

PO-CH/NL/0266
PART A

Part A

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Begins: 2/5/87.
Ends: 9/2/89.

PO -CH /NL/0266

PART A

Chancellor's (Lawson) Papers:

BRITAIN'S RELATIONSHIP WITH CANADA

PO -CH /NL/0266
PART A

Disposal Directions: 25 years

11/10/95



FROM: P D P BARNES
DATE: 21 May 1987

NOTE OF A MEETING HELD IN ROOM 51/2 TREASURY CHAMBERS
PARLIAMENT STREET AT 3.00 PM ON MONDAY 18 MAY

Those Present: Economic Secretary
Mr Ilett
Mr D Jones
Mr T Hockin, Canadian Minister of State for Finance
The Canadian High Commissioner in London
Canadian Officials

VISIT BY MR T HOCKIN, CANADIAN MINISTER OF STATE FOR FINANCE

Mr Hockin said that he had introduced a hundred page Bill to revise the system of financial supervision a month before. This would contain de-regulatory measures affecting the traditional 4 "pillars" of financial business and would create a superintendent of financial institutions with overall responsibility. The superintendent would sort out differences of view between the sectorial supervisors.

2. Mr Hockin expressed interest in the following areas:-

- (i) Deposit Protection. A Canadian scheme covered 100 per cent of deposits up to C\$60,000. The Canadians have been worried that to set a lower figure would make institutions subject to a bad run on deposits in the event of adverse rumours. This was particularly so given the more widely based nature of the Canadian deposit-taking business.
- (ii) The ease at which banks could be set up. In Canada capital of C\$25 million was required.
- (iii) Non-residential ownership of banks. Mr Hockin said that Canada had welcomed the purchase of the Continental Bank of Canada by Lloyds, and of the Bank of British Columbia by the Hong Kong and Shanghai Bank, which had provided satisfactory solutions to the problems of the domestic institutions concerned.

(iv) Non financial commercial ownership of financial institutions. Mr Hockin said that his Bill would outlaw the ownership of banks by non-financial companies, as he was worried about improper relations between a bank and companies associated to it. Major banks would not face this problem, as they were required to have shares that were widely held and publicly traded and individual share-holdings were limited to 10 per cent (though this brought with it the different problem of unaccountable senior banking management) but banks with a capital of less than C\$750 million could be closely held.

(v) Relations between supervisors in different countries. Mr Hockin said that he was worried that it might prove difficult for supervisors in one country to obtain relevant information from those in another. In particular, Mr Hockin feared that restrictions on the relationship between companies and connected banks could be circumvented by international transactions which the Canadian regulators would be unable to follow. He was particularly worried about the difficulty of persuading the Swiss to divulge regulatory information.

RB

P D P BARNES
Private Secretary

Those Present

PS/Chancellor 2

Mr Ilett

Miss Noble

Mr Matthews

Mr Board

Mr Hall

Mr Savage

Mr Wiseman

Mr Colenutt

GRS 750

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1. Alex
2. RP

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TO IMMEDIATE FCO

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OF 090611Z JUNE 87

INFO PRIORITY OTTAWA, WASHINGTON, PARIS, BONN

FROM PRIVATE SECRETARY

SECRETARY OF STATE'S BILATERAL WITH CANADIAN FOREIGN MINISTER

SUMMARY

1. NO MEETING OF MINDS ON SOUTH AFRICA. MR CLARKE HINTS OF WILLINGNESS TO DROP THE CANADIAN PROPOSAL FOR A SUMMIT 7 INITIATIVE IN RETURN FOR AGREEMENT ON A STATEMENT ON S AFRICA. SECRETARY OF STATE ARGUES STRONGLY AGAINST A STATEMENT. SHORT EXCHANGES ON NAVIGATION IN THE GULF AND SUB-SAHARAN DEBT.

DETAIL

SOUTH AFRICA

2. MR CLARKE SAID THAT THE CANADIANS HAD NO WISH TO CAUSE ELECTORAL PROBLEMS FOR THE BRITISH GOVERNMENT. NEVERTHELESS THEY FELT THAT THE MOMENTUM OF PRESSURE ON SOUTH AFRICA TO OPEN UP A DIALOGUE WITH THE BLACKS MUST BE MAINTAINED. SILENCE WOULD BE MISINTERPRETED, AND WOULD THEREFORE NOT BE NEUTRAL. SOME REFERENCE WAS NEEDED IN A DOCUMENT OR SUMMARY STATEMENT TO THE VIEWS OF THE SEVEN, WHICH IN FACT HAD MUCH IN COMMON.

3. THE SECRETARY OF STATE SAID THAT OUR JUDGEMENT WAS THAT A STATEMENT FROM THE SUMMIT WAS UNLIKELY TO BE EFFECTIVE ON THE GROUND IN SOUTH AFRICA. ONE CONSEQUENCE OF THE MEASURES TAKEN AGAINST SOUTH AFRICA OVER THE LAST YEAR HAD BEEN TO CONFIRM THE SOUTH AFRICAN GOVERNMENT IN THEIR POSITION OF IMPERMEABILITY TO OUTSIDE ADVICE. AN ATTEMPT TO ADVISE THEM ON HOW TO MANAGE THEIR AFFAIRS WOULD PROBABLY PROVOKE ONLY HOSTILE STUBBORNNESS. THIS WAS THE ADVICE FROM EC AMBASSADORS IN PRETORIA. WE WERE LIKELY TO ENCOUNTER A REBUFF FROM THE SOUTH AFRICAN

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GOVERNMENT, AND FROM THE WHITE OPPOSITION AS WELL. THERE WAS LITTLE EVIDENCE THAT EVEN THE MODERATE AFRICANS WOULD WELCOME SUCH AN INITIATIVE. WE SHOULD THEREFORE KEEP OUR POWDER DRY.

4. MR CLARKE CONTINUED TO ARGUE THAT SILENCE WOULD BE MISINTERPRETED. HE SAID THAT THE CANADIAN PROPOSALS FOR A REFERENCE TO SOUTH AFRICA FROM THE SUMMIT AND FOR SOME FORM OF INITIATIVE CHARGING SUMMIT FOREIGN MINISTERS TO BE SEIZED OF THE ISSUE COULD BE TAKEN AS TWO SEPARATE PROPOSALS. THE CANADIANS FOUND IT HARD TO UNDERSTAND WHAT OBJECTIONS WE COULD HAVE TO THE FIRST. THE SECRETARY OF STATE REPEATED THAT THERE WOULD BE A WRONG REACTION IN SOUTH AFRICA. THERE WAS NO REASON TO THINK THAT THE ECONOMIC SUMMIT HAD TO ISSUE POLITICAL STATEMENTS ON EVERY SUBJECT: INDEED TO ISSUE ONE ON SOUTH AFRICA WOULD BE A NEW DEPARTURE. MR CLARKE SAID THAT THE COMMONWEALTH WOULD BE ASTONISHED. THE SECRETARY OF STATE SAID THAT WE HAD NOT HAD ANY REPRESENTATIONS FROM THE COMMONWEALTH ON THE SUBJECT. WE SHOULD NOT PRETEND TO AN INFLUENCE ON EVENTS IN SOUTH AFRICA WHICH WE DID NOT IN FACT POSSESS.

5. MR CLARKE CONCLUDED THAT FURTHER DISCUSSION WOULD HAVE TO BE LEFT TO HEADS OF GOVERNMENT.

IRAN/IRAQ

6. THE SECRETARY OF STATE SAID THAT THE US TEXT WENT RATHER FURTHER THAN WE WOULD LIKE TOWARDS COMMITMENT ON COLLECTIVE ACTION, IN PARTICULAR IN SUGGESTING THAT THE FREEDOM OF NAVIGATION 'MUST' BE UPHELD, AND SAYING THAT WE SHOULD WORK TOGETHER. WE NEEDED TO BE A LITTLE CAUTIOUS US ABOUT SUPPORT FOR A PROPOSAL WHICH COULD POTENTIALLY TURN INTO ONE OF DIRECT INTERVENTION. THERE WAS ALREADY SENSIBLE PRACTICAL COORDINATION BETWEEN OURSELVES, THE FRENCH AND THE AMERICANS IN NAVAL ACTIVITIES. WE SHOULD BE CAREFUL NOT TO GET INVOLVED IN A CREEPING MULTINATIONAL FORCE.

7. MR CLARKE SAID THAT THE CANADIANS HAD LITTLE SUBSTANTIAL INTEREST IN THE GULF. THEY THOUGHT IT WOULD BE SENSIBLE TO CAPITALISE ON THE PRESIDENT'S SUGGESTION IN HIS LETTER THAT

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/WE

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WE SHOULD MAKE USE OF THE SECURITY COUNCIL. BUT THEY WERE WILLING WITHIN REASON TO GIVE THE UNITED STATES HELP IN DEALING WITH THEIR OWN DOMESTIC POLITICAL PROBLEMS.

8. THE SECRETARY OF STATE AGREED THAT IT WAS LARGELY A MATTER OF DRAFTING. IN RESPONSE TO A QUESTION FROM MR CLARKE HE SAID THAT WE HAD NO PROBLEM WITH A POSSIBLE SECURITY COUNCIL BAN ON ARMS SUPPLIES TO THE BELLIGERENTS. MR CLARKE SAID THAT HE FEARED THAT OTHER SECURITY COUNCIL MEMBERS HAD BEEN LESS PRUDENT THAN WE HAD.

SUB SAHARAN DEBT

9. THE SECRETARY OF STATE SAID THAT WE HOPED FOR SUPPORT FROM THE CANADIANS FOR THE CHANCELLOR'S INITIATIVE ON SUB-SAHARAN DEBT. MR CLARKE SAID THAT HE WOULD TALK TO THE CANADIAN FINANCE MINISTER. THE CANADIANS WERE SYMPATHETIC TO OUR POSITION.

10. THERE WAS A BRIEF MENTION OF AGRICULTURE: MR CLARKE COUNCELLED THAT WE SHOULD BE WARY OF THE GERMANS.

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✓
1. Alex ✓
2. Andrew ✓
3. R P ✓

CANADIAN TAX REFORM PROPOSALS: 18 JUNE

*ie giving relief at a flat rate, not marginal rates

SUMMARY

1. THE CANADIAN FINANCE MINISTER'S TAX REFORM PROPOSED OF 18 JUNE WERE BROADLY ALONG LINES EXPECTED:

- (I) A REDUCTION IN PERSONAL INCOME TAX RATES AND THE NUMBER OF TAX BANDS TOGETHER WITH A REDUCTION IN TAX BREAKS AND THE CONVERSION OF TAX DEDUCTIONS TO CREDITS.*
- (II) REDUCTIONS IN CORPORATE TAX LEVELS ALSO COMBINED WITH FEWER TAX BREAKS AND A PROPOSED GENERAL TAX AVOIDANCE CLAUSE.
- (III) A NEW FEDERAL SALES TAX TO BE IMPLEMENTED LATER AFTER CONSULTATION WITH THE PROVINCES AND TO COVER A BROADER BASE THAN THE EXISTING TAX. THERE WOULD BE AN INCREASED REFUNDABLE SALES TAX CREDIT FOR POORER CANADIANS TO OFFSET THIS TAX.

APART FROM OPPOSITION CRITICISMS THAT THE TAX TAKE FROM INDIVIDUALS WILL BE HIGHER AFTER TAX REFORM THAN WHEN CONSERVATIVES CAME TO POWER, INITIAL REACTIONS HAVE BEEN THAT WILSON HAS MET, AT LEAST ON PAPER, HIS OBJECTIVES OF MORE SIMPLICITY, FAIRNESS AND THE MAINTENANCE OF THE DEFICIT REDUCTION PROGRAMME: BUT MUCH DEPENDS ON THE SALES TAX WHICH WOULD HAVE TO PAY FOR THE REDUCTION IN THE INCOME TAX TAKE. BUSINESS COMMUNITY IS STILL STUDYING IMPLICATIONS: THE FINANCIAL SERVICES SECTOR WILL PAY MORE TAX. TOO EARLY TO SAY WHETHER WILSON WILL SUFFER FATE OF PREVIOUS CANADIAN FINANCE MINISTERS WHO ATTEMPTED TAX REFORM.

DETAIL

PERSONAL INCOME TAX

2. ON INCOME TAX, FROM JANUARY 1988, THE NUMBER OF TAX BRACKETS GOES FROM 10 TO 3: THE FIRST DOLLARS 27,500 IS TAXED AT 17 PER CENT, THE SECOND DOLLARS 27,500 IS TAXED AT 26 PER CENT AND EVERYTHING ABOVE DOLLARS 55,000 IS TO BE TAXED AT 29 PER CENT. THE CURRENT TOP RATE IS 34 PER CENT. 850,000 LOWER INCOME CANADIANS WILL NOT PAY TAX NEXT YEAR WITH A WIDE RANGE OF EXEMPTIONS AND DEDUCTIONS BEING REPLACED BY TAX CREDITS. 8.9 MILLION HOUSEHOLDS WILL PAY LOWER TAX. 1.2 MILLION OF 1.4 MILLION CANADIAN SENIORS WILL FALL IN THIS CATEGORY. 1.5 MILLION HOUSEHOLDS WILL PAY MORE TAX. CAPITAL GAINS, INTEREST AND DIVIDEND INCOME, MEALS, CARS AND ENTERTAINMENT DEDUCTIONS WILL BE REDUCED OR ELIMINATED.

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3. PERSONAL TAX REVENUES WILL DECREASE BY DOLLARS 2 BILLION NEXT YEAR BUT WILL STILL PROVIDE 63 PER CENT OF THE GOVERNMENT TAKE COMPARED TO 65 PER CENT THIS YEAR. THE PERCENTAGE SHOULD GO DOWN FURTHER OVER TIME.

CORPORATE TAX

4. FROM JULY 1988, THE GENERAL FEDERAL RATE WILL FALL FROM 36 PER CENT TO 28 PER CENT AND THAT FOR SMALL BUSINESS WILL FALL FROM 15 PER CENT TO 12 PER CENT. THE MANUFACTURING RATE WILL BE REDUCED BY 1991 FROM 30 PER CENT TO 23 PER CENT. BANKS, TRUST, LOAN, REAL ESTATE AND INSURANCE COMPANIES WHICH NOW PAY LITTLE OR NO TAX WILL DO SO STARTING NEXT YEAR. CAPITAL COST ALLOWANCES AND DEPLETION DEDUCTIONS WILL BE CUT. THE RESOURCE SECTOR WILL RETAIN CERTAIN INCENTIVES, AS WILL RESEARCH AND DEVELOPMENT AND LABOUR INTENSIVE ECONOMIC SECTORS. A NEW GENERAL ANTI-AVOIDANCE RULE IS PROPOSED WHICH WOULD INCORPORATE A 'BUSINESS PURPOSE TEST' AND A 'STEP TRANSACTION' CONCEPT INTO THE INCOME TAX ACT.

5. TAX REVENUE FROM CORPORATE TAX WILL INCREASE BY DOLLARS 5 BILLION OVER THE NEXT FIVE YEARS. REDUCED CORPORATE TAX PREFERENCES WILL BROADEN THE BASE BY ABOUT 20 PER CENT. UNDER PRE-REFORM RULES, 72 PER CENT OF REPORTED INCOME WAS TAXABLE. THIS WILL RISE TO 84 PER CENT AFTER REFORM. IN 1983, 110,000 OF 320,000 PROFITABLE CORPORATIONS DID NOT PAY TAX. 85,000 OF THESE, 35,000 AFTER A TIME LAG, WOULD HAVE BEEN CAUGHT BY THE TAX REFORMS. THE TAX TAKE FROM CORPORATION TAX IS ONLY PROJECTED HOWEVER, TO GO UP FROM 16 PER CENT NOW TO 17 PER CENT IN 1991-2.

SALES TAX

6. THE FORM OF THE NEW MULTISTAGE SALES TAX TO REPLACE THE EXISTING FEDERAL MANUFACTURERS' SALES TAX IS STILL NOT DECIDED BUT IT WILL INCLUDE SALES OF MOST GOODS AND SERVICES. THREE OPTIONS ARE OUTLINED: A NATIONAL SALES TAX COMBINING FEDERAL AND PROVINCIAL SALES TAX IS ON A RANGE OF GOODS SEMI-COLON A FEDERAL GOODS AND SERVICE TAX SEMI-COLON AND A FEDERAL VALUE ADDED TAX. ALL WOULD INCLUDE A REFUNDABLE SALES TAX CREDIT GEARED TO LOW INCOME EARNERS. WILSON FAVOURS THE FIRST SINCE IT WOULD MINIMISE THE OVERALL COMPLIANCE BURDEN AND ADMINISTRATIVE COSTS. HE WILL CARRY OUT FURTHER DISCUSSIONS WITH THE PROVINCES. THE DISCUSSION PAPER EXAMINES WAYS OF INCLUDING SERVICES IN THE NEW TAX BUT SENIOR FINANCE DEPARTMENT OFFICIALS TELL US THIS IS THE 'GREENEST' PART OF THE PROPOSALS. SECURITIES FIRMS IN PARTICULAR MIGHT BE VERY DIFFICULT TO CATCH.

7. WILSON SAID HIS TAX REFORMS WERE INTENDED TO BE REVENUE NEUTRAL. THIS WOULD MEAN THAT THE NEW SALES TAX WOULD HAVE TO RAISE DOLLARS 6 BILLION MORE THAN THE CURRENT ONE BY 1991-92 TO OFFSET THE SHORTFALL FROM PERSONAL INCOME TAX NOT MET FROM THE CORPORATE TAX INCREASE.

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8. IN THE MEANTIME, INCREASES IN CURRENT SALES TAX ON PAINT, WALLPAPER AND TELECOMMUNICATIONS SERVICES SHOULD RAISE DOLLARS 1.2 BILLION NEXT YEAR.

REACTIONS

9. THE PRESS, ECONOMISTS AND SOME OF THE BUSINESS COMMUNITY HAVE BEEN FAIRLY COMPLIMENTARY ABOUT THE REFORMS. THE MAIN CONCERN IS THAT THE SALES TAX REFORM IS AN INTEGRAL PART AND ITS INTRODUCTION WILL BE DELAYED, PROBABLY UNTIL AFTER AN ELECTION. COOPERATION BY THE PROVINCES IS NOT SEEN AS ASSURED. BCNI (THE EQUIVALENT OF CBI) MEMBERS WILL MEET THIS WEEK TO TAKE A VIEW. D'AQUINO, PRESIDENT AND CEO, TOLD US UNOFFICIALLY THAT HE BELIEVED THE MAJORITY VERDICT WOULD PROBABLY BE APPROVAL. THE FINANCIAL SERVICES WILL BE HIT BUT THEY HAD PRIVATELY ADMITTED THEY HAD BEEN LUCKY BEFOREHAND AND SHOULD PAY A FAIRER SHARE OF TAXES. THE MINING SECTOR MIGHT JUST ACCEPT THE PROPOSALS: THE OIL AND GAS SECTOR SHOULD SINCE THEY WILL BE WINNERS. SOME OF THE ACCOUNTANTS SECTOR HAVE ALREADY BEGUN TO SAY THE TAX AVOIDANCE RULE WOULD BE UNWORKABLE.

10. COPIES OF TAX REFORM PAPERS BY BAG.

11. FCO PLEASE PASS COPIES TO HM TREASURY FOR MATTHEWS, DTI FOR HAGESTADT, ENAB, AND BANK OF ENGLAND FOR GREEN.

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CANADIAN TAX REFORM PROPOSALS: 18 JUNE

SUMMARY

1. FURTHER REACTION TO THE FINANCE MINISTER'S TAX REFORM PROPOSALS OF 18 JUNE HAS TENDED TO BE LOW KEY. HIS FIRST STAGE PROPOSALS FOR CHANGES IN PERSONAL AND CORPORATE TAXES APPEAR LARGELY TO HAVE BEEN ACCEPTED, THOUGH WITH SOME RESERVATIONS. ATTENTION IS NOW FOCUSED ON THE DECISION TO DELAY COMPREHENSIVE SALES TAX REFORM AND PROSPECTS FOR THIS REMAIN UNCERTAIN. THE BUSINESS COUNCIL ON NATIONAL ISSUES HAS EXPRESSED SUPPORT FOR THE GENERAL THRUST OF MR WILSON'S FIRST STAGE PROPOSALS, AGAIN WITH RESERVATIONS, BUT HAS WARNED THAT HE RISKS LOSING BUSINESS SUPPORT FOR HIS TAX PACKAGE IF HE FAILS TO MOVE QUICKLY ON SALES TAX REFORM.

DETAIL

2. FURTHER REACTION TO THE FINANCE MINISTER'S TAX REFORM PROPOSALS OF 18 JUNE HAS TENDED TO BE LOW KEY. MR WILSON IS BEING GIVEN FULL MARKS FOR DRAFTSMANSHIP AND PRESENTATION OF HIS FIRST STAGE PROPOSALS FOR CHANGES IN PERSONAL AND CORPORATE TAXES. THOUGH READING OF THE FINE PRINT HAS INDICATED THAT THESE WILL NOT, IN FACT, DELIVER AS MUCH IN SOME AREAS AS THEY PROMISE, AND THAT THEY WILL IN PARTICULAR OBLIGE INDIVIDUAL CANADIAN INVESTORS TO RE-APPRAISE THEIR PORTFOLIOS, THEY ARE NOW GENERALLY CONSIDERED TO BE ACCEPTABLE. WHILE, HOWEVER, THEY ARE SEEN AS GOING SOME WAY TOWARDS IMPROVING THE FAIRNESS OF THE TAX SYSTEM, THEY ARE NOT CONSIDERED LIKELY TO HAVE MORE THAN A MARGINAL EFFECT ON THE ECONOMY. RESTRUCTURING OF THE SALES TAX SYSTEM IS SEEN AS CRUCIAL FOR LONG-TERM FISCAL POLICY AND DEFICIT REDUCTION AND AS ULTIMATELY DETERMINING WHERE THE TAX BURDEN WILL FALL. ATTENTION HAS THUS FOCUSED ON MR WILSON'S DECISION TO DELAY COMPREHENSIVE SALES TAX REFORM.

