’s banks to competition from foreign service providers. Instead, they have played a more limited role, by altering the nature of the domestic policy debate. Discourse about globalisation and global liberalization tended to strengthen the position of Canada’s banks in the policy network, lending credence to their claims that they needed to get bigger before foreign banks entered the Canadian market.

However, even this perception may be changing. In recent years Canada’s banks have become victims of their own economic and political success. Their initial ability to turn the deregulatory process away from efforts to increase domestic competition towards

support for widespread industry conglomeration laid the groundwork for a dramatic strengthening of their economic position.

Throughout the decade of reform, the dual perceptions that international trade agreements and international competition from foreign “superbanks” would inevitably challenge the viability of Canada’s financial services companies altered the basic assumptions of policymakers regarding which regulatory framework would best serve Canadians. The fear of globalisation in the industry and in government circles predisposed them to regulatory changes which would allow Canadian “superbanks” to emerge. The fact that this occurred in the absence of any serious foreign bank penetration into the core business markets of Canada’s largest financial services companies illustrates that globalisation’s main impact in sectoral reform was in altering policymakers’ perceptions of the long term challenges facing the industry. Policymakers abandoned concerns over the lack of competition within Canada and instead focused on the long term international challenges facing the industry.²⁸

This broad consensus about the need for conglomeration fell apart after 1998 as a result of struggles between competing policy goals, and the increased politicisation of sectoral regulation. Since there is little evidence that the banks’ position is being challenged in the Canadian market by larger foreign firms, opponents of intensified bank domination of all financial services sectors have been able to take advantage of a “backlash” against the banks.

²⁸ Furthermore, the industry has continued to be successful internationally. While the scale of Canadian FSPs has declined relative to the size of leading global banks, Canadian firms have steadily increased the scale of their foreign operations, particularly in the US market. All of this speaks to the health and competitiveness of the Canadian banking industry.

In the end, comparative historical institutionalist studies of financial services have argued that:

One lesson we can draw from this study is that domestic responses to globalization go beyond the commonly stipulated alternatives of either 'convergence' or 'persistence', but provide a mixture of both. . . . [In the case of financial services] . . . countries did converge on patterns of standardization and instruments of regulation, while differences in underlying institutional frameworks of regulation prevail.²⁹

These differences can be better understood by combining policy networks analysis with a more critical approach to globalisation which, instead of assuming global market integration as a given, places emphasis on how globalisation is interpreted in a specific policy subsystem.

This illustrates Howlett and Ramesh's argument that most of the effects of globalisation on domestic public policy are indirect, creating new opportunities for domestic actors to pursue existing political agendas, albeit it in a way that is often unpredictable. This kind of analysis brings public policy scholarship closer to the conclusions drawn by critical political economy perspectives on globalisation that see it in some sense as a "domestic" process in which elites deploy globalisation as a way to advance their own interests. As Howlett and Ramesh conclude, while:

. . . it is true that most governments in recent years have made varying levels of effort, albeit often more in word than deed, to deregulate the economy . . . contrary to what supporters and opponents of this trend believe, an analysis of these efforts reveals that the underlying causes of the shift are often domestic rather than global in origin.³⁰

²⁹ Susanne Lütz, "Convergence Within National Diversity: The Regulatory State in Finance," *Journal of Public Policy*, 2004, 24, 2, p. 190.

³⁰ Michael Howlett and M. Ramesh, "Globalization and the Choice of Governing Instruments: The Direct, Indirect, and Opportunity Effects of Internationalization," *International Public Management Journal*, 9(1), 2006, p. 7.

Deregulation and liberalization of the financial services industry, and the subsequent re-politicisation of the sector, has in large part emerged through domestic political processes. While “globalisation” has played a large role in explaining the initial trajectory of reform towards deregulation, it has mainly manifested itself by providing an important context, prompting a period of massive policy evaluation and change. This dynamic is clear in the Canadian case.

d) A Unique Canadian Case?

