EXECUTIVE SUMMARY

The integration of financial markets is taking place domestically and internationally. In the domestic context, the provision of financial services is becoming less diffuse. More firms are able to offer more products to more customers, both domestic and international. The international integration of financial markets is a reflection of the free flow of capital across borders.

The relationships between international capital flows, exchange rate movements, financial market integration and trade policy tend to be overlooked by economic theory and trade policy makers alike. Yet, with foreign investment in Canadian stocks and bonds at over C$250 billion, and daily foreign exchange volumes involving the Canadian dollar topping $25 billion, Canada's internationally integrated financial markets clearly have important implications for the economy and trade policy.

While the trend towards more open and internationally integrated financial markets has not diminished the effectiveness of monetary policy, particularly in Canada, where there is a relatively long history of financial integration with the U.S., it has resulted in fiscal policy becoming somewhat less effective. The free flow of capital, and the ability of governments to borrow in international markets, however, has increased the options available for deficit financing.

To the extent that internationally integrated financial markets -- when combined with a flexible exchange rate regime -- involve a degree of unpredictable exchange rate variability, firms engaged in the international trade of goods and services face a financial risk not shared by firms active solely in domestic markets. A number of financial instruments have been developed to help firms manage some of the risks associated with international trade, particularly currency risk. Such instruments -- known as hedges -- are equally available to small and large trading enterprises, since the financial institutions that arrange hedges are as concerned with the currency involved (preferring a major currency with a liquid market) as they are with the size, or dollar value, of the hedge. Small enterprises, however, face other export readiness difficulties.

When exporters are faced with exchange rate variability, such as an appreciation of the domestic currency, and they chose to absorb the exchange rate fluctuations rather than alter their export price, they could be exposed to anti-dumping actions. The threat of anti-dumping for a firm following a rational pricing strategy in order to maintain market share in the export market underlines the inadequacy of anti-dumping as a means of conducting trade relations as they relate to corporate behaviour.