3. THIS HAS BEEN THE MAIN ISSUE DURING A CROSS-COUNTRY TOUR BY THE FINANCE MINISTER TO SELL HIS TAX PACKAGE. MR WILSON HAS EXPLAINED THAT THE CHANGES IN PERSONAL AND CORPORATE TAXES WERE POSSIBLE WITHIN THE EXISTING SYSTEM WHILE SALES TAX REFORM WAS SO FUNDAMENTAL THAT IT REQUIRED FULL CONSULTATION WITH PROVINCIAL GOVERNMENTS AND INDIVIDUAL CANADIANS. HE HAS, AT THE SAME TIME, BEEN MAKING A STRONG PITCH FOR A NEW NATIONAL SALES TAX.

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CRITICISM HAS BEEN GROWING, HOWEVER, THAT THE PROPOSALS SO FAR REPRESENT TAX REVISION AND NOT TAX REFORM. THERE IS CONSIDERABLE SUPPORT FOR THE VIEW THAT THE DECISION TO HOLD BACK ON SALES TAX REFORM OWES AS MUCH AS ANYTHING TO THE WISH OF A GOVERNMENT LOW IN PUBLIC OPINION POLLS TO PRESENT ONLY PROPOSALS THAT WOULD BE GENERALLY UNCONTENTIOUS AND THAT SALES TAX REFORM IS A LONG WAY DOWN THE ROAD.

4. IN THE FIRST PUBLIC COMMENT ON THE TAX REFORM PROPOSAL BY A MAJOR BUSINESS GROUP, THE BUSINESS COUNCIL ON NATIONAL ISSUES HAS EXPRESSED SUPPORT FOR MR WILSON'S OVERALL MOVE TOWARDS GREATER EFFICIENCY AND FAIRNESS BUT CONCERN AT THE EFFECT OF THE TAX CHANGES ON THE MANUFACTURING AND FINANCIAL SERVICES SECTORS. THE COUNCIL HAS SAID THAT FAILURE TO REFORM SALES TAX, TOGETHER WITH SEVERAL OF THE PROPOSED CORPORATE TAX MEASURES, WILL HURT CANADA'S ABILITY TO RAISE INVESTMENT CAPITAL AND DAMAGE COMPETITIVENESS WITH THE UNITED STATES. IT HAS CALLED ON MR WILSON TO MOVE QUICKLY ON SALES TAX REFORM OR RISK LOSING SUPPORT FOR HIS TAX REFORM PACKAGE. IT HAS SET ITS SIGHTS PARTICULARLY ON THE MANUFACTURERS' SALES TAX WHICH IS LEVIED ON SOME CLASSES OF GOODS PRODUCED IN CANADA BUT NOT ON OTHERS AND NOT ON IMPORTS.

5. OTHER MAIN INTEREST GROUPS ARE EITHER STILL STUDYING THE PROPOSALS OR GEARING UP FOR DETAILED HEARINGS ON THE TAX PROPOSALS DUE TO BE HELD IN THE AUTUMN.

6. FCO PLEASE PASS COPIES TO HM TREASURY FOR MATTHEWS SEMI-COLON DTI FOR HAGESTADT, ENAB SEMI-COLON AND BANK OF ENGLAND FOR GREEN.

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MY TELEGRAM NO 771 OF 5 DECEMBER 1986

FINANCIAL INSTITUTIONS: ENTRY INTO AND OWNERSHIP OF ONTARIO'S
SECURITY INDUSTRY

SUMMARY

1. DEREGULATION OF THE ONTARIO SECURITIES MARKET DULY TOOK
EFFECT ON 30 JUNE. NO DRAMA BUT SOME INTERESTING MOVEMENTS.

DETAIL

2. THE NEW REGULATIONS GOVERNING ENTRY INTO AND OWNERSHIP OF ONTARIO'S SECURITIES INDUSTRY (WHICH ACCOUNTS FOR ABOUT 70% OF THE CANADIAN SECURITIES MARKET) DULY CAME INTO EFFECT ON 30 JUNE. COPIES FOLLOW BY BAG. THESE OPEN THE SECURITIES INDUSTRY TO BROADER DOMESTIC AND FOREIGN INVESTMENT. ON THE DOMESTIC FRONT, FEDERAL FINANCIAL INSTITUTIONS WILL HAVE THEIR IN-HOUSE SECURITIES ACTIVITIES REGULATED BY THE SUPERINTENDENT OF FINANCIAL INSTITUTIONS AND THUS WILL NOT NEED TO REGISTER WITH THE PROVINCE. BUT IF THEY WISH TO ENGAGE IN DEBT OR EQUITY UNDERWRITING, IN EQUITY TRADING OR IN THE UNDERWRITING AND SALES OF MUTUAL FUNDS, THEY MUST DO SO THROUGH A PROVINCIAL SUBSIDIARY REGULATED BY THE ONTARIO SECURITIES COMMISSION. THIS DIVISION OF JURISDICTION HAS BEEN CRITICISED BY THE OTHER PROVINCES AS FEDERAL INTRUSION INTO SECURITIES REGULATION, TRADITIONALLY AN EXCLUSIVE PROVINCIAL MATTER. DOMESTIC NON-FINAANCIAL ENTERPRISES WILL HAVE TO REGISTER WITH THE PROVINCE BUT WILL BE ABLE TO PARTICIPATE IN THE SECURITIES MARKET WITHOUT RESTRICTION. FOREIGN SECURITIES DEALERS WILL BE FREE TO SET UP WHOLLY-OWNED SUBSIDIARIES ALTHOUGH SUCH SUBSIDIARIES WILL BE RESTRICTED TO ACTIVITIES IN THE CURRENT EXEMPT MARKET UNTIL 30 JUNE 1988. UNTIL THEN, FOREIGN COMPANIES WILL BE RESTRICTED TO HOLDING UP TO 50% OF A DOMESTIC DEALER.

3. THIS DEREGULATION OF THE ONTARIO SECURITIES MARKET TOOK PLACE WITH VERY LITTLE DRAMA. THE MAJOR EVENT IN THE DAYS LEADING UP TO 30 JUNE WAS THE PURCHASE OF A 35% INTEREST IN WOOD GUNDY, CANADA'S SECOND LARGEST INVESTMENT DEALER, BY FIRST NATIONAL BANK OF CHICAGO. THE U.S. FIRM SHEARSON LEHMAN BROTHERS

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BOUGHT 20% OF MCLEOD YOUNG WEIR. THESE EVENTS TRIGGERED AN UPWARD MOVEMENT IN THE SHARE PRICES OF BROKERAGE FIRMS. THE ROYAL BANK OF CANADA HAD SHOWN SOME INTEREST IN BUYING INTO WOOD GUNDY BUT TALKS BROKE OFF IN MID-JUNE. ALTHOUGH NONE OF THE CANADIAN BANKS HAVE SO FAR BOUGHT A SECURITIES DEALER, THREE OF THE BIG FIVE HAVE ANNOUNCED PLANS TO BEGIN THEIR OWN SECURITIES SUBSIDIARIES. TWELVE FOREIGN DEALERS, INCLUDING S G WARBURG, HAVE APPLIED FOR CONDITIONAL REGISTRATION. THE TWELVE INCLUDE NOMURA SECURITIES COMPANY LIMITED, THE LARGEST DEALER IN THE WORLD, AND NEW YORK BASED SALOMON BROTHERS.

4. FCO PLEASE PASS COPIES TO RICHARDSON, ERD: GREEN, BANK OF ENGLAND: EVANS, TREASURY: AND MARRE AND HAGESTADT, DTI (OTTER).

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BRITISH HIGH COMMISSION
80 ELGIN STREET
OTTAWA K1P 5K7

P J Fowler Esq
North America Department (NAD)
F C O

10 July 1987

Dear Peter,

Parliament has just risen for the Summer recess. A certain uneasy calm is beginning to settle over Ottawa. I thought that this might therefore be an appropriate moment to let you have an 'end of term report' on the Mulroney Government, to highlight some of the current issues, and to look somewhat hesitantly into the future.

End of term report

2. We discussed the performance of the Mulroney Government at the Heads of Post Conference earlier this year. Our conclusion was a gloomy one, with the Government finding few friends across the country. There was suspicion of Mulroney as a leader, and distaste for his style of government. I certainly found in my recent journeys both to East and West, that Mulroney's standing as an individual was low, and that his Government did not enjoy much popular support. Part of the problem, as we have reported before, is that Mulroney tries to be all things to all men and to all Provinces and ends up by pleasing few, if any.
3. Although I would not want to overdo it, I think that there has been some slight change in the atmosphere and in attitudes since we discussed all this together at the Heads of Post Conference. There are still serious doubts about Mulroney as an individual. The recent hash that he has made over the appointment of one of his cronies, Patrick MacAdam, as Minister at the High Commission in London, shows how insensitive he or his closest associates can be. But the sharp slide in popularity which was evident during the earlier part of this year does now seem to have halted, and the Government is beginning to creep back, albeit very slowly and tentatively, up the popularity chart.
4. A number of factors have contributed to this, none of them in themselves decisive, but all of them have made some impact.
5. As we have reported, the House of Commons recently threw out a proposal that a Parliamentary Committee should be set up to make recommendations about the re-introduction of capital punishment. The vote came as something of a surprise, since

/pollsters



pollsters had suggested that a majority of Canadians were in favour of the death penalty. Whereas Mulroney normally swims with the tide, he decided on this occasion to let his principles override political expediency. He made a strong and effective speech in the Commons against the death penalty, and although I would not suggest that his intervention was decisive, it could well have had an effect upon many MPs who were undecided. By allowing a free vote, the Government also indicated that it was prepared to let individual consciences have a free run on this issue, rather than make it a matter of Party solidarity.

6. The Government's much-heralded tax reform proposals were tabled on 18 June. This is a generally thoughtful and comprehensive programme. Admittedly, it leaves on one side for the time being the difficult and contentious issue of a national sales tax. But at least the Government has got to grips with an issue which others have ducked in the past. The debate will continue, and criticism will no doubt be voiced at some of the proposals. But the Government will have earned some marks for coming out with a clear policy.

7. We have also had the publication of the Defence White Paper, the first one for 16 years. It is not an uncontroversial document, but at least the Government have now pinned their colours to the mast and made it clear that they intend to play a more meaningful role in the Alliance, and make up for some of the ground lost over the last decade or so. The proposed purchase of nuclear-propelled submarines has sparked off a debate, but, interestingly enough, this is primarily on the issue of cost rather than on the question of the use of nuclear power.

8. One of the major developments in recent months has been the Constitutional Accord reached between the Federal Government, Quebec, and the other Provinces. The reconciliation with Quebec was one of the major planks of Mulroney's electoral programme. Against all expectations, he has managed to pull off an agreement which, on my reckoning, will eventually be ratified by the Provinces and the Federal Government. This is no mean achievement.

9. During the first couple of years of his Government, Mulroney was plagued by the inexperience and hamfistedness of his personal staff in the Prime Minister's Office, and the tendency of some of his Ministers to behave in unacceptable ways. Here, too, the outlook has brightened in recent

/months.



months. There have been widespread changes in the PMO, which now bears a much more professional and disciplined image. It is also some time since we have had a major Government 'scandal' which the Press have been able to get their teeth into.

10. The Government and Mulroney have also benefited by the poor performance of the official Opposition. The Liberals, who should have been profiting from Mulroney's discomforture have, if anything, been sinking back in popular appeal. Much of this is due to the lacklustre performance of John Turner and the disarray within the Party on policy issues. Turner just does not attract the confidence or the enthusiasm of the average Canadian. He is not even particularly well-regarded amongst the Toronto business community from whence he emerged to capture the leadership of the Liberal Party in 1984. Those who were backing him then, now tend to write him off. The Party are also at sixes and sevens over their attitude towards the Meech Lake Agreement (on which one of their leading members, Don Johnson, has resigned as a shadow spokesman), on Canada/US free trade and on defence. The Party just does not strike the electorate as a credible alternative government, nor is it advocating any coherent policies on the major issues of the day. All this has given rise to speculation in the Press about a likely successor to John Turner. I rather doubt whether he will be ditched in the near future. After all, he was only endorsed as Party Leader by a substantial majority in November last. The state of the Liberal Party does not however present a very happy picture.

11. Meanwhile, the NDP is sitting back, keeping out of trouble, and basking in its current position at top of the polls. Much of this is due to the personal popularity of Ed Broadbent. He comes across extremely well in public as a plain-speaking individual full of common sense. He has none of the glibness of Mulroney or the robotic manner of Turner. The Party nevertheless is suffering some disadvantage from its rise in popularity. People have never hitherto thought of the NDP as a potential government. Now that this possibility cannot be discounted, people are beginning to wonder what the Party really stands for, and what its policies would be. How far would an NDP government be the slave of the Unions? Would the Party really pull Canada out of NATO? What would it do about the deficit? These are questions that are starting to be asked, and ones which the NDP will have difficulty in answering in a way that does not diminish its popularity.



12. Before leaving the political situation, I should mention that there are rumours of Mulroney calling a snap election this Autumn. I find this hard to credit. The Conservatives are still running behind both the other Parties in the polls. This does not suggest that an election would do them any good in the next few months. Furthermore, Mulroney has the Francophone Summit here in September, followed by CHOGM in October. He cannot conceivably want to fight an election whilst those two meetings are on the agenda.

Current issues

13. I have referred to the Meech Lake Constitutional Accord. This has now been ratified by the Quebec Government, and resolutions have been tabled in the Federal Parliament and in most if not all of the Provincial Legislatures. The process of ratification will drag on into 1988, as some of the Legislatures do not come back into session until the New Year. There will no doubt be continued debate and controversy about the Accord, with Mulroney being further accused of having sold out to the Provinces. Trudeau may enter the lists again. My own calculation, however, is that the Accord will be ratified during the first half of next year, and that this major Constitutional debate will thus be set aside.

14. The big topic at the moment is the negotiation for a new trading arrangement between Canada and the US. A final agreement has to be concluded by 2 October to meet the US 'fast track' procedure. Time is getting short. A great deal of groundwork has been covered in the negotiations, but several difficult issues remain unresolved. The one that is attracting most attention at present is the arrangements for settling trade disputes between the two Governments. Mulroney has gone on record as saying that he could not accept an agreement which did not provide a mechanism for the settlement of disputes which did not permit the US administration or Congress to take unilateral action harmful to Canadian interests. There are also difficult issues to resolve on investment and an intense fear, mainly in Ontario, that the Auto Pact could in some way be brought into question. All this is leading to a great deal of nervousness and anxiety. John Turner has recently come out with a statement calling on the Government to pull out of the talks, arguing that an agreement, as envisaged, would gravely damage Canada's future economic existence and even her sovereignty. Mulroney met

/the



the Provincial Premiers earlier this week. Many of these anxieties were voiced. It was nevertheless agreed that the negotiations should continue in the hope that satisfactory conclusions could be reached by the deadline of 2 October. I find it impossible to judge whether an agreement will emerge which the Provinces will support and which Mulroney could confidently put to the Canadian people. A few months ago, I was reasonably optimistic. Now, I have serious doubts.

Future outlook

15. In spite of the continued disillusionment that undoubtedly exists about the performance of the Mulroney Government, we would be most unwise to assume that he will not be re-elected next time round. He is a good political campaigner, and will be able to point to a reasonable record of achievements: a generally prosperous economy, unemployment down, tax reform, a clear defence policy, a Constitutional Agreement, etc. His prospects will be enhanced by a weak and ineffective Liberal Opposition and, I would guess, by growing reservations about the NDP as a credible and acceptable alternative government. No doubt Mulroney hopes that the Francophone and Commonwealth meetings here later this year will boost his image as an international statesman, and thus further improve his party's fortunes.

16. If the US/Canada trade negotiations break down, we could be in for a difficult period in US/Canada relations. Protectionist moves by Congress would produce sharp reactions here, which could spill over into other aspects of the relationship. We could get caught in the crossfire (shades of shakes and shingles and teabags). This would not help at a time when we could be in delicate UK/US/Canada discussions over nuclear submarines.

17. Thinking more specifically of the bilateral relationship, the immediate problem is the Air Services Agreement. A good start was made in negotiations here earlier in the month: the crunch will come in a week or so, when the main issues in dispute are discussed. I expect there will be a degree of brinkmanship on both sides, but I expect (and hope!) something will eventually be agreed.

18. My other main worry is South Africa, on which I am writing to Kieran Prendergast. I fear that our approach to CHOGM and that of the Canadians will take a lot of reconciling. They seem determined to do something. Much will depend on what, if anything, we have to offer.

Yours ever,

D M Day

Day

Q Not compulsory
reading - political
background - AA
Private Secretary

Alex Aman HMT

We spoke. Here's a
whiff of ✓
Canadian
corruption etc.
Some of it a little
old - but then
corruption improves
with age, I
guess

Adrian (over)



PM

C A N A D A

The Political Scene

There are three parties represented in the Federal Parliament. They are: Progressive Conservative Party (conservative), the Liberal Party (middle of the road/conservative), and the New Democratic Party (socialist). The difference between the Progressive Conservative and Liberal parties has in the past been more cultural and geographical than ideological. The PCs were historically an anglophone and rural party, while the Liberals drew their main strength from the small but highly populated area of Quebec and urban Ontario. However, this pattern was overthrown in the election of September 1984 when the PCs won 58 of the 75 seats in Quebec (where previously they had held only one) and the Liberals lost most of their main support in Quebec and Ontario.

The Progressive Conservative Party, led by Mr Brian Mulroney, won 211 out of 282 seats in the Canadian General Election on 4 September 1984, the third largest majority in Canadian history. This overwhelming victory brought to an end 21 years of almost unbroken Liberal Government. The Liberals retained only 40 seats (15 of the 25 outgoing Cabinet lost their seats), not far ahead of the New Democratic Party who, despite the Conservative landslide, held on to 30 of their previous 31 seats. Mr Mulroney's Cabinet consists of 41 Ministers, which is the largest in Canadian history, and includes six women. By expanding the Cabinet, Mr Mulroney has made room for ample representation from the Provinces.

The emphasis of Mr Mulroney's policies is on national reconciliation and national consensus through consultation and improvement in Federal/Provincial relations, and in particular the need to bring Quebec into the constitutional framework. Economic renewal and social justice were the other two main goals of the Government. Other policies included the need to reduce the Federal deficit and unemployment, the strengthening of the free market economy, the encouragement of foreign investment in Canada, the liberalisation of the National Energy Policy, the prime importance of closer relations with the United States and a commitment to strengthen Canada's defence efforts, give more support to NATO, and to promote peace and nuclear disarmament. Certain measures have already been taken to strengthen Canada's defence commitments in Europe. A number of policy reviews have been undertaken, and discussion papers published, including one on export promotion and one on foreign policy.

Since a series of difficulties including corruption scandals involving several Cabinet Ministers and provincial conflict over Federal grants, contracts and other largesse have seriously affected Prime Minister Mulroney's credibility. The PC have now sunk to third place in opinion polls with just over 25% behind the Liberals and the Left leaning New Democratic Party (NDP).



Mulroney's recent, and not inconsiderable success, which has eluded his predecessors, in overcoming the difficulties in reconciling within one country the differing aspirations of those of French (28%) and British (44%) origin, by persuading Quebec Province to sign the Constitution, may well have restored enough of the PC standing to turn the tide in the next general election due within two years. Mr Mulroney will be hoping for continued economic growth which could provide resources for electorally attractive initiatives such as comprehensive reform. More important, he hopes that statesmanlike activity on the world stage e.g. at Venice and CHOGM, will improve his standing.

There have been major changes in provincial politics in the last year. Mr René Lévesque resigned as leader of the Parti Québécois on 20 June 1985. Mr Pierre-Marc Johnson was chosen to succeed him on 29 September. In the ensuing elections in Quebec on 2 December, the Quebec Liberal Party defeated the Parti Québécois by 99 seats to 23, although their new leader, Mr Robert Bourassa, failed to win a seat. In the provincial elections in Ontario in May 1985, the Progressive Conservatives were returned with a reduced majority, and after losing a vote of confidence they were replaced on 26 June (after 40 years in power). An election was held in Saskatchewan in June 1986 which returned the Progressive Conservative Party under Premier Devine by a Liberal Government with New Democratic Party support.

September 1987

COVERING CONFIDENTIAL

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FROM: D SAVAGE

DATE: 11 September 1987

ECONOMIC SECRETARY

cc

PPS

Mr Matthews
Mr Walsh
Mrs Brown
Mr Pickford
Mr P Edwards
Mr Colenutt

VISIT BY MR D'AQUINO

You will be receiving a call from Mr Thomas D'Aquino, President and Chief Executive Officer of the Canadian Business Council on National Issues at 3.00pm on Monday 14 September. It has been suggested that the discussions be confined to macroeconomic/international financial issues. I attach:

- i. a personality note on Mr D'Aquino.
- ii. short notes on the Canadian economy, covering the current situation and the major reforms liberalising Canadian Financial markets.
- iii. A draft brief on the world economic outlook for the IMF Annual Meetings.

David Savage.

DAVID SAVAGE

Biographical Summary

THOMAS d'AQUINO

Thomas d'Aquino is President and Chief Executive Officer of the Business Council on National Issues, an organization composed of some 150 chief executive officers of major enterprises in Canada. Formed in 1976, the Business Council is the means chosen by senior business leaders to contribute personally to the development of public policy and to the shaping of national priorities. Member corporations are drawn from the full range of industry, trade, commerce and finance in Canada. These companies administer in excess of \$600 billion in assets which produce annually more than \$190 billion in revenues. The member companies employ some one-and-a-half million Canadians.