The findings of this study would be interesting but less compelling were it not for the fact that a similar pattern of “re-politicisation” of this sector has been noted in other states. Comparative analysis has suggested the continued importance of national institutional settings in financial services policymaking. For example, Susanne Lütz’s recent analysis of banking regulatory politics argues that while there is some convergence around a certain “hegemonic regulatory model” driven by international cooperation in areas like prudential regulation, “national diversity with respect to the timing and the extent of regulatory change depends to a large extent on the existence or absence of institutional veto points in the domestic political system.”³¹ Indeed, Lütz’s earlier work suggested that one common factor in this sector was that in a number of jurisdictions, globalisation had stimulated centralization of policymaking in the sector, expanding the power of national governments at the expense of local governments, and contributing to

³¹ Lütz, “Convergence Within National Diversity,” p. 169.

unexpected increases in state capacity.³² Country-specific studies have noted a pattern of re-regulation in recent years in France, Germany, Australia and the United States.³³

This suggests that the current proliferation of work focusing on international regulation and political cooperation in regards to financial services may be implicitly overestimating the importance of international politics at the expense of national regulatory initiatives. In the wake of the Basle Capital Adequacy Standards and ongoing international financial instability, it has become fashionable to assume that the financial services industry can only be regulated through international cooperation, if at all. Studies like this, which emphasize the latitude of domestic policymakers to pursue different regulatory goals, suggest that state capacity and autonomy are far from dead in this sector.

III) Implications for Financial Services in Canada:

This study also suggests a number of implications for the future of financial services politics in Canada. It suggests that policy outcomes are likely to remain contingent on political struggles inside the network. This makes policy unpredictable. It has become hard to predict whether bank mergers may be approved in the years ahead, or if the last vestiges of pillarization will be abandoned. Both seem unlikely given the

³² Lutz has shown that globalisation and international cooperation have led to increased centralization of authority over financial services, often improving the effective power of national regulatory agencies in various studies. See Suzanne Lutz, "The revival of the nation state? Stock exchange regulation in an era of globalized financial markets," *Journal of European Public Policy*, 1998, 5, 1, pp. 153-168 and Richard Deeg and Suzanne Lutz, "Internationalization and Financial Federalism: The United States and Germany at the Crossroads?" *Comparative Political Studies*, 33 3 (April 2000), pp. 374-405.

³³ See for example, Roberge, p. 197 and Andreas Busch, "Divergence on Convergence? State Regulation of the Banking System of Western Europe and the United States," Workshop on theories of Regulation, Nuffield College, 2002. For a similar argument in regards to the Australian case, see Canir Bakir, "The exoteric politics of bank mergers in Australia," *Australian Journal of Politics and History*, (51), 2, June 2005, pp. 235-256.

current shape of the network. However, the banks continue to have a great deal of potential political power. Consumer groups argue that the current round of *Bank Act* revisions will involve another rounding up of public oversight of the banking industry. However, as Coleman suggests in his study, the banks' sources of power and influence are pervasive. One wonders how long "anti-bank" politics can be sustained.

Indeed, a number of developments could radically alter the situation. For example, the banks are actively trying to improve their relations with small business, one of the key groups in promoting anti-bank politics in Parliament. A bank lobbyist suggested that the banks will never again treat small business the way they did in the 1990s, calling in their capital during a recession.³⁴ He is optimistic that over the long term, small business and the groups that represent them in the financial service sector can be convinced of the merits of some of the banks' demands.

Similarly, the rivalry between the insurance industry and the banks could erode at any time. For example, Manulife has sought several times to enter the banking business. A retired official said that if any of the large insurance companies were to buy a bank, or enter that sector; their position in opposition to most bank demands would change.³⁵ Politically, when restrictions on mergers between the demutualized insurance companies and banks are lifted, mergers between the two seem more politically feasible than bank/bank mergers. This could radically alter the politics of this sector.

The attitude of the new Conservative Government, if it survives its tenure as a minority government and manages to form a more stable majority government, could alter the playing field as well, if it turns out to be more supportive of the banks' agenda.

³⁴ Source: Confidential Interviews, 2006.

³⁵ Source: Confidential Interviews, 2006.

Finally, the banks continue to hone their arguments in support of further deregulation and conglomeration. They note that the number of competitors in the sector may finally be increasing, though they have made this argument this before. ING is certainly expanding its operations in Canada. HSBC has expressed some interest in buying branches from the existing big five banks if any of them merge and wish to “divest” themselves of the excess branches. One proponent of mergers suggests that this is an important development because it makes it potentially easier for the merging banks to satisfy the Competition Bureau. The HSBC’s expansion would mitigate any possible reduction in services and competition.³⁶ Indeed CBA officials note that HSBC and ING illustrate what might be possible if the government would let the banks pursue their own business strategies. They argue that in order for ING to become the global competitor it has, the Netherlands first had to accept levels of domestic concentration higher than Canada. The HSBC is now one of the largest banks in the world. In 1990 it was smaller than the RBC. The banks believe that their arguments are more valid than ever and the failure to come to grips with mergers is inhibiting the growth of Canadian banks.³⁷

However, despite the belief in the banking community that the case can be made more successfully for conglomeration in the not too distant future, perhaps as soon as there is a majority government in Ottawa, others see it as a non-starter. A former Deputy Minister noted that the industry might have changed, but the bottom line is that the banks’ returns on equity are better than ever and that is hard for them to rebut in policy debate.³⁸

³⁶ Source: Confidential Interviews, 2006.