A lawyer, Mr. d'Aquino is also Chairman of Intercounsel, an Ottawa based consulting group.

Mr. d'Aquino is a native of British Columbia and was educated at the Universities of British Columbia, Queen's, London and Paris. He holds B.A., LL.B., and LL.M. degrees having specialized in political science, economics, and international economic law. Mr. d'Aquino is a member of the Canadian and International Bar Associations and of the Law Society of British Columbia.

His professional experience has included: legal counsel to a national Canadian organization in the transportation field (1967-1968); four years in the federal government - one year as Executive Assistant to a federal minister and three years as a Special Assistant to the Prime Minister (1969-1972). For the past twelve years, including periods in London and Paris, he has acted as both legal counsel and advisor to a number of governments and major enterprises in Canada and abroad.

In the 1983/84 period, Mr. d'Aquino was Co-Chairman of the Founding Committee of the newly established Canadian Labour Market and Productivity Centre. From 1976 to 1982, he was Professor Adjunct of the Faculty of Law of the University of Ottawa where he taught a course on the law of international business transactions and the regulation of multinational enterprise.

Mr. d'Aquino is a member of the Board of Governors of the University of Ottawa. He is the author of a number of publications and has lectured and travelled widely.

Mr. d'Aquino and his wife Susan live in Ottawa.

September, 1984

CONFIDENTIAL**SOME NOTES ON THE CANADIAN ECONOMY**

1. Economic growth in 1986 was the strongest among the major industrial countries despite the impact of sharply lower international oil and grain prices. Strong employment growth reduced unemployment further. The pace of economic growth slowed somewhat during 1986, but recent indicators point to a subsequent pick-up in early 1987.

2. As a large energy producer and net exporter, Canada suffered from the steep drop in oil prices, given the unexpected slowness of the stimulatory effects of the price decline to emerge. The regional concentration of the energy industry has entailed a very uneven geographic distribution of the negative and positive repercussions of the oil price collapse. The adverse impact was particularly severe in Alberta where output fell, while Central Canada's economy - based largely on manufacturing and services - expanded strongly.

3. The sharp fall in grain as well as energy prices contributed to a sizeable deterioration in Canada's terms of trade and the current account balance, but contrary to experience in most countries, failed to reduce the rate of inflation. The external account was also aggravated by the unexpectedly slow growth of demand from major trading partners (particularly the US), which contributed to a further deceleration of exports.

4. The following table gives some summary statistics for 1985 and 1986 and IMF estimates for 1987.

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Percentage change on year earlier

	1985	1986	1987*
Real GNP	4.3	3.3	2.8
Consumer prices	4.0	4.2	4.3
Unemployment rate (level)	10.5	9.6	9.1
Current balance (level in US\$ billion)	- 0.9	- 6.9	- 7.5

* From IMF's draft 'World Economic Outlook' - not published till late September.

5. Financial markets in Canada are going through a period of rapid reform. The historical separation of the four financial sectors (banking, loan institutions, securities houses and insurance) ended in June 1987. Financial institutions are now able to perform a wide range of functions. Banks, for example, are able to own securities houses and offer portfolio management and investment advice. Non-bank financial institutions are free to offer commercial and consumer loans. Foreign financial institutions have also been admitted to the Canadian market but are currently restricted to a 50 per cent stake in a Canadian securities firm. Remaining restrictions will be removed in June 1988. The supervisory framework for the new system is still a matter of debate between the provincial authorities (that supervise the stock exchanges) and the Federal Government (responsible for the banking system).

Dave Savage

D SAVAGE

HER MAJESTY'S TREASURY
BRIEFING FOR THE 1987 ANNUAL MEETINGS OF
THE IMF, IBRD AND COMMONWEALTH FINANCE MINISTERS
WORLD ECONOMIC OUTLOOK

OBJECTIVES

1. Agree with IMF staff assessment that momentum of output growth in major countries will be reasonably well maintained in the short term, in the absence of any major shocks, although growth may fall short of potential in some countries.
2. Agree that projected current account imbalances are major cause for concern and that macroeconomic policies in the US, Japan and Germany should aim to achieve growth rates of domestic demand relative to productive potential that would reduce them. Credible action to reduce US Federal budget deficit in FY1988 remains central to any co-operative strategy. Exchange rate changes alone would not achieve the necessary adjustment.
3. Emphasise importance of sound adjustment policies for all debtors, but note their heterogeneity. Encourage international support for Chancellor's Sub-Saharan Africa initiative, especially given gloomy prospects for this region.
4. Stress importance of structural reforms for improving economic performance of industrial and developing countries.
5. Emphasise costs to all of increased protectionism. Regret trend toward bilateralism in trade questions.

POINTS TO MAKE

On Industrial Countries

1. External imbalances of three largest economies pose chief threat to sustainability of growth. Given present size of US deficit and Japanese and German surpluses, and what we know of elasticities, cannot expect exchange rate changes alone to correct imbalances over a reasonable time scale. Hence need to focus on relative growth rates of domestic demand.
2. It is essential in this connection that, as the US undertook in Paris in February, its fiscal deficit be reduced. Note some increase is expected in FY1988 due to one-off nature of additional revenues from tax reform in 1987.
3. Japan and Germany should, in accordance with their Louvre commitments, pursue policies to strengthen domestic demand and be prepared to re-examine their policies if the intended strengthening does not materialise. Hope that Japanese package is as large and stimulative as it has been presented. Germany should implement the tax cuts planned for 1988 and for 1990. Structural reforms would also help to promote domestically-generated growth in Japan and Germany. Japan should implement, as soon as possible, recommendations of Maekawa Commission. Germany should cut subsidies to declining industries.
4. Major objective of macro policy remains containment of inflation. Benefits of enhanced credibility have been hard won and should not now be thrown away. However countries where inflation is now very low should seek to sustain growth of money demand at rate sufficient to allow output to expand at (or, if there is slack, for a time above) productive potential.
5. Stress urgent need to resist protectionist pressures. Industrial countries should honour commitments to liberalise their agricultural trade.

Developing countries

6. For some heavily indebted low income countries, additional conditional loans from official sources on concessional terms are essential. Emphasise contribution that Chancellor's Sub-Sahara initiative could make.

7. Greater commitment to sound financial policies and structural reform among middle income debtors would help convince creditors that good money was not being thrown after bad. It would also help to stem capital flight. Debt relief for some countries could prejudice future financing.

8. Main contributions that industrial countries can make to alleviation of middle income debt problems are sustained economic growth, stable financial conditions, and liberalisation of trade restrictions (especially in agricultural products).

9. Currencies of some developing countries have become substantially under-valued. Taiwan and Korea, especially, should be encouraged to liberalise their trade. The efforts of these NICs to penetrate overseas markets, whilst maintaining barriers to protect their own domestic markets, are source of protectionist pressure in developed countries - particularly the United States.

BACKGROUND

Industrial countries

1. No major disagreements with IMF forecasts, which for output in the major seven in 1987 and 1988 are similar to the OECD's and to our own. Downward revisions to prospects for France and especially Germany in 1987 reflect disappointing performance over the year so far. Recent positive signs have led to upward revision to prospects for Japan. Agreement on moderate growth overall to end-1988 in industrial countries. Also agreement that underlying inflation in industrial countries will remain low. There are few signs of capacity constraints, except perhaps in US, where unemployment may be close to natural rate.

		<u>IMF</u>	<u>OECD</u>	<u>June WEP</u>
		<u>Percentage changes</u>		
Real GNP*	1987	2.5	2½	2.4
	1988	2.7	2½	2.8
Consumer prices*	1987	2.9	3	2.6
	1988	3.4	3½	3.2
Volume of world trade	1987	3.6	2½	2.8
	1988	4.5	4	4.2

* Major seven.

2. In the Louvre Agreement the United States said it would reduce the Federal deficit from an estimated 3.9 per cent of GNP in fiscal 1987 to 2.3 per cent (the Gramm-Rudman-Hollings target) in fiscal 1988. In the event, the deficit is likely to be a little lower than estimated for fiscal 1987 (at around 3.7 per cent), largely because of one-off receipts from tax reform. With existing tax rates and expenditure programmes, the Administration estimates that the deficit would decline only to 3.4 per cent in FY1988, and the IMF that it would remain unchanged at 3.7 per

cent. The present stalemate between the Administration and Congress on the Federal Budget for FY1988 gives little ground for hope that the deficit will be much below this.

3. The fiscal stance in Japan is hard to assess. A 'Y6 trillion' package, first announced in April, was presented in greater detail on 29 May. The 'Y6 trillion' includes sums made available for loans to private corporations for investment. Impact therefore depends on take up by private sector. The impact of the increase in disaster contingency fund of Y450 billion is also unclear, and about one-third of the package comprises spending by local authorities. However, IMF staff tentatively estimates that the package will raise Japanese GNP by $\frac{1}{2}$ per cent this year and by $1 - 1\frac{1}{2}$ per cent in 1988.

4. Soon after the Louvre Agreement, the German Government announced that income tax cuts of DM5.2 billion or 0.3 per cent of GNP (part of the larger tax reform originally scheduled for 1990) would be brought forward to next January. However, with public expenditure planned to continue to decline relative to GNP, the overall stance of fiscal policy in Germany is still not expansionary, in circumstances of low inflation and weak growth.

Developing countries

5. The experience of developing countries has been highly diverse over past two years. Oil producers and primary producers (many in Sub-Sahara) have suffered. But oil importers and manufacturers (particularly in Asia) have done well. Differences in performance have also reflected differences in domestic policies - successful domestic adjustment to adverse external developments of some countries which have avoided debt-servicing difficulties contrasting with lack of adjustment in countries with debt problems.

6. Commodity prices have recovered a little this year, and given sustained growth in industrial countries could strengthen further. This should help the position of many of the developing countries that have been hardest hit.



DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

01-212 3434

David Norgrove Esq
Private Secretary
10 Downing Street
LONDON SW1

CH/EXCHEQUER	
REC.	11 SEP 1987 ✓ 11/9
ACTION	CST
COPIES TO	

11 SEP 1987

Dear David

UK/CANADA AIR SERVICES

The present Air Services Agreement with Canada expires at midnight Ottawa time on Friday 18 September. I am writing about the final stages of our negotiations with Canada, which will be taking place in Ottawa during the week commencing 14 September.

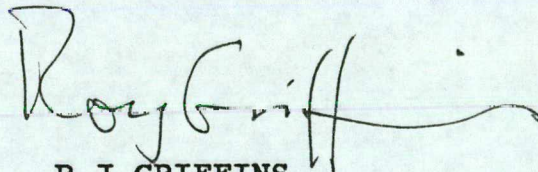
Officials here and at the FCO have been in close touch throughout the negotiations, and the Foreign Secretary has himself been directly involved in discussing the matter with the Canadian Foreign Minister, Mr Clark, on three occasions over the past year, most recently on 7/8 September. There is a possibility that the negotiations will break down either over Air Canada's wish to operate increased services between London and Bombay/Singapore or over their reluctance to allow BA to charge low fares on the North Atlantic to compete with Canadian charters.

Both points are of critical importance. If they cannot be resolved on acceptable terms, services may have to stop for a short period after 18 September while both sides take stock. BA have contingency plans to for services to nearby cities in the United States, (and Canadian airlines are understood to have similar plans). We would not want to rely on such arrangements for long and we would aim to get direct services going again on the basis of temporary permits even in the absence of a formal Agreement. The Canadians need permission for twice as many services as we do, so we should be in a strong position. The Canadians could hardly refuse a temporary arrangement without putting themselves in a highly embarrassing position as hosts of the Commonwealth Heads of Government meeting in October.

CONFIDENTIAL

We hope the negotiations next week will be successful, but you and others should be aware of the risks of a break down in services after 18 September and of our plans to deal with that situation if we have to. I am sending copies of this letter to Lyn Parker at the FCO, Alex Allan at Treasury, Tim Walker at DTI, Robert Gordon at Scottish Office and Peter Baldwinson at DE.

Yours sincerely

A handwritten signature in cursive script that reads "R J Griffins". The signature is written in dark ink and has a long, sweeping tail that extends to the right.

R J GRIFFINS
Private Secretary



CHIEF SECRETARY	
NO.	15 SEP 1987
<i>Mr Colman</i>	
<i>Cx Mr Butler</i>	
<i>Mr Anson Mr Havelle</i>	
<i>Mr Monck Mr Burgess</i>	
<i>Mr Calmore Mr Moore</i>	

Foreign and Commonwealth Office

London SW1A 2AH

14 September 1987

Mr P Davis Mr Revolta Mr Tyne Mr Call

Lea David Mr Mountfield

UK/Air Canada Air Services

We have received a copy of Roy Griffins' letter to you of 11 September, about the UK/Canada air services problem.

The FCO and DTp have kept in close touch throughout these difficult negotiations and the Foreign Secretary believes the tactics which Mr Channon has endorsed are the right ones.

He naturally hopes that any disruption to the travelling public consequent upon a breakdown in the negotiations can be kept to a minimum, but he believes that we should stand firm on the need for a more liberal tariff regime.

Copies of this letter go to the recipients of Roy Griffins' letter.

James

R N Culshaw

(R N Culshaw)
Private Secretary

D Norgrove Esq
PS/No 10 Downing Street



FROM: P D P BARNES
DATE: 15 September 1987

MR SAVAGE

CC

PPS *Z*
Mr Matthews
Mr Walsh
Mrs Brown
Mr Pickford
Mr P Edwards
Mr Colenutt

VISIT BY MR D'AQUINO, PRESIDENT OF THE CANADIAN BUSINESS COUNCIL

Thank you for your brief for Mr D'Aquino's visit and for supporting the Economic Secretary in the meeting with him yesterday afternoon.

2. As you are aware, Mr D'Aquino explained that he was in the UK because of a desire within the Canadian business community to diversify away from too great a dependence on trade with the United States and to revive or develop European links. The UK, already Canada's third largest trading partner, was an obvious focus of this diversification.

3. Mr D'Aquino asked questions about the Government's handling of the economy, and in particular: privatisation; the formation of economic policy; the Government's attitude towards ERM: inflation; the exchange rate; trade performance; and investment. The Economic Secretary gave no hostages to fortune.

PB

P D P BARNES
Private Secretary

CONFIDENTIAL

014/3

Ottawa
16 September 1987

CANADA: FINAL REFLECTIONS

The British High Commissioner at Ottawa to the
Secretary of State for Foreign and Commonwealth Affairs

SUMMARY

1. Significant British interests in Canada: trade, investment, defence collaboration and sales (paras 1-7).
2. Canada's place in the Western Community. Stranded between the US and the EC. Canadians feel threatened by the former and neglected by the latter. Partly their own fault. In our interest to keep Canada a contented and contributing member of the Alliance (paras 8-13).
3. Future outlook for Canada. Short-term economic prospects good. Longer term anxieties. A massive deficit which cannot be significantly reduced without painful political decisions. The will may not be there (paras 14-17).
4. Valedictory. A changed but improved Service. We'll miss it (paras 19-24).

CONFIDENTIAL

014/3

OTTAWA

16 September 1987

The Rt Hon Sir Geoffrey Howe, QC MP
LONDON

Sir,

CANADA: FINAL REFLECTIONS

1. What are British interests in Canada? Where does Canada fit into the Western community of nations? What is the future outlook for Canada? I realise that I was ill-prepared to respond to these questions when I arrived in Canada a little over three years ago. Now, with my departure imminent, is the time to suggest some answers.

British interests in Canada

2. Canada has not featured particularly prominently in our calculations over the years. For most people, 'North America' means the United States. Our interests there will invariably outweigh and overshadow our interests in Canada. Our ever-closer identity with our partners in the European Community will mean that we have less time, and, perhaps, inclination, to concern ourselves with others, such as Canada. Furthermore, this country does not normally create problems for us, apart from occasional tiffs over tariffs or air services. British public opinion pays little heed to Canada. That, perhaps, is why none of the British media see the need to keep a full-time resident correspondent here. The best-known Canadian in the UK is probably Cliff Thorburn - who is virtually unknown in his own country. So what is there about Canada that should merit our attention?

Trade

3. First, trade. Canada is our tenth largest market, world-wide. Outside the European Community, only the United States and Sweden buy more from us. We sell more to Canada than we do to Japan or Australia or India. Per capita, Canada bought more from us in 1986 than did the United States. There is a ready market here for British goods. Sentiment for things British remains. We can, and should, capitalise further on this.

4. Canada is also a fruitful field for British investment. The abolition by the Mulroney Government of the Foreign Investment Review Agency opened the way for increased and profitable investment in Canada. Many British companies have taken advantage of this in the

/past

past three years. Lloyds Bank, British Telecom, Allied-Lyons, Longmans, Ultramar, Hilldown, W H Smith, are but a few of those who have acquired or increased their stake here. British Gas is in the queue. Our total investments in Canada are probably around £8 billion. This is a substantial asset.

5. Now, at long last, we have our foot in the door for defence sales. The Mulroney Government, recognising past neglect, has set about the regeneration of Canada's armed forces. We missed the first major contract (Rapier for Low Level Defence). We, with our Italian partners in European Helicopter Industries, are now the sole contender for the supply of naval helicopters (value £995m approximately). Subject to further discussions with the US, we have a chance to win the contract for nuclear-propelled submarines (value £7.5b approximately). Other major items are in the pipeline: communications equipment (£1.2b approximately), tanks (£2b approximately). There is big business to be done.

Defence

6. Our defence interests are not confined to sales. Canada provides us with military training facilities that are unavailable elsewhere in the world. Low-level flying training (600 mph at 100 feet) is based at Goose Bay in Labrador. Every year, one-third of BAOR travels to Southern Alberta to conduct live firing exercises, with tanks, artillery and infantry. Canada's geography, and relatively sparse population, offers space and freedom of movement that none of our other NATO allies can match.

7. We tend to take these facilities for granted, as we do Canada's political and military commitment to the Alliance. However, we would clearly be the losers if Canada went neutralist or isolationist. We have an interest in ensuring that she does not. Not only would such a development put at risk our training facilities and potential defence sales, it could also have a damaging effect upon the stability and cohesion of the Alliance. Canadian disillusionment with - or even withdrawal from - NATO, could set an unwelcome example to others. It would certainly inflame relations between Washington and Ottawa, and thus complicate our relations with both. It would undermine existing arrangements for North American defence and possibly start a process which could result in the unravelling of the Alliance as a whole. If, then, we believe that the Alliance between North America and Europe is essential for our continued security and prosperity, then it is in British interests to keep Canada a contented and contributing member of that Alliance.

Canada and the Western Community

8. Why is it that, at times, Canada appears to be a fractious member of the Western Community? Why is she so sensitive on certain issues? The causes are to be found partly in history and partly in geography.

9. Historically, Canada's being was intimately linked with Europe, and specifically with the United Kingdom. Canada looked across the Atlantic for its trade, its political and legal systems and for its immigrants. It felt generally comfortable in that environment. Britain, at times resented, but generally admired, provided most Canadians with their identity. After all, we shared a Head of State and a flag.

10. The aftermath of the Second World War saw significant changes. Canadian nationalism became more pronounced. Immigrants flooded in from elsewhere in Europe, and more recently from Asia. Britain became more concerned with, and eventually linked by Treaty to, its Continental European neighbours. The Commonwealth grew in size and the influence of its individual members became diluted. It no longer provided for Canada the political and economic security of the Empire. And, most significantly for Canada, the United States emerged as the world power.

11. This is where geography plays its part. Canada found herself alongside the world's greatest political, military and economic power. As Britain's trade swung in the direction of Europe, so Canada's moved towards the US, to the extent that some 75% of all Canadian exports now go to her Southern neighbour. The US influence is everywhere visible: cars, television, sports, and even political patronage. This worries Canadians. They don't want to be absorbed politically or culturally by the United States, though they recognise that they cannot escape from their economic bondage. They therefore seek constantly for some role, or position, which will distinguish them from the US. Europe, the other natural partner, does not offer an alternative. Canada is geographically off-limits. There is no place for her within European Political Cooperation. She is not offered a seat in institutions such as the IEPG. She sees emerging a duumvirate of the United States and Europe in whose deliberations she has no direct voice. She is beginning to feel left out, or 'marginalised', in current Canadian jargon.

12. These may seem to us unreasonable and exaggerated fears. Canada, after all, can make her voice heard and influence felt in many fora. She is a member of the Commonwealth and the Francophonie, NATO, the Summit Seven, OECD etc, etc. True; but Canadians do not see any of these organisations giving them the political and economic clout that we, for example, derive from our membership of the European Community or the US from her overall dominance. Canada sees herself becoming the perpetual 12th man in the Western league, standing on the touchline, whilst the European and United States teams play out the game. Canadians see less and less opportunity for them to join in.

13. What is the remedy? To some extent, it is in Canadian hands. They must stop being sorry for themselves and make themselves a more valued member of the team. They must earn their

/place

place and not expect automatic selection. They must realise that more is demanded than pious statements and a 'do-gooding' reputation. To do him credit, Mulroney, and particularly his Foreign Secretary, Joe Clark, have sought to play a more positive international role. The Mulroney Government's commitment to the Alliance is firm. He is a far less troublesome and awkward partner than Trudeau. What we can do, as Canada's closest and most trusted partner in the Alliance, is to keep our eyes open for opportunities to include Canada in evolving European or Alliance institutions or groupings. For example, was it really out of the question to include Canada within the IEPG? In setting up the Eurogroup within NATO, did we deliberately exclude Canada and assume that she would keep company with the US? I have no easy solution to offer. But if Canada gains the impression that we, and our European partners, ignore, discount or ridicule her concerns, we could find that Canada becomes a less favourable outlet for our exports and a less comfortable member of the Alliance. Certain worrying tendencies are abroad. The Liberal Opposition is developing neutralist hues, and the NDP (well ahead in the polls), is committed to withdrawal from NATO and NORAD. The present Government needs what help we can give them to counter these influences.

The future outlook for Canada

14. In the short term, the outlook is reasonably bright. The economy is performing well. The OECD says that Canada's output growth was the fastest of any leading industrialised country in 1986 and it could well be so again this year. The first six months show growth at 6%. Unemployment is down to 8.8% and falling. Interest rates are steady. Investment continues to flow in. This is an affluent country. The standard of living is high. The cities and countryside are clean and well-tended. Crime rates are low. The population is cushioned by an extensive system of social security.

15. There are thus no immediate economic anxieties. The one development that could distort the picture is a deterioration in relations with the US. I have referred earlier to the dependence of Canada upon its trade with the United States. Should the current negotiations between the two countries for a more comprehensive trading arrangement fail, the consequences for Canada could be serious. If the two parties decided, amicably, that agreement was not possible, and the trading relationship continued as at present, no great harm need ensue. But if the negotiations were broken off in acrimony, there could be an upsurge of protectionism on both sides of the border. Canada is infinitely more vulnerable. Numerous sectors of the Canadian economy could suffer, with the shock waves being felt throughout the country. We will have a clearer idea of the outlook by the turn of the year.

/16.

16. I must, however, admit to an even wider concern. The Federal deficit, though reduced by the Mulroney Government, is probably running at around C\$30b a year. This, per capita, is not far short of twice the size of the current US deficit. The accumulated deficit is C\$260b. I find it hard to see how this sum can be reduced significantly without cutting severely into benefits which Canadians currently enjoy or by substantial tax increases. Neither are attractive political options. Canadians will not readily sacrifice the extremely high standard of living that the majority of them enjoy. The Finance Minister, Michael Wilson, with only lukewarm support from the Prime Minister, has tried to get to grips with the problem, but the political will is not really there. If the nettle is not grasped by a Government with the current massive majority, the outlook is not good. No alternative Government is likely to be more resolute.

17. Furthermore, Canada has to sustain the infrastructure of the second largest country in the world with a population of only 25 million people. It is as if half the population of the United Kingdom had to finance a territory more than four times the size of the entire 12 nation European Community. Large areas of Canada are admittedly barren and sparsely populated. But the North West and Yukon Territories impose costly obligations upon the central exchequer not dissimilar to those we incurred in our former colonies. I find it hard to see how Canada can, indefinitely, continue to sustain all these obligations and expectations.

Omissions

18. I have left much unsaid: the future of the Mulroney Government (uncertain); the prospect of an NDP Government (unlikely); the outlook for John Turner as leader of the Liberal Opposition (very bleak); Canada's role within the Commonwealth and her increased involvement with the Francophonie; her relationship with the Third World; South Africa. These and others are all issues which will preoccupy my successor. But they are merely the backdrop to the basic question of our interests in Canada. These, as I have indicated, are extensive and beneficial to us. We should continue to do what we can to maintain and nourish them. Canada matters more to us than we sometimes realise.

Valedictory

19. So much for Canada. What about 36 years in the Foreign and Diplomatic Service?

20. The Service is not what it was. It is different - and better.

/21.

CONFIDENTIAL

21. Different in many respects. We now perforce spend much more time and effort in multilateral diplomacy. The governments we deal with around the world are more numerous and infinitely more unpredictable. Trade promotion is central to our work. Diplomacy has become a more physically dangerous profession. Our interests and activities are now more sharply focussed on Europe and the United States. We nevertheless still need to follow, and wherever possible influence, events world-wide.

22. The Service has changed to meet these different demands. We have fewer resources, so we have had to become more professional. We have a clearer idea of our interests and objectives. Our conditions of service have improved (hard though this may be for some to accept). We may have less time to polish and re-polish despatches (or even to write them), but we concentrate more on the essentials. In short, we are a better-tuned machine.

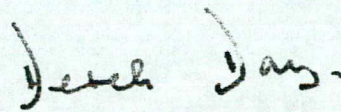
23. One feature of the Service has not, however, changed. That is the fellowship to be found within it. When other memories fade, the one that will remain is the friendship and the encouragement that we have had, at all times, from all our colleagues. Canada has been no exception. I've had a wonderful team here.

24. It has been hard work, but it's been fun. For me, it wouldn't have been possible without the cheerful support and tolerance of my wife and family. I have a feeling that we are all going to miss it.

25. I am copying this despatch to the Heads of Missions in NATO and EC capitals, and to the Heads of our Delegations to NATO, the European Community and the UN, and to Heads of Consular Posts in Canada.

I am Sir

Yours faithfully



DEREK DAY

Canadian High Commission



Haut Commissariat du Canada

1. Please s/o (Davis?) whether
we need to send a reply.
2. bf. 12/10

CH/EXCHEQUER	
REC.	06 OCT 1987
ACTION	CST EST SIR P. MIDDLETON SIR G. LITTLE
COPIES TO	MR LAVELLE MR MONIC MR HP EVANS MR MOUNTFIELD MRS. W. MATTHEWS MR P.G.F. DAVIS.

Macdonald House,
1 Grosvenor Square,
LONDON.
W1Z 0AB

5th October, 1987

Dear Mr. Lawson

Our Prime Minister has announced on October 4th that an agreement in principle was reached on the basic elements of a Free Trade Agreement with the United States of America. I am therefore writing to provide you with some details on the agreement and to enclose a copy of the Prime Minister's statement as well as a synopsis of the Agreement.

The Canadian Government strongly feels that the Free Trade Agreement concluded with the United States is consistent with and supportive of Canada's international trade and economic priorities and obligations and should provide greater trade opportunities generally for all of Canada's trading partners.

The Canada/USA Free Trade Agreement is a broad and balanced package which will lead to significant trade liberalisation, phased in over a period of time. Although the Agreement will lower trade barriers between Canada and the United States, it will not raise barriers to any other country. Third countries will continue to enjoy existing MFN access to both markets. The economic growth generated by such trade liberalisation will provide increased opportunities for third countries.

The Agreement provides a basis for Canada to secure and expand access to its largest market, in return for opening up the Canadian economy to additional competition. Hence, the Agreement will result in a strengthened and more competitive Canadian economy, making Canada an increasingly valuable and affluent market as well as a highly competitive, reliable supplier for third countries. As a result of the Agreement, Canada will become a more attractive site for direct and equity investment, given the freer access to the USA market for businesses established in Canada.

The Agreement is in complete keeping with Canada's global objectives and reinforces the trade liberalisation goals of the Uruguay Round.

The Agreement is consistent with GATT obligations regarding free trade areas. At the appropriate time, Canada and the United States will be notifying GATT to provide its members with an opportunity to examine the Agreement.

You should be aware that the Agreement has been initialled ad referendum and will not be signed until January 1988. The ratification process which will follow will not likely be completed prior to mid 1988 with the Agreement entering into force on January 1st, 1989.

I trust that this information provides you with an adequate overview of what this historical Agreement entails.

Yours sincerely,



R. Roy McMurtry
High Commissioner

The Right Honourable Nigel Lawson, M.P.,
Chancellor of the Exchequer,
H.M. Treasury,
Parliament Street,
LONDON.
SW1P 3AG

CANADA/USA FREE TRADE AGREEMENT

STATEMENT BY THE PRIME MINISTER ON FREE TRADE AGREEMENT
WITH THE UNITED STATES

I AM PLEASED TO ADVISE THAT AN AGREEMENT IN PRINCIPLE HAS BEEN CONCLUDED ON THE MAJOR ELEMENTS OF A FREE TRADE AGREEMENT WITH THE UNITED STATES. THE PACKAGE APPEARS TO BE POSITIVE AND WELL BALANCED WITH BENEFITS FOR ALL REGIONS. THERE REMAINS SOME IMPORTANT WORK ON LANGUAGE TO BE CONCLUDED LATER TONIGHT AND TOMORROW. OUR NEGOTIATORS BELIEVE THAT WHILE DIFFICULTIES MAY ALWAYS ARISE, NO MAJOR OBSTACLES REMAIN TO THE IRONING OUT OF OUTSTANDING LANGUAGE ISSUES. THIS AGREEMENT CONSTITUTES AN IMPORTANT STEP FORWARD IN A VITAL AREA OF TRADE LIBERALISATION. WE VIEW IT AS A SIGNIFICANT ACCOMPLISHMENT FOR CANADA AND ONE THAT SHOULD RENEW THE ECONOMIES OF BOTH COUNTRIES.

OCTOBER 5, 1987

CANADA/USA FREE TRADE AGREEMENT

SYNOPSIS

On October 3rd, 1987, Canada and the United States agreed in principle on the elements to be included in a Free Trade Agreement. These elements will be transformed into the actual legal text of the Agreement over the course of the next three weeks. A synopsis of the elements that have been agreed follows.

OBJECTIVES AND SCOPE

The two Governments have agreed to establish a Free Trade Area Agreement between them pursuant to the provisions of Article XXIV of the General Agreement on tariffs and trade with the following objectives:

- To eliminate barriers to trade in goods and services;
- To establish predictable rules, secure access and fair competition;
- To reduce significantly impediments to cross-border investment;
- To establish effective procedures and institutions for the joint administration of the Agreement and the resolution of disputes; and
- To lay the foundation for further bilateral and multilateral co-operation to expand and enhance the benefits of the Agreement.

The Agreement will cover trade in goods and services and investment and involve federal, state and provincial measures.

TARIFFS AND RULES OF ORIGIN

The two Governments have agreed to remove all tariffs by January 1st, 1988. Tariffs will be eliminated on the basis of three formulas:

- Some will be eliminated on the Agreement entering into force on January 1st, 1989;
- Some will be eliminated in five equal steps, most starting on January 1st, 1989, and;
- Some will be eliminated in ten steps, most starting on January 1st, 1989.

Goods which originate in Canada and the United States will qualify for the new tariff treatment. For goods incorporating offshore raw materials or components, it has been agreed that goods qualify for treatment as either of USA or Canadian origin if they have been sufficiently changed either in Canada or the United States to be classified differently than the raw materials or components from which they are made. The Governments will use the tariff classification of the harmonised system now being implemented by both Governments. In certain cases, goods will need to incur a certain percentage of manufacturing cost in the country of origin.

CUSTOMS MATTERS

The two Governments have agreed that:

- Duty drawbacks and similar programmes on goods imported from other countries, including through USA foreign trade zones, will be eliminated for bilateral trade after January 1st, 1994;
- Neither party will introduce new duty waivers tied to specific performance requirements. All existing duty waivers will be eliminated by January 1st, 1998; and
- Customs user fees will be phased out on bilateral trade by January 1st, 1993.

QUANTITATIVE RESTRICTIONS

Both parties have agreed to maintain the basic rules of GATT to regulate quantitative restrictions on imports or exports. Existing quantitative restrictions will be eliminated, either immediately or according to a timetable, or grandfathered.

TRADE REMEDIES AND DISPUTE SETTLEMENT

The two Governments have agreed to a unique dispute settlement mechanism which guarantees the impartial application of their respective anti-dumping and countervailing duty laws and other aspects of trade remedy law. Either Government may seek a review of an anti-dumping or countervailing duty determination by a bilateral panel with binding powers. Concurrently, the two Governments will work towards establishing a new regime to address problems of dumping and subsidisation to come into effect at the end of the seventh year.

Additionally, the two Governments have agreed that changes in anti-dumping and countervailing duty legislation apply to each other only following consultation and if specifically provided for in the new legislation. Moreover, either Government may ask a bilateral panel to review such changes in light of the object and purpose of the Agreement and their rights and obligations under the GATT anti-dumping and subsidies codes. Should a panel recommend modifications, the parties will consult on such modifications. Failure to reach agreement gives the other party the right to take comparable legislative or equivalent executive action or terminate the Agreement.

EMERGENCY MEASURES

The two Governments have agreed to more stringent standards for the application of emergency safeguards (quotas or surcharges on imports causing serious injury) to bilateral trade. Except where the other party is the major source of injury or is contributing importantly to the injury, they agree to exempt each other from safeguard measures. Bilaterally applied emergency measures are subject to compensation and protection against reductions below the trend line of previous bilateral trade.

GOVERNMENT PROCUREMENT

The two Governments have agreed to expand access to purchases by Governments by building on the GATT Government Procurement Code. They have agreed to improved procedures for trade between them and to extend coverage of the code to purchases between US \$25,000 and US \$171,000, the current threshold for coverage under the GATT code.

NATIONAL TREATMENT

The two Governments have agreed to build on the GATT provision requiring that they will extend the same treatment to each others goods as regard internal regulatory and fiscal requirements.

TECHNICAL STANDARDS

The two Governments have agreed to build on the GATT standards code. They will seek to harmonise federal standards and encourage harmonisation at the state and provincial and private level.

TRADE IN AGRICULTURAL GOODS

The two Governments have agreed to a package of trade liberalising measures for trade in agriculture including:

- Eliminating all tariffs (but allowing Canada to restore temporarily tariffs on fresh fruits and vegetables for a twenty-year period (under depressed price conditions);
- Exempting each other from restrictions under their respective meat import laws;
- Prohibition of export subsidies on bilateral trade;
- An exemption for Canada from any future quantitative import restrictions on products containing 10% or less sweetener and on grains and grain products; and
- Conditional elimination of Canadian import licences for wheat, barley and oats and their products and eliminating Canadian western grain transportation subsidies on exports to the United States.

They will work with others bilaterally and in the GATT to further improve and enhance trade in agriculture.

WINE AND DISTILLED SPIRITS

The two Governments have agreed to reduce barriers to trade in wine and distilled spirits. Beer is not covered in the Agreement. They will eliminate discriminatory markups for spirits immediately and for wine over a period of seven years. All other discriminatory pricing measures will be eliminated immediately. They will also reduce discrimination in listing practices and extend national treatments to future changes in distribution systems.

TRADE IN ENERGY

They have agreed to eliminate a range of specific barriers to trade in energy (oil, gas, coal, electricity, uranium), including: all USA restrictions on enrichment of Canadian uranium; and the embargo on exports of Alaskan crude oil up to 50,000 barrels a day.

They have also agreed to ease regulatory restrictions on trade in energy products.

AUTOMOTIVE TRADE

The two Governments agreed to leave the Auto Pact intact. In order to provide for improved conditions of trade in automotive products, they have agreed:

- To eliminate all tariffs on automotive products within ten years;
- All vehicles will be subject to a special rule of origin creating new opportunities for production and employment in North America;
- To eliminate the duty remission programmes by 1996; and
- To limit the duty-free entry privileges of the Auto Pact to current participants.

They have also agreed to establish a blue-ribbon panel to advise the two Governments on automotive issues.

TRADE IN SERVICES

The Agreement will provide, for the first time, a set of disciplines covering a large number of service sectors. The Agreement will provide that the two Governments in future will extend the principles of national treatment, right of commercial presence and right of establishment to each others providers of services. Additional sectoral annexes will clarify this general obligation with respect to transportation, enhanced telecommunications and computer services, tourism and architecture.

TEMPORARY ENTRY FOR BUSINESS PURPOSES

The Agreement will provide for improved and easier border crossing by business persons trading in goods and services.

FINANCIAL SERVICES

The two Governments have undertaken to grandfather existing privileges in each others market and improve access and competition for financial institutions consistent with prudential and regulatory requirements. Additionally, Canadian banks in the United States will be able to underwrite Canadian Government securities. Canadian financial institutions will be treated the same as USA banks with respect to any changes in the Glass-Steagall Act governing the relationship between the banking and securities industries.

INVESTMENT

The two Governments have agreed in future to liberalise the treatment given to each others investors with respect to: the acquisition of existing firms, and the conduct, operation and sale of established firms.

Both Governments retain the right to maintain existing measures not in conformity with these principles.

Canada retains the right to review the acquisition of firms in Canada by USA investors, but has agreed to phase in higher threshold levels for direct acquisition. The review of indirect acquisition will be phased out.

CULTURAL INDUSTRIES

The Government retains its full capacity to support cultural industries in Canada (film and video, music and sound recording, publishing and cable and broadcasting).

INSTITUTIONAL PROVISIONS

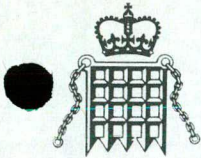
The Agreement will establish a bilateral commission at the ministerial level to supervise the implementation and administration of the Agreement.

NOTIFICATION AND CONSULTATION

The Agreement will provide mandatory notification and consultation procedures to ensure the smooth operation of the Agreement and to encourage the avoidance of disputes.

DISPUTE SETTLEMENT FOR MATTERS OTHER THAN TRADE REMEDIES

The two Governments have agreed to binational panel procedures at the instance of either party to make recommendations for the settlement of disputes regarding the interpretation and application of the Agreement. By mutual agreement, they may also refer such disputes to binding interpretation.



10

H M CUSTOMS AND EXCISE
KNOLLYS HOUSE BYWARD STREET
LONDON EC3R 5AY
01-382 -5295 (GTN 2913)

FROM: E N TAYLOR
7 October 1987

PS/PMG

cc PS/Chancellor
PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Sir G Littler
Mr SCholar
Miss Sinclair

You asked for advice concerning the letter of 2 October to the Paymaster General from the Canadian High Commission concerning the visit to London of Mr Dick Johnson, Alberta Provincial Treasurer; Mr Johnston has requested a meeting on the morning of 15 October.

Mr Johnston is the Minister responsible for the Treasury in the Government of the province of Alberta, one of the ten provinces of Canada. Each of the other provinces has a retail sales tax of some kind on a limited range of goods (or in a few cases of goods and services) but Alberta has none. The Federal Government is examining, in conjunction with the provinces, the possibility of introducing a country-wide and much simplified form of VAT: it is discussing with the provincial governments whether this federal tax should subsume their own sales taxes (and if so at a single rate or at rates varying

Internal circulation

CPS

Mr B H Knox

Mr P Jefferson Smith

Mr B J Cockerell

from province to province) or should be applied in addition to the existing provincial sales taxes. At present the Federal Government imposes a 12 per cent tax, applied at the manufacturing stage, on a limited range of goods only. The whole matter has serious constitutional implications in addition to the purely fiscal considerations.

I have twice visited Canada on secondment to the Department of Finance in Ottawa to advise the Federal Government on the introduction of a value added type tax, the last time for some 4 months during the winter of 1986-87: I was present at two of the exploratory meetings held at official level between the federal and provincial governments. I would be available to attend the proposed meeting if the Paymaster General so wished.



E N TAYLOR
VAT ADMINISTRATION
DIVISION D



15
FROM: Diary Secretary
DATE: 7 October 1987

MR E N TAYLOR - C&E

cc PS/Chancellor
PS/Financial Secretary
PS/Economic Secretary
Sir Peter Middleton
Sir Geoffrey Littler
Mr Scholar
Miss Sinclair
PS/Customs & Excise

**PAYMASTER GENERAL'S MEETING WITH MR DICK JOHNSON, ALBERTA
PROVINCIAL TREASURER**

Thank you for your minute of 7 October which I will show to the Paymaster General on his return from the Conservative Party Conference in Blackpool.

In the Paymaster's absence, i have arranged for Mr Dick Johnson to come along to the Treasury for a meeting on Thursday, 15 October at 10.00am.

Mr Johnson will be accompanied by his assistant, Mr John Jacobson and Mr Nick Rost van Tonningen, whose title has yet to be advised.

I would be grateful if you could arrange for the Paymaster to receive briefing and official support at the meeting.

Kathy Byrne

PP
MRS J DALY
Diary Secretary

HAI COMMISSARIAT DU CANADA,
DIVISION COMMERCIALE/ECONOMIQUE
MACDONALD HOUSE,
1 GROSVENOR SQUARE,
LONDON, W1X 0AB



CANADIAN HIGH COMMISSION,
COMMERCIAL/ECONOMIC DIVISION,
MACDONALD HOUSE,
1 GROSVENOR SQUARE,
LONDON, W1X 0AB.

Telephone: 01-629 9492 Ext.

Telex No.: 261592 (CDALDN G)

8th October, 1987

ppp

The Honourable Peter Leonard Brooke, M.P.,
Paymaster General,
H.M. Treasury,
Parliament Street,
LONDON.
SW1P 3AG

Dear Mr. Brooke,

This letter is to confirm the appointment arranged for Mr. Dick Johnston - Alberta Provincial Treasurer, to meet with you on Thursday, 15th October, at 10.00 a.m. at H.M. Treasury.

Mr. Johnston will be accompanied by his Assistant Mr. John Jacobson, Mr. Nick Rost Van Tonningen from Mr. Johnston's office, along with Dr. Ian Logan, Counsellor (Economic), from the Canadian High Commission.

As previously mentioned, Mr. Johnston would like to discuss VAT in Britain, in light of the proposed introduction of a similar system in Canada.

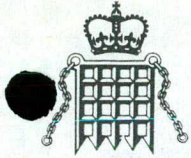
Yours sincerely,

Roger Ferland
Counsellor,
(Commercial/Economic)

PAYMASTER GENERAL	
DATE	9 OCT 1987
REASON	
INFO	PS/ch/EX
	PS/ST, PS/ST
	Sir P Macdellon
	Sir G Little

Mr Schlar
Miss Sinclair
PS 1 c + 2

Mr G TAYLOR CTE
PM 19



H M CUSTOMS AND EXCISE
KNOLLYS HOUSE BYWARD STREET
LONDON EC3R 5AY

01-382 - 5295 (GTN 2913)

jmp

FROM: E N TAYLOR

12 October 1987

PS/PMG

cc PS/Chancellor
PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Sir Geoffrey Littler
Mr Scholar
Miss Sinclair

**PAYMASTER GENERAL'S MEETING WITH MR DICK JOHNSTON ALBERTA PROVINCIAL
TREASURER**

1. The Diary Secretary's note of 7 October asked for briefing for this meeting.
2. The Federal Government of Canada has been examining, for some 3 years now, the possibility of introducing a form of VAT as part of a package of tax reforms. The tax would replace the present 12 per cent federal sales tax on a small range of goods, which is levied at the manufacturing stage and is somewhat similar to the Purchase Tax which was replaced by VAT here. Since initial opposition from trade bodies centred on the administrative complexities of VAT as operated

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CPS

Mr B H Knox

Mr P Jefferson Smith

Mr B J Cockerell

Mr K Romanski

in EC countries, the proposals have so far centred around a virtually all-embracing, single-rate tax with almost no exemptions or zero-ratings: this, it was thought, would obviate the need for a tax invoice requirement. At the end of a tax period the typical trader would simply apply the VAT fraction to his total sales and total purchases: the difference between the two figures would represent his liability. The exemption threshold for small businesses would be negligible.