³⁷ Source: Confidential Interviews, 2006.

³⁸ Source: Confidential Interviews, 2006

Indeed, the larger lesson for participants in this policy network has to be to “be careful of what you wish for.” Ultimately, had the banks not been so successful at dominating the period of deregulation, they might not have lost control of the agenda in recent years. Had the banks accepted proposals for a more effective industry-wide regulator in the 1980s, they might not have had to deal with MPs on so many issues in recent years. There can be little doubt that given years of record-breaking profits and rates of return on equity that are the envy of bankers around the world, the banks may currently be victims of their past economic and political success.

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APPENDIX: CHRONOLOGY OF EVENTS

1983	TD opens its discount brokerage, “Green Line Investor Service”
1984	OSC Chairman Peter Dey study of the securities industry in response to foreign interest in entering the sector.
January	Roy Maclaren (Junior Finance Minister) Appointed William Dimma to study the industry
	“Four Pillars” still intact when Conservatives came to office in 1984.
1985	
March	CCB problems could no longer be hidden. Negotiations began as to what to do to prevent Canada’s first bank collapse in 60 years.
April	Barbara McDougall (The new Conservative “junior” minister of finance releases the “Green Paper” favoring programmatic de-pillarization
Labour Day	Northland Bank and the Canadian Commercial Bank both fail
1986	
Summer	Ontario’s Liberal Government plans to remove provincial ownership restrictions on investment dealers.
Summer	AMEX applies for a charter to form a Schedule II bank.
October 19	Montebello Meeting: Michael Wilson and the bank chairman meet to discuss deregulation and the banks’ demands to be let into the securities industry.
December	Ontario Announces its plans to deregulate the securities industry – Kwinter’s “little bang” - effective June 30, 1987. Canadian financial institutions would be allowed to own 100% of a securities firm. Effective June 1988, foreign firms would be granted the same right.

December Two months after Montebello, Tom Hockin, the new “junior” Minister of Finance releases a Federal Government working paper proposing that restrictions on banks’ ownership of securities firms be removed. This resolves the struggle between the Federal Government and Ontario. Canada, Minister of State for Finance, “New Directions for the Financial Sector” (1986) - The “Blue Paper”.

The Blue Paper also promised a “big shall not buy big” policy during deregulation.

1987

Spring Kwinter-Hunkin accord to resolve jurisdiction over deregulation of the securities industry.

June *Bank Act* Amended. Banks allowed to enter the securities trading sector for the first time. (Legislation comes into effect in June)

OSFI established and CDIC reformed.

Fall Stock market crash.

Fight between Blenkarn Committee (Commons Standing Committee on Finance) and Banks over Credit card interest rates.

1988

Basil Accord (BIS) – Bank of Canada commits to abolishing non-interest bearing reserve requirements.

April Blenkarn-led Commons Finance Committee held public hearings on bank service fees.

May 10 Subcommittee of Commons Finance Committee met with bank heads to negotiate limitations on service fees. Banks, prompted by the Government reject the proposals.

June Commons Finance Committee reports a 34 page finding on Bank Service Charges – McCrossan Private Member’s Bill

Wilson and Hockin negotiate a service fee reform package to end the fight between the banks and the Commons Standing Committee on Finance.

- Nov 21 Federal election - Cabinet passes an order in council granting AMEX the right to pursue a Schedule II bank.
- 1989** Canada/US Free Trade Agreement. Size restrictions on US bank operations in Canada were lifted
- January 25 CBA meeting with Wilson over AMEX issue.
- Commons Consumer Affairs Committee report arguing for a cap on credit card interest rates of 8% above the prime rate. No government Response.
- 1990**
- April AMEX issued a license to form a Schedule II bank in Canada.
- 1992** *Bank Act* amended. Banks could now own insurance companies. "Widely-held" non-bank financial service providers (trust companies, insurance companies and credit unions) could now own schedule II banks without the required 10 year divestiture. All companies were now allowed to "network" different financial services offered by subsidiary or parent companies. Banks could now offer portfolio management and investment advice directly.
- Bank non interest-bearing reserves at Bank of Canada legally abolished.
- Conference Board of Canada Report argues that competition was going to decline in the industry.
- Commons Finance Committee investigates the collapse of Central Guarantee Trust. Highly critical of the OSFI.
- June 1 Legislation came into effect effectively dissolving pillars.
- FIRP, Bill C-48 passed – allowing regulators to seize and sell troubled companies.
- 1993**
- September 1 Royal Trust formally taken over by Royal Bank.
- 1994** The non-interest bearing reserve requirement for banks was eliminated as per the 1992 amendments to the *Bank Act*.

	Under the terms of the North American Free Trade Agreement (NAFTA), size restrictions on foreign bank operations were lifted for Mexican Banks.
October	Commons Standing Committee on Industry issues report arguing for a Bank Ombudsman.
1996	<i>MacKay Task Force on the Future of the Canadian Financial Services Sector</i> appointed.
June	Bank-funded, Canadian Banking Ombudsman established.
June	White Paper Released: 1997 Review of Financial Sector Legislation: Proposals for Changes
1997	<i>Bank Act</i> amended.
	Government proposes that foreign banks, which had been required to establish separately capitalized subsidiaries to operate in Canada, could now establish branches directly in Canada. This legislation was due in 1998, but was not tabled and passed until 1999.
	Under the terms of the WTO/Uruguay Round Agreements, size restrictions on foreign bank subsidiaries in Canada were abolished.
December 12	Final Negotiations on GATS Agreement on Financial Services concluded.
1998	The legislation of new rules which allow foreign banks to directly operate branches in Canada (which was announced in the 1997 changes to the <i>Bank Act</i>) were tabled.
January 23	Royal Bank and Bank of Montreal announce their merger plans.
April 13	Toronto Dominion and Canadian Imperial Bank of Commerce announce their merger plans.
September 14	<i>MacKay Task Force</i> Report released.
October	Standing Senate Committee on Banking, Trade and Commerce release Report comparing Financial Regulatory Regimes.
November 4	"Ianno Report" calling for a rejection of proposed merger released.
November 29	Finance Minister Paul Martin privately informs Banks that the mergers will not receive approval.

December Standing Senate Committee on Banking, Trade and Commerce release their Response to the *Mackay Task Force*.

December Commons Standing Committee on Finance releases its response to the task force.

December 10 OSFI Report on the two mergers released.

December 11 Competition Bureau Report on the two mergers released

December 14 Finance Minister Paul Martin publicly announces that the proposed mergers could not go forward at that time. Instead any mergers would have to await an overhaul of Canada's Banking Regulations which was due in response to the *MacKay Report*. That overhaul would include new guidelines to govern the process for evaluating mergers in the banking sector.

1999

January Legislation allowing insurance companies to demutualize passed.

January 21 Toronto Dominion and Canada Trust inform Department of Finance of their intention to merge.

March 1 WTO GATS Agreement on Financial Services Comes into Force.

June 25 Paul Martin announces a "New Policy Framework" which included proposed guidelines for evaluating mergers.

August 3 Toronto Dominion/Canada Trust Merger announced.

2000

January 28 Competition Bureau informs Martin that with some minor changes the TD/CT merger was acceptable.

January 31 Martin announces that with modifications, the TD/CT has received government approval.

June 13 Government tables Bill C-38 *An Act to Establish the Financial Consumer Agency of Canada, and to Amend Certain Acts in Relation to Financial Institutions* which contains Martin's new Financial Services Legislation including the new merger rules.

November Bill C-38 dies on Order Paper - General Election

2001

February 7 Bill C-8 introduced. The bill was a repeat of Bill C-38.

June 14 Bill C-8 Receives Royal Assent.

2002

December 12 Senate Study on Competition in the Public Interest: Large Bank Mergers in Canada is released.

2003

March 28 Commons Finance Committee releases the “Barnes Report” clarifying the bank merger review process.

June 25 Finance Minister John Manley announces a 2004 timetable for considering new bank merger proposals.

2004

June 28 General Election – Liberal Minority Government – Consideration of Mergers and regulatory reform halted.

2005

November Government begins the legislatively mandated review of the *Bank Act* – legislation must be passed to extend the *Bank Act* by October 24, 2006.

2006

January 20 General Election – Conservative Minority Government.