3. The intention was that only education and health would be exempt and only exports zero-rated. Even financial services and insurance would be taxed, though under special rules. At a later stage, Ministers began to question the political wisdom of applying the tax to food and clothing and an elaborate system was devised for reimbursing the lower paid to the extent of the tax on the average expenditure on these items by means of a refundable tax credit. The administrative burden of such a scheme led to the Federal Government looking again at the possibility of a tax invoice system which would enable food and other items to be exempted or zero-rated.

4. There are 10 provinces in Canada, each with its own provincial government. Provincial governments have a constitutional right to levy direct taxes. The Constitution also exempts them from paying federal taxes but this right has been waived in favour of a reciprocal agreement in all but Alberta and Saskatchewan. For administrative convenience, provincial income tax is in fact collected centrally together with the federal income tax. However, **with the exception of Alberta**, the provinces each levy a retail sales tax which, because it is defined as falling directly on the consumer with the retailer acting as his agent, is somewhat dubiously regarded as covered by the Constitution. These retail taxes vary widely in rates and coverage and are applied to the retail price inclusive of federal tax.

5. The tax reform package on which the the Federal Government has issued a consultation document proposes abolishing the 12 per cent federal sales tax and replacing it by some form of multi-stage tax. Three variants are under consideration at present:

- (a) a national sales tax, which would be a combined federal/provincial VAT to apply across Canada, either at a single rate or at a rate which varied from one province to another to take account of the different current rates of taxation in each;
- (b) a Goods and Services tax, to apply at the federal level only, in the simplified form outlined at paragraphs 2 and 3 above; or
- (c) a VAT, with tax invoices, again to apply at the federal level only, but with greater flexibility to exempt some products or small businesses from tax.

6. Alone among the Canadian provinces, Alberta has had no sales tax for many years. It is rich in natural resources, particularly oil and although the provincial economy has been affected by the down-turn in the oil market, the Alberta government is still believed to be politically reluctant to introduce a sales tax. However, it might favour the introduction of a national tax if this were to apply at the same rate in all provinces. Clearly a rate which varied according to the existing level of taxation in each province could lead to distortion of trade which could make the tax unworkable if Alberta continued not to levy a provincial rate.

7. It is apparent that the Canadian Government is a long way from introducing a VAT of any sort: the Conservative Government of Brian Mulroney, which has some 18 months of its term of office to run, is doing very badly in the polls and it seems unlikely that this part of the reform package would be introduced before the next election.

On the other hand, the overhaul of direct taxation, with lower rates of personal income tax, seems a distinct possibility, leaving an already planned VAT as Hobson's choice for the incoming government. This is no more than conjecture, however; the strongly entrenched views held on the constitutional issues by all provinces, but particularly Quebec, will make it extremely difficult for the Federal Government to reach agreement on a national tax, while a federal-only tax will produce very considerable administrative and compliance difficulties, whether it takes the form of VAT with tax invoices or the simplified Goods and Services tax being considered.

8. Mr Romanski and I will attend from here.



E N TAYLOR
VAT ADMINISTRATION
DIVISION D

HAUT-COMMISSARIAT DU CANADA,
DIVISION COMMERCIALE/ECONOMIQUE
MACDONALD HOUSE,
1 GROSVENOR SQUARE,
LONDON, W1X 0AB



CANADIAN HIGH COMMISSION,
COMMERCIAL/ECONOMIC DIVISION,
MACDONALD HOUSE,
1 GROSVENOR SQUARE,
LONDON, W1X 0AB.

Telephone: 01-629 9492 Ext.

Telex No.: 261592 (CDALDN G)

13th October, 1987

The Honourable Peter Leonard Brooke, M.P.,
Paymaster General,
H.M. Treasury,
Parliament Street,
LONDON.
SW1P 3AG

Dear Mr. Brooke,

Following my letter to you dated 8th October relating to the meeting between Mr. Johnston - Alberta Provincial Treasurer and yourself on October 15th at 10.00 a.m., please be advised that Mr. Johnston will now be accompanied by his Assistant - Mr. Randy Dawson, Mr. Alastair McPherson - Deputy Minister, Alberta Provincial Treasurer's Department and Mr. Nick Rost Van Tonningen from Mr. Johnston's office, along with Dr. Ian Logan, Counsellor (Commercial/Economic) from the Canadian High Commission.

Yours sincerely,


Roger Ferland
Counsellor,
(Commercial/Economic)

cc PS/CHANCELLOR
PS/FST, PS/EST
SIR P MIDDLETON
SIR S LITTLE
MR SCHOLAR
MISS SINCLAIR
PS/CEB
MR EN TAYLOR
MR ROMANSKI



FROM: Diary Secretary

DATE: 19 October 1987

MR E N TAYLOR - C&E

cc PS/Chancellor

PS/FST

PS/EST

Sir P Middleton

Sir G Littler

Mr Scholar

Miss Sinclair

PS/C&E

PAYMASTER GENERAL'S MEETING WITH MR DICK
JOHNSTON, ALBERTA PROVINCIAL TREASURER

The Paymaster General was grateful for
the briefing you provided for this meeting.

MRS J DALY
Diary Secretary

CONFIDENTIAL

pmf

FROM: SIR T BURNS
DATE: 20 OCTOBER 1987

SIR P MIDDLETON

cc PPS
Sir G Littler o r
Mr Cassell

✓
✓

CONVERSATION WITH DR WENDY DOBSON, ASSOCIATE DEPUTY MINISTER,
CANADIAN DEPARTMENT OF FINANCE

Dr Dobson phoned me this afternoon to discuss the current economic situation. I noted that, although the equity markets had been hit very hard, the effects had not spread through into the other financial markets, which was some consolation. Dr Dobson said that the Canadian dollar had fallen against the US dollar, reflecting perceptions of Canada's status as a major producer of primary commodities. We agreed that the fall in equity markets might hold back domestic demand growth a little, given the effects on financial wealth (which may have made some contribution to the recent buoyancy of domestic demand).

2. Dr Dobson said that the Chancellor's statement had been welcomed. They too were distressed at the public nature of the disagreement between Baker and Stoltenberg and welcomed the reassuring messages this morning. She pointed out that this could be interpreted as a sign of the problems that could emerge if markets thought that co-operation had broken down. She had spoken to Mulford and thought that he seemed more interested than usual in suggestions from others.

Sh
T BURNS

120
/10

HAI COMMISSARIAT DU CANADA,
DIVISION COMMERCIALE/ECONOMIQUE
MACDONALD HOUSE,
1 GROSVENOR SQUARE,
LONDON, W1X 0AB



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MACDONALD HOUSE,
1 GROSVENOR SQUARE,
LONDON, W1X 0AB.

Telephone: 01-629 9492 Ext.

Telex No.: 261592 (CDALDN G)

Mr Huw Evans
Under Secretary
International Finance
H M Treasury
Parliament Street
LONDON
SW1P 3AG

H/EXCHEQUER	
28 OCT 1987	
Mr H.P EVANS	
Sir P. Middleton	
Sir G. Little	
Sir T. Burns	
Mr Cassell	
Mr Peretz	

28 October 1987

Dear Huw

Attached is the text of the letter from Mr Wilson to Mr Lawson of which I spoke this morning.

Before coming to London mid-day of November 12, Mr Wilson will visit Paris, Zurich and Bonn, and meet his counterparts, central bank governors and bankers in each centre. He may also meet Mr Amoto in Brussels on November 15 or 16. The primary purpose of his visit will be to discuss recent market turmoil and possible actions by G-7 countries.

I would be grateful for your early reply regarding a possible dinner on November 12 or lunch on November 13 with Chancellor Lawson and a private meeting which could precede the lunch or dinner.

Many thanks.

Yours sincerely

Glen Bailey

GLEN BAILEY
First Secretary (Economics)

PS. The original of Mr Wilson's letter will follow by bag.
our diplomatic

Canadian High Commission



Haut Commissariat du Canada

Macdonald House
1 Grosvenor Square
LONDON
W1X 0AB

October 28, 1987

The Right Honourable
Nigel Lawson MP
Chancellor of the Exchequer
Parliament Street
LONDON
SW1P 3AG

Dear Colleague

I am writing to you with some thoughts I would like to discuss in more detail during my visit to Europe scheduled for the week of November 9.

Events of the past week have impressed upon us all the importance of close cooperation within the Group of Seven. During these tumultuous days, I have had extensive discussions with the North American financial-market community. Three points have arisen repeatedly:

- our cooperative efforts as a Group of Seven in reducing interest rates and injecting liquidity into the market have been very well received;
- on the other hand, our efforts in the Group of Seven to deal with some longer standing problems remain as a major ongoing concern;
- the expectation is widespread and strongly held that more visible action on the policy directions identified in the Louvre Accord could have a stabilizing effect.

Financial markets are seen to be giving a clear signal that we should follow through on our communiqués with concrete action. This action may have to be taken at a very early date, possibly sooner than when I visit with you.

I believe this signal will become even more insistent in the days and weeks ahead. We must, as a matter of urgency, take a second look at a number of areas. Some of these areas are ones in which political factors have been holding us back.

Of course, much attention is being focussed on the three largest countries and the policy actions required of them. But I believe, to be truly credible, all members of the group must implement policy changes that will sustain economic growth, reduce external imbalances and cool inflationary pressures.

I enjoyed seeing you again at the recent Fund/Bank meeting and look forward to hearing an elaboration of the views you put forward on the role of indicators in multilateral surveillance.

Yours sincerely

Original Signed by
Original signé par

MICHAEL H WILSON

Minister of Finance



Ministre des Finances

Put with pp. for mty

CH/EXCHEQUER *10/11* OCT 28 1987

10 NOV 1987

MR MP EVANS
 CST EST
 SIR P MIDDLETON
 SIR G LITTLE
 MR CASSELL
 MR PEREZ
 MRS COMAR
 MR MOUNTFIELD

The Right Honourable
 Nigel Lawson
 Chancellor of the Exchequer
 Parliament Street
 London, 5W1P3A6
 England

Dear Colleague:

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.../2

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Yours sincerely,



Michael H. Wilson

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CANADIAN STOCK MARKETS

SUMMARY

1. CANADIAN STOCK MARKETS FOLLOWED WORLD-WIDE DROP BUT SO FAR BROKERAGE FIRMS ARE SURVIVING. BANK OF CANADA INJECTED LIQUIDITY INTO THE SYSTEM. ECONOMY LIKELY TO GROW MORE MODESTLY.

DETAIL

2. THE CANADIAN STOCK MARKETS HAVE BEEN BEHAVING MUCH AS EVERY OTHER MAJOR MARKET IN THE WORLD OVER THE LAST TWO WEEKS. ON MONDAY, 19 OCTOBER THE TORONTO STOCK EXCHANGE (TSE) LOST 37 BILLION CANADIAN DOLLARS AS THE COMPOSITE INDEX DROPPED BY 11.3 PER CENT. THE MONTREAL EXCHANGE DROPPED 9.5 PER CENT THE SAME DAY. THE WEEK AS A WHOLE SHOWED A LOSS OF 47 BILLION CANADIAN DOLLARS ON THE TSE, DOWN 14.4 PER CENT. THE MONTREAL EXCHANGE FARED SLIGHTLY BETTER BUT THE MUCH SMALLER VANCOUVER EXCHANGE FELL A REMARKABLE 23 PER CENT, EQUALLING LONDON'S DROP.

3. THIS WEEK BEGAN ON ANOTHER DOWNWARD TREND BUT SHARE PRICES RALLIED SLIGHTLY ON TUESDAY, 27 OCTOBER, BEFORE SLIPPING BACK AGAIN ON WEDNESDAY.

4. THE BANK OF CANADA LOWERED ITS BASE RATE BY 157 POINTS TO 8.26 PER CENT ON 22 OCTOBER, FOLLOWING SIMILAR INTEREST RATE CUTS IN THE U.S.. PRIME RATES CAME DOWN AS DID MORTGAGE RATES. THE GOVERNOR OF THE BANK OF CANADA TOLD US LAST WEEK THAT THE FEDERAL AUTHORITIES WERE PROVIDING A LOT OF LIQUIDITY. HE HAD TALKED TO THE BANKS AND THE INVESTMENT DEALERS ASSOCIATION (IDA) AND TOLD THEM TO REPORT IF CUSTOMERS WERE IN SEVERE DIFFICULTIES. HE DID NOT, HOWEVER, FORESEE ANY MAJOR BANKRUPTCIES.

5. THE IDA AND THE THREE MAJOR STOCK EXCHANGES HAVE ASKED INVESTMENT FIRMS TO DISCLOSE THEIR FINANCIAL POSITION. ALTHOUGH SOME MAY BE IN DIFFICULTY IT LOOKS AS THOUGH, AS A RESULT OF THE DEREGULATION-RELATED MERGERS AND SHARE ISSUES OR POSSIBLY JUST TIGHTER MARKET SAFEGUARDS, ALMOST ALL BROCKERAGE FIRMS WILL

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SURVIVE.

6. THE PROBLEMS OF SHARE PRICES VIS-A-VIS THE BP ISSUE HAVE BEEN GIVEN SOME PROMINENCE HERE. A GROUP OF 3 CANADIAN DEALERS STAND TO LOSE SIGNIFICANTLY BECAUSE OF THEIR UNDERWRITING OF THE ISSUE. FINANCE MINISTER WILSON IS REPORTED TO HAVE SOPOKEN TO CHANCELLOR LAWSON ABOUT CANADIAN CONCERNS (OUR TELNO 692).

7. THE EFFECT OF ALL THIS ON THE CANADIAN ECONOMY IS DIFFICULT TO PREDICT. CANADA LEADS THE INDUSTRIAL WORLD IN REAL GDP GROWTH. THE ECONOMY GREW STRONGLY AGAIN IN AUGUST, 0.8 PER CENT SEMI-COLON AND GDP STOOD 5 PER CENT HIGHER IN REAL TERMS THAN A YEAR AGO. THE LOWERING OF THE BANK RATE SEEMS TO HAVE WORKED AT LEAST IN THE SHORT TERM. RETAIL SALES HAVE SO FAR MAINTAINED A BRISK RATE. WHILE MOST OF THE FUNDAMENTALS OF THE CANADIAN ECONOMY APPEAR SOUND, ITS DEPENDENCE ON THE U.S. MUST CAUSE APPREHENSION. MOST FORECASTERS ARE PREDICTING SOME SLOW-DOWN IN THE GROWTH RATE.

WENBAN-SMITH

YYYY

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MONETARY
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NNNN

Minister of Finance



Ministre des Finances

mp

November 3, 1987

- postmarked 14/11
- arrived H.C.
17/11

✓

The Right Honourable Nigel Lawson, M.P.
Chancellor of the Exchequer
House of Commons
London, England
SW1A 0AA

Dear Nigel:

I read with great interest your statement regarding your government's decision to continue with the sale of the BP shares. We had spoken about this earlier and as you know, my preference was to see the issue withdrawn because of its possible impact on already shaken markets. However, I was pleased with your decision which, in my view, was a well crafted compromise. The proposed Bank of England buyback mechanism seems to have been well received by the market and has been helpful to Canada.

On a more general note, I would like to say that the international cooperation among Group of Seven countries has been very effective in dealing with the recent stock market difficulties.

I am very much looking forward to meeting with you on November 12.

Yours sincerely,

Michael H. Wilson

Alex

Canadian High Commission



Haut Commissariat du Canada

CH/EXCHEQUER	
REC.	10 NOV 10/11
ACTION	DJ L MOORE
COPIES TO	CST FST Sir P Middleton Sir G Ritter Mrs Brown Mr Williams

Macdonald House,
1 Grosvenor Square,
LONDON, W1X 0AB

November 5, 1987

My Dear Minister,

I am enclosing a copy of a letter from Michael Wilson to you concerning the British Government's decision to proceed with the BP share offer.

I should like to take this opportunity to thank you most warmly for agreeing to host a working luncheon for Michael Wilson when he is in London on November 12. I very much look forward to seeing you on that occasion.

Yours sincerely,

R. Roy McMurtry
High Commissioner

The Rt. Hon. Nigel Lawson, MP
Chancellor of the Exchequer,
11 Downing Street,
LONDON, SW1

Canadian High Commission



Haut Commissariat du Canada

Macdonald House,
1 Grosvenor Square,
LONDON,
W1X 0AB

November 3, 1987

The Rt Hon Nigel Lawson, MP
Chancellor of the Exchequer
11 Downing Street
LONDON
SW1

Dear Nigel,

I read with great interest your statement regarding your government's decision to continue with the sale of the BP shares. We had spoken about this earlier and as you know, my preference was to see the issue withdrawn because of its possible impact on already shaken markets. However, I was pleased with your decision which, in my view, was a well crafted compromise. The proposed Bank of England buyback mechanism seems to have been well received by the market and has been helpful to Canada.

On a more general note, I would like to say that the international cooperation among Group of Seven countries has been very effective in dealing with the recent stock market difficulties.

I am very much looking forward to meeting with you on November 12.

Yours sincerely,

Original Signed by
Original signé par

MICHAEL H. WILSON

HAUT-COMMISSARIAT DU CANADA,
VISION COMMERCIALE/ECONOMIQUE
MACDONALD HOUSE,
1 GROSVENOR SQUARE,
LONDON, W1X 0AB



CANADIAN HIGH COMMISSION,
COMMERCIAL/ECONOMIC DIVISION,
MACDONALD HOUSE,
1 GROSVENOR SQUARE,
LONDON, W1X 0AB.

Telephone: 01-629 9492 Ext.

Telex No.: 261592 (CDALDN G)

Mr Jonathan Taylor
Private Secretary to the
Chancellor of the Exchequer
H M Treasury
11 Downing Street
LONDON

prep for Wilson meeting tomorrow

10 November 1987

Dear Mr Taylor

This is to confirm arrangements for the meeting and working lunch of the Honourable Michael H Wilson, Minister of Finance with Chancellor Lawson on Thursday November 12. A biography of Mr Wilson is attached.

Mr Wilson is arriving at Heathrow at 12.15 pm on the BA flight from Bonn-Cologne and we have arranged for him to come directly to No 11, barring uncontrollable airplane delays, for the scheduled 1.00 pm meeting and the working lunch. I understand Chancellor Lawson has a 3.00 pm engagement, as does Mr Wilson, and we will expect to leave around 2.45 pm.

During the discussions, Mr Wilson would of course like to share views on coordination of economic policies among G-7 members, preparations for the Economic Summit in Toronto next June and the implications of recent turbulence in financial markets for governments and regulatory bodies. Mr Wilson would be interested in having information on UK economic policies and prospects and Mr Wilson would be pleased to do similarly for Canada. Prior to London, Minister Wilson will have visited Paris, Zurich and Bonn.

As we discussed, Mr Wilson would welcome the opportunity for a private meeting prior to the working lunch should Chancellor Lawson be so inclined.

Accompanying the Minister will be High Commissioner R Roy McMurtry, Wendy Dobson, Associate Deputy Minister, Department of Finance, Don McCutchan, Senior Departmental Assistant and L J Taylor, Minister at the High Commission.

I trust the above is satisfactory.

Yours sincerely

Glen Bailey

GLEN BAILEY
First Secretary (Economic)

THE HONOURABLE MICHAEL H WILSON
BIOGRAPHICAL NOTES

The Honourable Michael H Wilson, Member of Parliament for the riding of Etobicoke Centre (Toronto), has been the Minister of Finance since the election of the Conservative Canadian government in 1984. Mr Wilson is also a member of the Cabinet Committees for Planning and Priorities, Economic and Regional Development, and Social Development.

Mr Wilson was first elected to the House of Commons in May 1979. On June 4 of the same year, he was appointed the Minister of State for International Trade in the government of Prime Minister Joe Clark. After the 1980 election, Mr Wilson assumed responsibility as the Progressive Conservative Party's Opposition spokesperson for Industry, Trade and Commerce. This was followed by that of Energy, Finance and then of Regional Industrial Expansion.

Born in Toronto in 1937, Mr Wilson holds a Bachelor of Commerce degree from the University of Toronto. Upon graduation in 1959, he worked in international banking in London and New York. In 1961, he joined the investment firm of Harris and Partners Limited in Toronto. Mr Wilson worked for the Department of Finance in the Capital Markets division from 1964-1966. He then returned to Harris and Partners, which later merged with Dominion Securities Limited, to form Canada's largest investment firm.

In 1973, Mr Wilson was appointed Executive Vice-President of Dominion Securities, with responsibilities for international and government finance activities. He continued in this capacity until his election as a Member of Parliament in 1979.

Mr Wilson currently resides in Ottawa; he and his wife, Margie, have three children, two sons and a daughter.

Throughout his business and government career, Mr Wilson has been active in community affairs, serving in senior roles with the Canadian Cancer Society, the Canadian Club, and the Dellcrest Community Centre.

November 1987

MINISTERIAL DELEGATION

Ms Wendy Dobson joined the Department of Finance in March 1987 as Associated Deputy Minister (2nd Permanent Secretary) responsible for International Finance and Trade. Previously she had worked for some years with the CD Howe Institute, a private economic research centre, most recently as its Director. She holds a doctorate in Economics.

Mr Don McCutchan, originally from Toronto, was an economist with the Department of Finance before becoming Senior Departmental Assistant (Private Secretary) in Minister Wilson's office in September 1984.

Mr Tom Kane was Director of the Energy Resources Division of the Department of Finance before coming to Orion Royal Bank 1986-87 on an executive interchange program. He has now returned to Finance in Ottawa as Director of Debt Management.

Mr L J Taylor, a graduate of McGill University, has been a member of Canada's Foreign Service since 1958, specialising in commercial affairs and economic policy. Recent assignments included Tokyo and Washington before his transfer to the Canadian High Commission, London as Minister (Commercial/Economic) in 1984.

Mr Glen Bailey has been a member of the Foreign Service for 12 years with postings in Ethiopia, Cameroon and now Britain. He has specialised in international economics and developing country affairs.

(M)

FROM: MICHAEL GUNTON
DATE: 11 NOVEMBER 1987

- 1. MR ALLEN
- 2. CHANCELLOR

✓ RIA. M₁₁

Ch/content? OK ✓

mpw

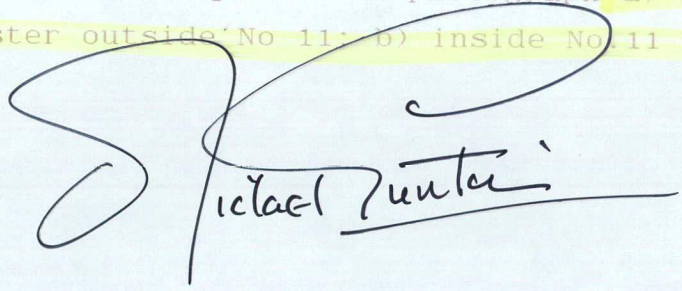
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cc Mr Pickford

CANADIAN FINANCE MINISTER VISIT

Canadian Broadcast News have put in a bid to photograph the Chancellor greeting the Canadian Finance Minister when he arrives for a visit in Downing Street on Thursday. They would also like to photograph them together in No.11.

Would the Chancellor agree to a photograph a) greeting the Finance Minister outside No 11; b) inside No 11?.


Michael Gunton

MICHAEL GUNTON

FROM: MICHAEL GUNTON
DATE: 11 NOVEMBER 1987

- 1. MR ALLEN
- 2. CHANCELLOR

RA *M* *Ch/contant?* *OK*

WPH
11 cc Mr Pickford

CANADIAN FINANCE MINISTER VISIT

Canadian Broadcast News have put in a bid to photograph the Chancellor greeting the Canadian Finance Minister when he arrives for a visit in Downing Street on Thursday. They would also like to photograph them together in No. 11.

Would the Chancellor agree to a photograph on greeting the Finance Minister outside No. 11 or inside No. 11?

Michael Gunton

MICHAEL GUNTON

FROM: S W MATTHEWS
DATE: 11 November 1987

CHANCELLOR

cc: Sir P Middleton
Sir G Littler
Mr Evans
Mr Savage

VISIT BY MICHAEL WILSON

The Canadian Finance Minister, Mr Michael Wilson, is calling on you at 1pm on Thursday 12 November for a meeting, to be followed by lunch.

2. Mr Wilson has written to say that he is pleased with your decision on BP shares, describing it "a well crafted compromise" and "helpful to Canada".

3. Like you, Mr Wilson will probably want to use the meeting to talk about the international financial situation and the prospective Group of Seven meeting. You will recall that he wrote about this on 28 October and you replied on 2 November - correspondence attached.

4. Despite its strong performance this year the Canadian economy would be vulnerable to a US recession. The Canadians are anyway amongst the strongest supporters of economic co-operation between the major countries. Their views on the importance of sound macroeconomic policies and a medium-term policy framework are similar to your own, but they have rather greater confidence in the usefulness of the G7/IMF indicators exercise. They have, for instance, been the most assiduous country in providing the Fund staff with national forecasts to 1991 for all the Tokyo/Venice Summit indicators.

5. You may also wish to cover debt issues, including progress on your initiative on sub-Saharan debt and the IMF's Structural Adjustment Facility. A short brief is attached.

6. Two issues that might come up on trade policy are the USA/Canada Free Trade Agreement and the UNCTAD Common Fund for commodities. A short brief is attached.

7. The Canadian economy grew very strongly - and more quickly than the UK - in the first half of 1987. Canada's Real GNP growth between 1986 and 1987 is, however, forecast to be a bit below the UK's: $3\frac{1}{2}$ per cent, compared with 4 per cent. A background note on the Canadian economy with more detail is attached.

8. The Canadians still have problems with their fiscal deficit, which is currently higher than other G7 countries (except Italy). Mr Wilson might welcome some G7 pressure on Canada to reduce its deficit further.

SM.

S W MATTHEWS



mpw

FROM: MISS M P WALLACE

DATE: 12 November 1987

MR M GUNTON

cc Mr R I G Allen
Mr Pickford

CANADIAN FINANCE MINISTER VISIT

The Chancellor has seen your minute of 11 November, and he agrees to the photographs you suggest.

mpw.

MOIRA WALLACE

DEBT ISSUES**SUB-SAHARAN INITIATIVE****Line to Take**

Commend Canadian action on RTA (although would have liked some conditionality to be attached) and their support in the Paris Club for 20 year rescheduling terms. Grateful for support for interest rate concessions on bilateral official debt but would like Canadians to take a higher profile.

Background

Canada has been generally supportive of the Chancellor's SSA initiative. They have supported 20 year terms in the Paris Club and have provided RTA to SSA countries but without applying any conditionality - even for Zambia which the UK has excluded from RTA because of their arrears to the IMF.

STRUCTURAL ADJUSTMENT FACILITY**Line to Take**

UK has offered an interest subsidy contribution rising to \$30 million per annum and is considering a capital contribution which will depend on security, liquidity and remuneration arrangements of proposed Trust Fund being satisfactory. Hope Canada will support differentially favourable access for debt distressed countries especially in sub-Saharan Africa.

Background

Canadians have, according to staff, offered a 200 million SDR contribution to the SAF plus an appropriate interest subsidy. This is a reasonable contribution (roughly on a par with a possible UK contribution - if we were to make one at all - of \$500 million, given our relative quota sizes in the Fund).

12/022

USA/CANADA: FREE TRADE AGREEMENT

Background

Canada and the USA are the world's largest trading partners. The Agreement, which was reached last month, aims to eliminate tariffs and other barriers to trade in goods and services, facilitate cross border investment and establish a trade dispute settlement mechanism. Specific areas targetted for tariff reductions are agricultural goods, wines and spirits, and cars.

Motives behind the free trade pact are Canadian anxieties that past US trade actions could turn into full scale protectionism and the opportunity to create jobs by improved access to the huge US market. In return, the US administration wanted better access for US brokers and banks to the Canadian market, easing of Canadian restrictions on foreign investment and greater protection for US intellectual property.

Claims by the two countries that the Agreement is consistent with GATT free trade area provisions and will provide access on equal terms to third countries have yet to be evaluated as the agreement's exact terms are not yet settled.

Line to take

As it is too early to judge whether the Agreement falls within GATT provisions it would be inappropriate to pass any comment at this stage.

UNCTAD: COMMON FUND

Background

The Canadian government are believed to have doubts about their country remaining as signatories to the Common Fund agreement. Canada is not a member of the coffee agreement nor will be party to the new rubber agreement, the only agreements which, as things ^{currently} stand, could call on the First Account. On the assumption that it is

agreed at the No 10 meeting that EC partners should be lobbied the case for deratification, you may wish to use this opportunity to lobby the Canadians as well.

Line to take

- Fund is relic of earlier and now discredited approach to solving commodity problems. No real help to commodity dependent countries' economic ills. Agreements embracing price intervention, which the First Account may foster, can lead to economic damage if prices kept at unsustainable level. Tin crisis classic example of what can happen.

- Desirable for consumer countries to deratify agreement and prevent Fund coming into operation. Failing that, aim should be to neutralise First Account in long term and focus Fund's activities on Second Account.

WILSON, THE HON MICHAEL, PC MP

Minister of Finance.

Born in Toronto in 1937.

Educated at Upper Canada College and University of Toronto. A successful businessman and former Executive Vice-President of Canadian Investment Funds Dominion Securities. Spent two years working at their branch in the City of London.

First elected to the House of Commons in May 1979 and appointed Minister of State for International Trade in June of that same year. He has subsequently served as party spokesperson for industry, trade and commerce; energy; finance and regional industrial expansion.

In 1983 he was a candidate for the leadership of the Federal PC party. He stepped down early in the proceedings to support Mr Mulroney's candidature.

As Minister of Finance he has been greatly concerned about the size of the Federal deficit and the problems of servicing the accumulated debt. He has been obliged to soften some of his proposals for deficit control in order to retain the support of the Prime Minister. This was reflected in the balanced nature of his first budget in May.

Serious, reflective and hardworking.

Married (Margaret). Three children.

FROM: R I G ALLEN
DATE: 24 NOVEMBER 1987

rup

SIR GEOFFREY LITTLER

cc Mr A C S Allan

JOHN FERGUSON: SOUTHERN NEWS GROUP

I got a call yesterday afternoon from Douglas Donald, Press Officer in the British High Commission in Ottawa.

2. Donald said that John Ferguson, an apparently influential columnist with Canada's Southern News Group (whose papers include the Ottawa Citizen) had been in touch with the High Commission to say that he would be in Geneva for the GATT talks next week, and would subsequently be in London for the period 4-7 December. He had asked for an interview with the Chancellor to discuss current world economic developments, prospects for G7 and related issues. I replied that this seemed of pretty marginal value to us and it was unlikely that the Chancellor would grant an interview. Other Treasury Ministers are not well placed to do it. But I wonder whether you might be prepared to take it on: half an hour should suffice?

3. Donald commented that the British image in Canada is not exactly at a high point currently: the Prime Minister's performance at CHOGM had not been forgotten, nor had Michael Wilson's public comments on BP underwriting. But this is clearly not an overriding reason for you doing the interview.

irl

R I G ALLEN

CONFIDENTIAL



FROM: A C S ALLAN
DATE: 27 NOVEMBER 1987

NOTE FOR THE RECORD

VISIT BY MICHAEL WILSON: 12 NOVEMBER

Lunch was on completely predictable lines, with discussion about markets and G7 dominating.

2. One point worth noting was on protectionism. Wilson was keen to make sure that the US/Canada trade agreement was not seen as a threat to the Canadian commitment to the new GATT round, but as part of their overall effort at trade liberalisation. The Chancellor said that he had never considered this a hostile act. Wilson also noted that the binding settlements procedure agreed for the US/Canada trade agreement had pointed the US to consider the wider application of such procedures, for example, in the GATT.

A C S ALLAN

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FM OTTAWA
TO ROUTINE FCO
TELNO 798
OF 312015Z DECEMBER 87
INFO SAVING TORONTO, MONTREAL

OTTAWA TELNO 496 OF 15 DECEMBER 1986:
CANADIAN FINANCIAL DEREGULATION: TRUST COMPANIES

SUMMARY

1. UNDER DRAFT LEGISLATION, ANNOUNCED ON DECEMBER 21, TRUST AND LOAN COMPANIES WILL BE ABLE TO OFFER A WIDER RANGE OF FINANCIAL SERVICES AND TO DO MORE CONSUMER AND COMMERCIAL LENDING. RESTRICTIONS ON CROSS OWNERSHIP OF FINANCIAL INSTITUTIONS WILL BE LIFTED. LARGE NON-FINANCIAL COMPANIES WILL NOT BE ABLE TO OWN TRUST COMPANIES IN THE FUTURE BUT EXISTING LINKAGES CAN CONTINUE WITHIN A 65 PER CENT OWNERSHIP LIMIT. SELF-DEALING IS TO BE STRICTLY REGULATED.
2. DRAFT LEGISLATION ON INSURANCE COMPANIES AND BANKS IS EXPECTED TO FOLLOW IN THE SPRING AND TO BE MODELLED ON THAT FOR THE TRUSTS. UK INSURANCE COMPANIES ARE RELATIVELY CONTENT WITH THE LATTER.

DETAIL

3. MR HOCKIN, MINISTER OF STATE, FINANCE CANADA, PRESENTED THE 254-PAGE DRAFT LEGISLATION. HE HAS ASKED FOR COMMENTS ON THE FINE DETAIL BUT NOT ON THE MAIN POINTS, WHICH ARE NOW FIXED, BY MID-FEBRUARY AND EXPECTS TO INTRODUCE FINAL LEGISLATION IN THE SPRING. THE DRAFT IS LARGELY CONSISTENT WITH HIS DECEMBER 1986 DISCUSSION PAPERS (OTTAWA TELNO 781).
4. THE NEW RULES VIRTUALLY PRECLUDE NON-FINANCIAL COMPANIES FROM STARTING OR BUYING A TRUST COMPANY. BUT A CONCESSION IS TO ALLOW, UNDER 'GRANDFATHERING' CLAUSE, EXISTING LINKS BETWEEN NON-FINANCIAL COMPANIES AND TRUST COMPANIES AND TO ALLOW THE TRUST COMPANIES CONCERNED TO DEVELOP NEW SERVICES. THIS IS OF INTEREST TO IMASCO, 44 PER CENT OWNED BY BRITISH AMERICAN TOBACCO, BUT CONSIDERED CANADIAN, WHICH BOUGHT THE CANADA TRUST COMPANY LAST YEAR. THE CHAIRMAN OF IMASCO HAS SAID THAT HE IS PLEASED THAT CANADIAN TRUST COMPANIES WILL BE ABLE TO OFFER NEW SERVICES.
5. ON THE OTHER HAND, IMASCO WILL BE CAUGHT BY THE STIPULATION THAT EXISTING COMPANIES WITH COMMERCIAL LINKS WILL HAVE TO MEET A 35 PER CENT PUBLIC OWNERSHIP REQUIREMENT IF THEY HAVE

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MORE THAN DLRS 50 MILLION IN CAPITAL. IMASCO IS RESIGNED TO THIS AND INDEED ANNOUNCED LAST SUMMER THAT IT INTENDED TO MAKE THE NEW HOLDING COMPANY PUBLIC AS A WAY OF REDUCING ITS STAKE IN CANADA TRUST COMPANY FROM 99 PER CENT TO THE REQUIRED 65 PER CENT LEVEL. PLANS TO DO SO IN THE AUTUMN WERE PUT ON HOLD AS A RESULT OF THE STOCK MARKET FALL.

6. UP TO NOW TRUST COMPANIES HAVE HAD TO KEEP THEIR COMMERCIAL LENDING TO 7 PER CENT OF ASSETS. NOW A TRUST COMPANY CAN MAKE LOANS OF UP TO DLRS 100,000. PROVIDED THE TRUST COMPANY HAS DLRS 25 MILLION CAPITAL AND SUPERVISORY APPROVAL IT CAN MAKE LOANS WITHOUT PORTFOLIO LIMIT. A TRUST COMPANY CAN ALSO SELL THROUGH ITS BRANCH SYSTEM PRODUCTS OF OTHER FINANCIAL INSTITUTIONS WITH ONE EXCEPTION - LIFE AND GENERAL INSURANCE.

7. THEORETICALLY, AT THE MOMENT, A LARGE TRUST COMPANY COULD GET 30 PER CENT OF ANOTHER LARGE COMPANY. IN PRACTICE IT DOES NOT HAPPEN AS LARGE TRUST (AND INSURANCE) COMPANIES ARE RARELY AVAILABLE. UNDER THE NEW RULES A COMPANY WITH CAPITAL OF DLRS 750 MILLION WILL NOT BE ALLOWED TO HAVE A SIGNIFICANT INTEREST, THAT IS, MORE THAN 10 PER CENT, IN ANOTHER TRUST COMPANY. BUT MEDIUM SIZE COMPANIES WILL BE ABLE, SUBJECT TO MINISTERIAL APPROVAL, TO ACQUIRE OTHER TRUST COMPANIES. IF THIS IS TRANSLATED INTO THE INSURANCE FIELD AND IS APPLICABLE TO NON-RESIDENT COMPANIES, THE UK LIFE INSURANCE COMPANIES, STANDARD LIFE AND PRUDENTIAL, ARE LIKELY TO BE CONTENT. FERNIE, PRESIDENT AND CEO OF STANDARD LIFE, SAID THAT HE EXPECTED THE PROPOSALS FOR INSURANCE COMPANIES WOULD BE VERY SIMILAR IN THIS RESPECT. HE WOULD BE COMFORTABLE WITH THEM. HE ALSO SAID THAT HE BELIEVED THAT THE GENTLMAN'S AGREEMENT REACHED WITH FINANCE CANADA ABOUT UK LIFE INSURANCE COMPANIES HAVING EQUIVALENT RIGHTS ON ACQUISITION TO THOSE OF DOMESTIC COMPANIES (OTTAWA TELNO OTTER 78) WOULD HOLD. HE ACCEPTED THAT THE FREE TRADE AGREEMENT DISCUSSIONS ON THIS SUBJECT WOULD HAVE TO SETTLE DOWN BEFORE FINANCE CANADA WENT PUBLIC ABOUT UK COMPANIES.

8. ON SELF-DEALING THE RULES IN THE DECEMBER DISCUSSION PAPER WERE CRITICISED BY THE INDUSTRY AS TOO STRICT. MR HOCKIN ADMITTED THAT THE COUNTERPART TO GIVING BROADER POWERS TO THE INDUSTRY WAS TO SET INPLACE FAIRLY STRICT RULES FOR SELF-GOVERNANCE - 'WE ARE RE-REGULATING RATHER THAN DE-REGULATING'. FERNIE TOLD US THAT WHILST THE RULES HAD BEEN A LITTLE RELAXED FROM THOSE IN THE DECEMBER PAPER, HE BELIEVED THAT THEY WERE STILL TOO STRICT AND WOULD PREVENT CERTAIN KINDS OF COMMON AND LEGITIMATE BUSINESS PRACTICES.

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FOR EXAMPLE, ALTHOUGH THE APPOINTMENT OF DIRECTORS HAD BEEN LOOSENED MARGINALLY FROM THE DECEMBER PAPER, IT WAS STILL TOO STRICT. AT LEAST ONE-THIRD OF A FINANCIAL INSTITUTION'S BOARD HAD TO BE INDEPENDENT, THAT IS, NEITHER AN EMPLOYEE, A MAJOR BORROWER, OR A SUPPLIER OF GOODS.

9. MR HOCKIN HAS SAID THAT HE WILL BE TRYING TO GET THE FEDERAL GOVERNMENT AND THE PROVINCES TO ALIGN THEIR RULES AND REGULATIONS WITH THOSE OF THE FEDERAL GOVERNMENT. WHILST THE FEDERAL GOVERNMENT AND ONTARIO GOVERNMENT HAVE THRASHED OUT A BASIC AGREEMENT, MR HOCKIN HAS STILL NOT REACHED ONE WITH QUEBEC AND THE OTHER PROVINCES. THE FEDERAL AND QUEBEC GOVERNMENTS IN PARTICULAR DISAGREE OVER WHO SHOULD REGULATE WHAT IN FINANCIAL MARKETS. A MEETING TOOK PLACE BETWEEN HOCKIN AND FORTIER QUEBEC'S ASSOCIATE FINANCE MINISTER ON NOVEMBER 16 BUT THE QUESTION WAS NOT RESOLVED.

10. FCO PLEASE PASS ADVANCE COPY TO SMITH, FSD, DTI, HELLINGS INS 3, DTI, GREEN, BANK OF ENGLAND, ILETT, TREASURY.

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CANADIAN ECONOMY: NATIONAL DEBT

SUMMARY

1. IN A TIMELY AND HIGHLY PUBLICISED SPEECH, CHAIRMAN OF CANADA'S LARGEST BANK IS HEAVILY CRITICAL OF EXTENT OF NATIONAL DEBT BUT OFFERS NO SPECIFIC SUGGESTIONS ON HOW GOVERNMENT SPENDING MIGHT BE CUT OR TAXES RAISED.

DETAIL

2. ROYAL BANK OF CANADA CHAIRMAN, ALAN TAYLOR, SPEAKING AT THE BANK'S ANNUAL MEETING ON 12 JANUARY, HIGHLIGHTED THE EXTENT OF CANADA'S NATIONAL DEBT. HE POINTED OUT THAT TOTAL BORROWING IN CANADA HAD GROWN 30 PER CENT FASTER THAN NATIONAL INCOME OVER THE PAST DECADE AND THAT THE TOTAL EXTENT OF CONSUMER (DOLLARS 300 BILLION), BUSINESS (DOLLARS 240 BILLION), MUNICIPAL, PROVINCIAL AND FEDERAL GOVERNMENT (DOLLARS 484 BILLION) DEBT AT THE END OF 1987 AMOUNTED TO MORE THAN ONE-TRILLION CANADIAN DOLLARS OR ROUGHLY CDN DOLLARS 41,000 FOR EVERY MAN, WOMAN AND CHILD. DEBT OF ALL LEVELS OF GOVERNMENT HAD CLIMBED TO 88 PER CENT OF GDP FROM 66 PER CENT IN THE 1970S. HE DESCRIBED CANADA'S HIGH INTEREST RATES AS BEING A 'DEFICIT TAX' AND CONSIDERED ADDING TO THE DEBT AND NOT CUTTING PROGRAMMES WAS 'FISCAL IRRESPONSIBILITY AND AN OUTRIGHT BETRAYAL OF PROVINCIAL AND NATIONAL INTERESTS'.

3. TAYLOR PUT FORWARD NO SOLUTIONS TO THE DEBT PROBLEM OTHER THAN THE NEED FOR MORE INCOME AND LESS OUTGOINGS. THE ECONOMIC COUNCIL OF CANADA'S ANNUAL REVIEW, WHICH CAME OUT TEN DAYS AGO, ALSO POINTED TO THE GROWING DEBT AND ALSO FAILED TO SUGGEST HOW IT MIGHT BE CUT BACK.

4. IT IS AN ANNUAL TRADITION SHORTLY IN ADVANCE OF THE FINANCE MINISTER'S BUDGET FOR INTEREST GROUPS TO PROMOTE THEIR VIEWS. HOWEVER, THE COMMENTS FROM SUCH A HIGHLY REGARDED AND SENIOR FIGURE AS TAYLOR WILL INCREASE PUBLIC AWARENESS OF WHAT HAS BEEN ACKNOWLEDGED AS THE NEW GOVERNMENT'S NUMBER ONE POLICY PRIORITY. DISCUSSING TAYLOR'S REMARKS WITH US, THE HEAD OF ECONOMIC ANALYSIS AND FORECASTING AT FINANCE CANADA AGREED WITH WHAT TAYLOR SAID AND

ADDED THAT IT WAS HELPFUL OF HIM TO HAVE RAISED THIS ISSUE AT THIS TIME, PERHAPS SOFTENING THE WAY FOR THE BUDGET.

5. OTHER SENIOR OFFICIALS IN FINANCE CANADA HAVE EXPRESSED CONCERN TO US THAT WHILE THE NEED FOR DEFICIT REDUCTION IS RECOGNISED, THERE IS NOT YET THE BEGINNINGS OF A CONSENSUS OF WHICH PROGRAMMES SHOULD BE CUT OR OF WHO SHOULD PAY HIGHER TAXES. PART OF THE PROBLEM IS THAT VERY LITTLE OF THE SPENDING IS SEEN AS DISCRETIONARY, APART POSSIBLY FROM AID AND DEFENCE (AND THEY COULD NOT YIELD THE SUMS REQUIRED EVEN IF THERE WAS THE POLITICAL WILL TO CUT BACK IN THESE AREAS). THE NEW SALES TAX WILL PROBABLY NOT BEGIN TO BE OPERATIONAL FOR ANOTHER TWO YEARS. THE FINANCE MINISTER, MR WILSON, HAS SUGGESTED THAT HE IS DETERMINED TO BRING IN A TOUGH BUDGET. HE WILL NOT BE ABLE TO DO THIS WITHOUT TRAMPLING ON A LOT OF SACRED COWS - INCLUDING POSSIBLY RAISING TAXES FROM THE BANKS.

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MR GILLMORE

NNNN



Gouvernement du Québec
Délégation générale
Londres

17 January 1989

Mrs Julie Thorpe
Chancellor's Office
Treasury Chambers
London SW1P 3AG

Dear Mrs Thorpe,

Please find enclosed, as requested, a list of the guests at the dinner to be given by the Government of Québec on Thursday 19 January at the Berkeley.

I have tried several times, but unsuccessfully, to get through to Mr Jonathan Taylor to let him know how much we appreciate the fact that he and the Chancellor have accepted our invitation and I would be very grateful indeed if you would convey the message to him.

Mr Scowen, the Agent General for Québec, intends to place Mr Lawson at the head table between Premier Bourassa and Sir Ralf Dahrendorf of St Antony's college. I hope this arrangement suits him. Should he have any objections, however, I would appreciate it very much if he could let me know as soon as possible.

Yours sincerely,

Mireille Attas

Mireille Bellefleur-Attas
Public Affairs Attachée

cc: R. Scowen

enc.

DINNER IN HONOUR OF THE PREMIER OF QUÉBEC
M. ROBERT BOURASSA

The Berkeley, Thursday 19 January 1989

GUEST LIST

M. Robert Bourassa
Premier of Québec

M. Pierre MacDonald
Québec's Minister of Industry, Commerce and Technology

M. Paul Gobeil
Québec's Minister of International Affairs

M. Jean-Claude Villiard
Deputy Minister of International Affairs

M. Charles Garneau
M. MacDonald's Director of Cabinet

M. Bernard Labrecque
M. Gobeil's Director of Cabinet

M. Ronald Poupart
Government of Québec's Director of Communications

Mr Reed Scowen
Agent General for Québec in London

M. Herman Vyncke
Counsellor (Economic) for the Government of Québec in London

M. Marc T Boucher
Political Counsellor for the Government of Québec in London

M. Louis B Parent
Counsellor (Tourism) for the Government of Québec in London

Mme Mireille Bellefleur-Attas
Public Affairs Attachée for the Government of Québec in London

LISTE DES INVITES AU DINER AU BERKELEY HOTEL

19 JANVIER 1989

Mr William Castell
Group Commercial Director
Wellcome PLC

Mr John Darby
Chairman
Ultramar PLC

Mr Peter Darling
Chairman
Mercury Asset Management

Mr Jake Eberts
Katevale Productions Ltd

Mr David Elton
Executive Director
Ultramar plc

Mr Dudley G. Eustace
Director of Finance
British Aerospace PLC

Sir Campbell Fraser
Chairman
Scottish Television PLC

Mr Clifford Hatch
Finance Director
Allied Lyons PLC

Mr John A. Jackson
Vice-Chairman
Hillsdown Holdings PLC

Mr John Jump
Chief Executive
B.P. Minerals International Ltd

Mr Robert Maxwell
Editor
Mirror Group Newspapers

Mr Keith Plant
Chief Executive
Tioxide Group plc

Mr Patrick Sheehy
Chairman
BAT Industries plc

The Lord Weinstock
Managing Director
The General Electric Company PLC

Mr Richard A. Cameron
Executive Director
Blackwood Hodge plc

Mr Scott Bell
Managing Director
Standard Life Assurance Co

Mr John G Marks
Chairman
Trebor Group Ltd

Mr Daniel W Colson *

Senior Partner
Stikeman, Elliott

Mr Ronald E Blair *

The Rt Hon. Nigel Lawson, MP
Chancellor of the Exchequer

Mr Jonathan Taylor
Private Secretary to
The Chancellor of the Exchequer

Mr Gilberto Bologna
Managing Director
EH Industries inc.

Mr Tony Orton
Director
Marks & Spencer plc

Mr Roger J Felber
Chairman
Parkfield Group plc

The Earl of Limerick, KBE
Director
Kleinwort Benson Group plc

Mr John Forsyth
Group Director
Morgan Grenfell & Co Ltd

Mr Charles Hambro
Chairman
Hambros plc

Mr Ian Paterson
Executive Director
(UK & N. America)
Standard Chartered Bank

Mr Nicholas E.H. Ferguson
Chairman
Schroder Ventures

Mr Peter Leslie
Deputy Chairman
Barclays Bank plc

Mr J.W. Melbourn
Chief Executive
Corporate & Industrial Banking
National Westminster Bank plc

Mr David W. Green
International Division
Bank of England

Mr Robin Broadley
Managing Director
Baring Brothers & Co Ltd

Mr Geoffrey Spencer
Head of Commercial Banking Group
Coutts & Co

Mr Donald R. Clarke
Finance Director
3i Group plc

Mr Christopher Hampson
Director
Imperial Chemical Industries PLC

Mr John York
Chief Executive Officer
European Vinyl Corporation Intl

Mr James McAdam
Deputy Chairman &
Group Chief Executive
Coats-Viyella plc

Mr J Peter Williams *

Chairman &
Chief Executive Officer
Reed Packaging Group

Tim Eggar Esq, MP
Parliamentary Under Secretary
of State for Foreign &
Commonwealth Affairs

Mr Ian Molson *

Executive Director
Credit Suisse - First Boston

Sir William Barlow
Chairman
BICC plc

Mr Frank Noah
Commercial Director
Vickers Shipbuilding
and Engineering Ltd

Mr Peter F. Macfarlane
Rolls Royce plc

Mr Gerald M. Abrahams
Chairman
Aquascutum Group Plc

Sir Robin Ibbs, KBE
Deputy Chairman
Lloyds Bank plc

Mr John P. McMonigall
Managing Director
British Telecom plc

Dr I.G. Patel
Director
The London School of Economics
and Political Science

Mr Simon Webley
British North America Committee

Mr G.H. Weston
Chairman
Associated British Foods

The Rt Hon. John Wakeham, FCA, JP, MP
Lord President of the Council &
Leader of the Commons

Mr Brian D. McGowan
Chief Executive
Williams Holdings plc

Sir Ralf Dahrendorf
Warden
St Antony's College, Oxford

Mr Eric Barnes
Finance Director
Great Universal Stores plc

Mr Peter Burden
Rolls-Royce & Associates Ltd

Mr Stan Keyworth
Divisional Managing Director
Manufacturing Divisions
Parkfield Steel Wheels

Mr Frank Kirk
Managing Director
Kirk Precision Ltd

Mr Ron Berlet
Minister (Commercial)
Canadian High Commission

Mr Michael Pragnell
Chief Executive
Courtaulds plc

Mr Ian Harvey
Chief Executive
British Technology Group

Mr Iain Vallance
Chairman
British Telecom

Mr William Halbert
Managing Director
Software Sciences Ltd

Sir Hugh Cubitt
President
London Chamber of Commerce

Mr Derek Brown
Chairman
BTF Precision Machining Ltd

Mr John P. Oratis
Corporate Development Director
FKI Babcock

* Conseiller en Commerce extérieur

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FROM: D RAMSDEN

DATE: 17 January 1989

1. ~~MR EVANS~~ *HPE 17/1*
2. CHANCELLOR

cc PS/Economic Secretary
Mr N Wicks
Mr Lankester
Mr Melliss
Mr Edmonds

DINNER WITH PRIME MINISTER OF QUEBEC: THURSDAY 19 JANUARY

I attach briefing notes for your dinner with the Prime Minister of Quebec, Mr Robert Bourassa. The notes cover:-

- the economies of Canada and Quebec (including the Canada /US free trade agreement);
- the political situation in Canada and Quebec;
- a personality note on the Prime Minister, and details of his programme whilst in the UK;
- a guest list.

2. You will also be meeting the new Canadian High Commissioner, Donald McDonald, when he pays you a courtesy call at 2.30 pm on 24 January. The Chief Secretary is meeting the Deputy Premier of Ontario, Robert Nixon on 30 January. In addition, Lord Young has agreed to see Mr John Crosbie, the Minister for International Trade on February 2, when he visits London on his way back from the Davos Conference.



D RAMSDEN

ECONOMIES OF CANADA AND QUEBEC**Background figures**

	Canada (1987)	Quebec (1986)
GDP*	US \$440 bn	US \$ 98 bn (24% of total GDP in 1986)
Population	25.65m	6.54m
GDP per capita *	US \$17,200	US \$15000

* using purchasing power parities.

Canada has the smallest GDP of the major 7 countries, though only the US has a higher level of GDP per capita.

2. Quebec is Canada's second largest province after Ontario with GDP about a quarter of the Canadian total.

Recent Economic Developments

3. The following table gives summary statistics including latest OECD estimates for Canada. Figures for Quebec, where available, are given in brackets.

	(Percentage change on a year earlier)		
	1987	1988	1989
Real GDP	4.0(5.0)	4½(4.8)	3(<3)
Business Investment	8.8	19½	7¾
Consumer prices	3.7	3½	3¾
Unemployment rate	8.9(10.3)	7¾(9.4)	7¾
Current Account (US \$bn)	-8	-8	-10

Source: OECD, Conference Board of Canada

4. As in other major 7 countries, activity in Canada was more buoyant than originally expected in 1988. Business investment was particularly strong. Quebec has grown at a faster rate than Canada for the last two years, with growth lead by construction investment. Quebec's economy is expected to grow by less than Canada as a whole in 1989, as the residential construction boom tails off.

5. Inflation picked up a little during 1988 and inflationary pressures remain. The unemployment rate is at its lowest level for six years, and capacity utilisation rates in manufacturing are close to previous peaks. Quebec's unemployment rate remains higher than the average for Canada.

6. The strength of the Canadian dollar, which reached a peak against the US dollar immediately after the election - has helped to keep import prices down.

7. Canada moved into deficit on current account in 1985, and has remained so since. The visible surplus shrunk partly as result of loss of export market share, particularly in the US automobile market, and partly because of strong growth of imports of manufactures related to the investment boom.

8. Canada's net external debt rose from 25 per cent of GDP in 1975 to 40 per cent in 1986.

Policy

9. Monetary policy has been tightened considerably since the beginning of 1988; short term interest rates have risen by 2½ percentage points since January. Real short term rates at 6½ per cent are the highest of the major 7 countries.

10. The following table shows figures for the general government deficit and net public debt as a percentage of GDP.

(As percentage of GDP)

	1985	1987	1988
Net public debt	30.6	36.2	36.7
General Government deficit	-7.0	-4.6	-3½

Source: OECD estimates, on national accounts basis.

1 The Federal government's policies are set out in the Agenda for Economic Renewal (begun in 1984). This proposes better budgetary balance, tax reform, the freeing of trade with the US and other structural reforms.

12. The general government deficit fell as a percentage of GDP in 1988 to about 3½ per cent with the overall provincial deficit almost eliminated. Quebec's deficit, which is high compared with the other provinces, has also fallen. Further reduction of the federal deficit remains a high priority of the Mulroney government.

13. The first stage of the tax reform programme came into effect on 1 January 1988 and simplified the personal tax system and reduced marginal rates. The second stage will see the replacement of the manufactures' sales tax with a more broadly based sales tax similar to VAT.

Canada/US Free Trade Agreement (FTA)

14. The Agreement was implemented on January 1 1989. Its main provisions are for the elimination of all tariffs between the two countries, the reduction of non-tariff barriers to trade, and the liberalisation of investment flows. Road haulage, air and rail transport are not covered by the Agreement, neither are government subsidies to industry.

15. The Agreement will almost certainly benefit Canada. Points to note are:-

- as the US takes about 75 per cent of Canada's exports, the macro-economic effects are potentially large.
- tariffs between the US and Canada fell considerably in the 1960s and 1970s. For example, trade in automobiles, the main Canadian manufactured export, was liberalised through the US - Canada Auto Pact of 1965. The elimination of remaining tariffs is in comparison small.

16. Quebec is a strong supporter of the FTA. It hopes to benefit by:-

- attracting foreign investment as a result of it's increased access to the US market;
- Increasing exports of hydro-electric energy to the US.

POLITICAL SITUATION (PREPARED BY FCO)GATT

The MTM was held in Montreal. The Quebec Government did a superb organisational job and showed close interest. Lord Young made a brief courtesy call on M Bourassa during the MTM.

Canada is a member of the Cairns Group.

1992/US/Canada FTA

Canada shares US concerns about external implications of 1992. The parallels between the US/Canada Free Trade Agreement and the Single European Market were drawn in Toronto and are still useful. There is some risk in the FTA of discrimination against third countries and we will need to watch implementation carefully.

EC/US Hormones

The Canadians, like the US, have not agreed to guarantee that meat exports to the EC will be hormone-free. The new ban therefore affects them - but they have not taken retaliatory action.

Revival of the Athlone Fellowship Scheme

HMG has committed £20,000 (AUS programme budget) to the revival of the Scheme which, between 1951 and 1972, brought 750 engineering scholars from Canada to the UK for postgraduate studies. We hope that the revival will see a two-way scheme by which British students can also travel to Canada to further their studies. Lavalin, a large French-Canadian firm have matched our input and we hope the first scholars will travel to UK in September this year - with first UK scholars going to Canada in 1990.

Trade and Investment

Quebec has enjoyed several years of economic growth with rates well above the Canadian average. GDP is estimated to have risen by 5% in real terms in 1987. This owes much to the emergence of a new generation of entrepreneurs. 25 of Canada's 50 fastest growing public companies have their headquarters in the province.

British exports to Quebec in 1987 were worth £1 bn (7.7% of Quebec's total imports): 31% higher than in 1986. Quebec exports to the UK in 1987 were worth over £300m.

Work will shortly begin on the expansion of the James Bay hydro-electric project to increase capacity by 10% by 1995. There may be worthwhile orders for outside suppliers. Balfour Beatty (contracting) and Rolls Royce (gas turbine stand-by generators) are among interested British firms.

Already significant investment in the UK by large Quebec-based firms: Seagrams, Alcan, Consolidated Bathurst (paper) and the Laurentian Group (Trident Imperial Life Insurance Company). Possibility of further French/Canadian companies establishing themselves in the Community as 1992 approaches. Many Quebec companies find the UK an easier and more congenial place to do business than France.

Meech Lake Accord

Meech Lake Accord met Quebec's demands for recognition of Quebec's distinct society. Proposals have been ratified by the Canadian House of Commons and the Senate and by all the provinces except New Brunswick and Manitoba. If the two remaining Provinces ratify the Accord it will bring Quebec into the constitution for the first time since its patriation in 1981. However, all is not smooth sailing following the recent Federal Election and because of recent Quebec decisions on language of signs.

Language Issue

In 1976 the Parti Quebecois Government introduced legislation (Bill 101) which forbade the use of English in commercial signs. In mid-December the Canadian Supreme Court declared that Bill 101 contravened both Federal and Quebec Charters of rights and freedoms and thus the constitution. Bourassa's Government responded by introducing legislation to permit the use of English only inside commercial premises and since this was also likely to contravene the constitution invoked the provision allowing Canadian parliaments to legislate "notwithstanding" the provisions of the Charter. There has been heated debate by both hardline francophones and anglophones ever since (including the fire-bombing of the Alliance Quebec, the main anglophone organisation).

:

North America Department
13 January 1989

CONFIDENTIAL

GENERAL NOTES PREPARED BY THE FCO

1. M Bourassa will be visiting the UK from 18-20 January as part of a wide-ranging European tour calling on, among others, Chancellor Kohl and M Mitterrand. He will also be attending the Davos World Economic Forum.

2. M Bourassa's main objectives in making this tour are to attract inward investment to Quebec; and to demonstrate to his electorate that Quebec, under his leadership, commands external influence and respect (he has to go the polls before Spring 1990 and may call an election as early as May this year).

3. M Bourassa is a strong supporter of the US/Canada Free Trade Agreement and, despite being a Liberal, supported Mr Mulroney during the recent federal election campaign.

M BOURASSA'S PROGRAMME IN THE UNITED KINGDOM

Wednesday 18 January

- 1700 - Arrive airport. Met by Agent-General for Quebec.
- 1930 - Dinner at Savoy with representatives from British Aerospace and Bombadier.

Thursday 19 January

- 1100 - Meeting with two senior industrialists who have projects in Quebec.
- 1245-1430 - Lunch hosted by Warburgs (Sir David Scholey).
- 1500-1530 - Meeting with Secretary of State for Foreign and Commonwealth Affairs, Sir Geoffrey Howe.
- 1700 - Meeting with the Prime Minister.
- 2000 - Dinner at the Berkeley Hotel hosted by the Quebec Government (50 - 75 guests).

Friday 20 January

- 1100 - Meeting with businessmen who have projects in Quebec.
- 1245 - Lunch at the High Commission for journalists.
- 1430 - Meeting with journalist from The Financial Times.
- 1630 - Meet staff of the Quebec delegation in London.
- 1800 - Reception hosted by the Agent-General for financiers, Foreign Office representatives, bankers, businessmen and foreign trade advisers.
- 1930 - Depart for Paris.

BOURASSA, THE HON ROBERT, MNA MA

Premier of Quebec (Liberal) since December 1985.

Born in Montreal, July 1933.

Educated at Jean de Brebeuf College and University of Montreal. He was a Rhodes Scholar at Oxford in 1959 and also studied at Harvard.

A lawyer and economist, Mr Bourassa was a Fiscal Adviser in the Federal National Revenue Department in 1960. From 1963-65 he was Secretary and Research Director for the Belanger Commission on Taxation in Quebec. He taught at Ottawa University.

He was first elected to the Quebec National Assembly in 1966. He became Financial (Opposition) Critic. He was chosen Leader of the Quebec Liberal Party in January 1970 and sworn in as Premier of Quebec in May 1970. He held the Portfolios of Finance (1970) and Intergovernmental Affairs (1971-72). In 1976 he lost the Liberal leadership and the Quebec provincial election. He went to Europe and the US to study for several years. In October 1983 he was elected Leader of the Quebec Liberal Party for a second time and by an overwhelming majority.

Bourassa led his party to a landslide victory over the Parti Quebecois in December 1985.

Mr Bourassa lacks charisma and became notably unpopular before his defeat in 1976. His draft legislation to promote the use of French satisfied no-one. English speakers thought it went too far; many francophones regarded it as not going far enough. Mr Bourassa and his government were also widely accused of corruption.

More of a technocrat than a politician by nature, he has made himself into a politician by application. He is now a good political tactician, but is respected rather than loved. His performance since 1985 demonstrates that he has learned a lot. He is very much the master of his Government but now gives his Ministers a greater share of the limelight and is careful not to put himself in a position where he will attract unfavourable publicity. His general approach to difficult political questions is still to look for ways of finding an acceptable compromise rather than to risk confronting one or other party to a dispute. His heart lies in promoting the economic advancement of Quebec and he played a key role in the Seventies in authorising work on the James Bay hydro-electric project. He announced some months ago that work would begin soon on the second phase of the project.

He is intelligent, well informed, and follows events in the UK with a keen and sympathetic interest. He is very ambitious and has no consuming interests outside work.

Married to Andrée Simard of the wealthy Quebec shipbuilding family. Two children.

DR
FROM: D RAMSDEN
DATE: 18 January 1989

- CHK 18/1*
1. MR MELLISS
2. CHANCELLOR

cc PS/Economic Secretary
Mr N Wicks
Mr Lankester
Mr H Evans
Mr Edmonds

DINNER WITH PRIME MINISTER OF QUEBEC: THURSDAY 19 JANUARY

You may be interested to see the attached telegram in which the Chairman of the Royal Bank of Canada comments on the size of Canada's National debt (defined here as gross liabilities not net liabilities as in my note to you of 17 January).

D Ramsden

D RAMSDEN

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TELNO 024
OF 132200Z JANUARY 89
INFO ROUTINE WASHINGTON, HM TREASURY, BANK OF ENGLAND

CANADIAN ECONOMY: NATIONAL DEBT

SUMMARY

1. IN A TIMELY AND HIGHLY PUBLICISED SPEECH, CHAIRMAN OF CANADA'S LARGEST BANK IS HEAVILY CRITICAL OF EXTENT OF NATIONAL DEBT BUT OFFERS NO SPECIFIC SUGGESTIONS ON HOW GOVERNMENT SPENDING MIGHT BE CUT OR TAXES RAISED.

DETAIL

2. ROYAL BANK OF CANADA CHAIRMAN, ALAN TAYLOR, SPEAKING AT THE BANK'S ANNUAL MEETING ON 12 JANUARY, HIGHLIGHTED THE EXTENT OF CANADA'S NATIONAL DEBT. HE POINTED OUT THAT TOTAL BORROWING IN CANADA HAD GROWN 30 PER CENT FASTER THAN NATIONAL INCOME OVER THE PAST DECADE AND THAT THE TOTAL EXTENT OF CONSUMER (DOLLARS 300 BILLION), BUSINESS (DOLLARS 240 BILLION), MUNICIPAL, PROVINCIAL AND FEDERAL GOVERNMENT (DOLLARS 484 BILLION) DEBT AT THE END OF 1987 AMOUNTED TO MORE THAN ONE-TRILLION CANADIAN DOLLARS OR ROUGHLY CDN DOLLARS 41,000 FOR EVERY MAN, WOMAN AND CHILD. DEBT OF ALL LEVELS OF GOVERNMENT HAD CLIMBED TO 88 PER CENT OF GDP FROM 66 PER CENT IN THE 1970S. HE DESCRIBED CANADA'S HIGH INTEREST RATES AS BEING A ''DEFICIT TAX'' AND CONSIDERED ADDING TO THE DEBT AND NOT CUTTING PROGRAMMES WAS ''FISCAL IRRESPONSIBILITY AND AN OUTRIGHT BETRAYAL OF PROVINCIAL AND NATIONAL INTERESTS''.

3. TAYLOR PUT FORWARD NO SOLUTIONS TO THE DEBT PROBLEM OTHER THAN THE NEED FOR MORE INCOME AND LESS OUTGOINGS. THE ECONOMIC COUNCIL OF CANADA'S ANNUAL REVIEW, WHICH CAME OUT TEN DAYS AGO, ALSO POINTED TO THE GROWING DEBT AND ALSO FAILED TO SUGGEST HOW IT MIGHT BE CUT BACK.

4. IT IS AN ANNUAL TRADITION SHORTLY IN ADVANCE OF THE FINANCE MINISTER'S BUDGET FOR INTEREST GROUPS TO PROMOTE THEIR VIEWS. HOWEVER, THE COMMENTS FROM SUCH A HIGHLY REGARDED AND SENIOR FIGURE AS TAYLOR WILL INCREASE PUBLIC AWARENESS OF WHAT HAS BEEN ACKNOWLEDGED AS THE NEW GOVERNMENT'S NUMBER ONE POLICY PRIORITY. DISCUSSING TAYLOR'S REMARKS WITH US, THE HEAD OF ECONOMIC ANALYSIS AND FORECASTING AT FINANCE CANADA AGREED WITH WHAT TAYLOR SAID AND

ADDED THAT IT WAS HELPFUL OF HIM TO HAVE RAISED THIS ISSUE AT THIS TIME, PERHAPS SOFTENING THE WAY FOR THE BUDGET.

5. OTHER SENIOR OFFICIALS IN FINANCE CANADA HAVE EXPRESSED CONCERN TO US THAT WHILE THE NEED FOR DEFICIT REDUCTION IS RECOGNISED, THERE IS NOT YET THE BEGINNINGS OF A CONSENSUS OF WHICH PROGRAMMES SHOULD BE CUT OR OF WHO SHOULD PAY HIGHER TAXES. PART OF THE PROBLEM IS THAT VERY LITTLE OF THE SPENDING IS SEEN AS DISCRETIONARY, APART POSSIBLY FROM AID AND DEFENCE (AND THEY COULD NOT YIELD THE SUMS REQUIRED EVEN IF THERE WAS THE POLITICAL WILL TO CUT BACK IN THESE AREAS). THE NEW SALES TAX WILL PROBABLY NOT BEGIN TO BE OPERATIONAL FOR ANOTHER TWO YEARS. THE FINANCE MINISTER, MR WILSON, HAS SUGGESTED THAT HE IS DETERMINED TO BRING IN A TOUGH BUDGET. HE WILL NOT BE ABLE TO DO THIS WITHOUT TRAMPLING ON A LOT OF SACRED COWS - INCLUDING POSSIBLY RAISING TAXES FROM THE BANKS.

URWICK

YYYY

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MR GILLMORE

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(for reading/letter)

FROM: D RAMSDEN
DATE: 20 January 1989

- 1. MR MELLISS ^{QH} 20/1
- 2. CHANCELLOR

- cc PS/Economic Secretary
- Mr N Wicks
- Mr Lankester
- Mr Evans
- Mr Edmonds

NEW CANADIAN HIGH COMMISSIONER: COURTESY CALL

The new Canadian High Commissioner, Mr Donald McDonald is paying you a courtesy call at 2.30 pm on Tuesday 24 January. The briefing notes attached are effectively the same as you had for your dinner with the Prime Minister of Quebec with the exception of the points covered in paragraphs 2-5 below. The notes cover:-

- the Canadian economy, including the Canada/US free trade agreement (FTA).
- the political situation in Canada;
- personality notes on the High Commissioner and the new Minister (Commercial and Economic), Mr Berlet.

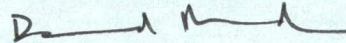
2. There is one outstanding bilateral issue which you should be aware of. This is an issue of reciprocity about whether UK firms and financial institutions in Canada should receive the same national treatment now granted to US firms and financial institutions under the FTA. Attached is part of a letter from the British High Commission in Ottawa to the Foreign Secretary on this issue. Since the existing arrangements are not currently adversely affecting any UK banks in Canada we recommend that you don't raise this issue with the High Commissioner at this stage.

3. The issue of the discriminatory treatment of UK exports of Whisky and beer by some Provincial liquor boards (paragraph 20) has been resolved satisfactorily.

4. Though a Liberal, the High Commissioner supports the FTA and as former chairman of the Royal Commission on the future of the Canadian economy he originally recommended its negotiation. (see personality note).

5. The High Commissioner may raise his own idea (not cleared with Ottawa) for the interest rate on the UK's outstanding debt to Canada (see paragraph 2\) to be raised slightly and for the subsequent revenue to be used to sponsor an exchange of students between the UK and Canada.

6. The Chief Secretary is meeting the Deputy Premier of Ontario, Robert Nixon on 30 January. Lord Young has agreed to see Mr John Crosbie, the Minister for International Trade on February 2, when he visits London on his way back from the Davos Conference.



D RAMSDEN

CANADIAN ECONOMY**Background figures****Canada (1987)**

GDP* US \$440 bn

Population 25.65m

GDP per capita* US \$17,200

* using purchasing power parities.

Canada has the smallest GDP of the major 7 countries, though only the US has a higher level of GDP per capita.

Recent Economic Developments

2. The following table gives summary statistics including latest OECD estimates for Canada.

	(Percentage change on a year earlier)		
	1987	1988	1989
Real GDP	4.0	4¼	3
Business Investment	8.8	19½	7¾
Consumer prices*	3.7	3½	3¾
Unemployment rate	8.9	7¾	7¾
Current Account (US \$bn)	-8	-8	-10

* deflator of private consumption

Source: OECD, Conference Board of Canada

3. As in other major 7 countries, activity in Canada was more buoyant than originally expected in 1988. Business investment was particularly strong.

4. Inflation picked up a little during 1988 and inflationary pressures remain. The unemployment rate is at its lowest level for six years, and capacity utilisation rates in manufacturing are close to previous peaks.

5. Canada is the only major industrial country other than the UK to include mortgage interest payments in its consumer price index. However, because of the prevalence of fixed rate mortgages in Canada, changes in mortgage rates have little impact on the inflation rate. In November the 12-month inflation rates including and excluding mortgage interest payments were both 4.1 per cent.

7. The strength of the Canadian dollar, which reached a peak against the US dollar immediately after the election - has helped to keep import prices down.

8. Canada moved into deficit on current account in 1985, and has remained so since. The visible surplus has fallen since 1984 partly as a result of loss of export market share, particularly in the US automobile market, and more recently because of strong growth of imports of manufactures related to the investment boom.

9. Canada's net external debt rose from 25 per cent of GDP in 1975 to 40 per cent in 1986.

Policy

10. Monetary policy has been tightened considerably since the beginning of 1988; short-term interest rates have risen by almost 3 percentage points since January 1988 and stood at 11.4 per cent on January 20. Current real short term rates at 7 per cent are the highest of the major 7 countries.

11. The following table shows figures for the general government deficit and net public debt as a percentage of GDP.

(As percentage of GDP)

	1985	1987	1988
Net public debt	30.6	36.2	36.7
General Government deficit	-7.0	-4.6	-3½

Source: OECD estimates, on national accounts basis.

12. The Federal government's policies are set out in the Agenda for

Economic Renewal (begun in 1984). This proposes better budgetary balance, tax reform, the freeing of trade with the US and other structural reforms.

13. The general government deficit fell as a percentage of GDP in 1988 to about 3¼ per cent with the overall provincial deficit almost eliminated.

14. Further reduction of the federal deficit and national debt remain a high priority of the Mulroney government. Measures to tackle them are expected to be included in the 1989 budget to be announced in February.

15. The first stage of the tax reform programme came into effect on 1 January 1988, simplifying the personal tax system and reducing marginal rates. The second stage will see the replacement of the manufactures' sales tax with a more broadly based sales tax similar to VAT.

Canada/US Free Trade Agreement (FTA)

16. The Agreement was implemented on January 1 1989. Its main provisions are for the elimination of all tariffs between the two countries, the reduction of non-tariff barriers to trade, and the liberalisation of investment flows. Road haulage, air and rail transport are not covered by the Agreement, neither are government subsidies to industry.

17. The Agreement will almost certainly benefit Canada. Points to note are:-

- as the US takes about 75 per cent of Canada's exports, the macro-economic effects are potentially large;
- tariffs between the US and Canada fell considerably in the 1960s and 1970s. For example, trade in automobiles, the main Canadian manufactured export, was liberalised through the US - Canada Auto Pact of 1965. The elimination of remaining tariffs is in comparison small though the

elimination of other trade barriers will have a substantial effect.

Canada's role in G7

18. Canada has played an active role in the G7 cooperation process, at Summit, Finance Minister and Deputy level. The G7 deputies meeting of 3 June 1988 was held in Toronto prior to the Toronto Economic Summit of 19-21 June.

19. Canada recently hosted the GATT mid-term-meeting held in Montreal.

UK/Canada Trade Issues

20. In Canada, each state has a liquor board which is responsible for the sale of alcohol in the state. Some states, notably Ontario have levied substantial excise duties on imported products affecting UK exports of spirits, wine and beer. The dispute was taken to a GATT adjudication panel and has been resolved satisfactorily from the UK stand point.

Canada - UK Loan

21. Immediately after the War, Canada loaned the UK C\$1½ billion to help with reconstruction at an interest rate of 2 per cent. The loan was last rescheduled in 1976; C\$522 million is currently outstanding.

Implications for Third Countries

12. The agreement is not intended to be for the benefit of third country suppliers such as the UK. But neither is it designed to encourage the development of an inward-looking protectionist trading bloc. If it achieves its objectives, the Canadian and US markets will grow faster than they would otherwise have done. This extra growth, insofar as it cannot be satisfied by North American suppliers, should offer greater opportunities for British exporters. British companies may conclude that additional investment in Canada will be worthwhile because they will also be able to cover the US market from a Canadian base; but in some instances the reverse will also be true.

13. We shall also need to consider whether to press for the same relaxation of the rules of investment for British firms as are now afforded to American companies under the agreement. Similarly we shall need to make it clear that, as a matter of principle and also of reciprocity, the national treatment granted to US financial institutions in Canada under the agreement will also be accorded to their British equivalents. Canadian investors in the UK do not face review and Canadian banks, insurance companies and lawyers can operate freely in the UK without restriction. As our rules are much more open than those of most of our European partners, we might fare better negotiating on our own in this area than in the company of other EC countries or in the GATT (although this would not of course preclude working simultaneously within the EC and the GATT for multilateral concessions). If in their general trading activities British companies should find themselves in difficulties as a result of the agreement, we shall of course have to take up the cudgels on their behalf whenever we can legitimately do so. Some preparatory analysis has already been done by ourselves on the agreement; the European Commission have yet to produce their own analysis of it. Much will obviously depend on how it all works out in practice. But we shall clearly need to monitor closely sectors where British interests are likely to be particularly affected: for example, financial and other services, investment, steel products, machinery, textiles and clothing, chemicals, leather and so forth.

Conclusion

14. It seems likely that the agreement, while not perfect, will indeed result in more growth in the Canadian economy and a leaner and more competitive Canadian industry. It should open up opportunities for British exporters and investment. In addition,

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/by

* the issue is specifically over the growth of banks. Overseas banks can only grow as fast as the market grows. Under the FTA, the US is now exempt from this restriction which still applies but is not currently affecting any UK banks.

POLITICAL SITUATION (PREPARED BY FCO)GATT

The MTM was held in Montreal. The Quebec Government did a superb organisational job and showed close interest. Lord Young made a brief courtesy call on M Bourassa during the MTM.

Canada is a member of the Cairns Group.

1992/US/Canada FTA

Canada shares US concerns about external implications of 1992. The parallels between the US/Canada Free Trade Agreement and the Single European Market were drawn in Toronto and are still useful. There is some risk in the FTA of discrimination against third countries and we will need to watch implementation carefully.

EC/US Hormones

The Canadians, like the US, have not agreed to guarantee that meat exports to the EC will be hormone-free. The new ban therefore affects them - but they have not taken retaliatory action.

Revival of the Athlone Fellowship Scheme

HMG has committed £20,000 (AUS programme budget) to the revival of the Scheme which, between 1951 and 1972, brought 750 engineering scholars from Canada to the UK for postgraduate studies. We hope that the revival will see a two-way scheme by which British students can also travel to Canada to further their studies. Lavalin, a large French-Canadian firm have matched our input and we hope the first scholars will travel to UK in September this year - with first UK scholars going to Canada in 1990.

Trade and Investment

Quebec has enjoyed several years of economic growth with rates well above the Canadian average. GDP is estimated to have risen by 5% in real terms in 1987. This owes much to the emergence of a new generation of entrepreneurs. 25 of Canada's 50 fastest growing public companies have their headquarters in the province.

British exports to Quebec in 1987 were worth £1 bn (7.7% of Quebec's total imports): 31% higher than in 1986. Quebec exports to the UK in 1987 were worth over £300m.

Work will shortly begin on the expansion of the James Bay hydro-electric project to increase capacity by 10% by 1995. There may be worthwhile orders for outside suppliers. Balfour Beatty (contracting) and Rolls Royce (gas turbine stand-by generators) are among interested British firms.

Already significant investment in the UK by large Quebec-based firms: Seagrams, Alcan, Consolidated Bathurst (paper) and the Laurentian Group (Trident Imperial Life Insurance Company). Possibility of further French/Canadian companies establishing themselves in the Community as 1992 approaches. Many Quebec companies find the UK an easier and more congenial place to do business than France.

Meech Lake Accord

Meech Lake Accord met Quebec's demands for recognition of Quebec's distinct society. Proposals have been ratified by the Canadian House of Commons and the Senate and by all the provinces except New Brunswick and Manitoba. If the two remaining Provinces ratify the Accord it will bring Quebec into the constitution for the first time since its patriation in 1981. However, all is not smooth sailing following the recent Federal Election and because of recent Quebec decisions on language of signs.

Language Issue

In 1976 the Parti Quebecois Government introduced legislation (Bill 101) which forbade the use of English in commercial signs. In mid-December the Canadian Supreme Court declared that Bill 101 contravened both Federal and Quebec Charters of rights and freedoms and thus the constitution. Bourassa's Government responded by introducing legislation to permit the use of English only inside commercial premises and since this was also likely to contravene the constitution invoked the provision allowing Canadian parliaments to legislate "notwithstanding" the provisions of the Charter. There has been heated debate by both hardline francophones and anglophones ever since (including the fire-bombing of the Alliance Quebec, the main anglophone organisation).

2
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North America Department
13 January 1989

THE HONORABLE DONALD (STOVEL) MACDONALD

56 years old. Distinguished legal and political career. Liberal Minister of Finance, 1975-77. Resigned from Parliament in 1978. From 1982-85 he chaired a major commission on the economy which in 1985 recommended that Canada negotiate a Free Trade Agreement with the US.

Macdonald is an able and effective operator who could have become Liberal party Leader. He was a good Minister of Finance and, although his spell as Minister of Defence was short, he reportedly took a real interest in Canadian defence problems and should prove helpful to us over nuclear submarines and other defence sales prospects. As Energy Minister during the first oil price shock he tried to insulate Canada from worldwide price levels. His chairmanship of the Royal Commission on the future of the Canadian economy seems likely to prove a more enduring monument. It showed him to have a thorough grasp of complex economic issues. His recommendation that Canada should negotiate a Free Trade Agreement with the US was in the Liberal party's tradition, but was in the event taken up by Mulroney's Conservative government. If the Mulroney government is re-elected on 21 November, he may well enjoy the confidence of his Prime Minister and should prove authoritative generally for explaining Canadian policy. Although himself a Liberal, his position would be much less comfortable if the Liberals were to triumph at the next election.

Macdonald is lively and interesting. He is reputed to have a formidable temper which, together with his protruding front teeth, account for his nickname "Thumper". Macdonald's first wife, by whom he had 4 children, died some years ago. Lately he has lived with Adrian, the estranged wife of Otto Lang, a former Liberal Ministerial colleague: they were married in September. She is reputed to make up in vitality what she lacks in height, and to be a social live-wire. She has 7 children by her first marriage.

Born on 1 March 1932 in Ottawa, where he went to school. He obtained a BA from the University of Toronto in 1951, a Masters degree in Law from Harvard in 1956 and a Diploma in International Law at Trinity Hall, Cambridge in 1957. He was elected MP for the Toronto constituency of Rosedale in 1962 and remained an MP until his resignation in 1978.

He served as Parliamentary Secretary to a number of Ministers between 1965 and 1968, when he became President of the Privy Council and government House Leader. In 1970 he became Minister of National Defence, in 1972 Minister of Energy, Mines and Resources and in 1975 Minister of Finance.

Between 1957 and 1962 he practiced Law with the leading Toronto firm of McCarthy & McCarthy; he has been a senior partner since 1977. He holds a number of banking and industrial directorships; from 1980-84 he was Chairman of the International Development Research Centre.

2/3

CURRICULUM VITAE**Ronald J.L. Berlet****PERSONAL**

Date of Birth: July 17, 1936
West Monkton, Ontario

Marital Status: Married, three children

EDUCATION

Primary: Ontario

Secondary and Junior College: Fort Wayne, Indiana
pre-theological studies

University: University of Toronto, B.A. Sc. (1960)

London School of Economics: Business Administration and Economics (1962)

BUSINESS EXPERIENCE

1962 General Electric Company of England, London
Market Research

1963-1964: Canadian Westinghouse Limited
Marketing/Sales Engineer

GOVERNMENT OF CANADA**Industry, Trade & Commerce/External Affairs**

1964 Trade Commissioner Service, London

1965-1968: Canadian Embassy, Vienna, Second Secretary
Trade development reporting and negotiating
trade agreements in Eastern European States,
viz., Bulgaria, Romania, Hungary, Yugoslavia
and Czechoslovakia.

1968-1970: Canadian Embassy, Prague, Czechoslovakia,
First Secretary. Similar activity to
Vienna.

1970-1973: United Nations, New York; Canadian
Permanent Mission, Counsellor aid and
economic matters -U.N.D.P., Ecosoc

1973-1975: Treasury Board of Canada, Ottawa
Programs Branch analyst for RCMP,
Penitentiaries and Parole Board

3/3

- 2 -

1976 External Affairs, Ottawa, Operational Audit

1976-1980: Canadian High Commission, London, England
Counsellor; development in high technology
and defence equipment sectors in United
Kingdom

1980-1984: Canadian Consulate General, Hamburg, West
Germany
Consul General

1984 External Affairs, Ottawa
Director, Operational Resource Planning
(CMA)

1985-1988: External Affairs, Ottawa
Director General, Technology and Investment
Development Bureau

1988-Present Canadian High Commission, London, England
Minister (Commercial/Economic)

HOBBIES

Sportsman: tennis, golf, skiing, sailing (skipped yacht on Trans-Atlantic trip), travel

EXTRA CURRICULAR ACTIVITIES

Former president of Tradex Mutual Fund, Ottawa, Canada

Former Chairman, International School of Hamburg, Germany



FROM: J M G TAYLOR

DATE: 20 January 1989

Prop

MR RAMSDEN

cc PS/Economic Secretary
Mr Wicks
Mr Lankester
Mr Melliss
Mr Evans
Mr Edmonds

DINNER WITH PRIME MINISTER OF QUEBEC: THURSDAY 19 JANUARY

The Chancellor was grateful for the briefing you prepared for this dinner.

JMG

J M G TAYLOR

Canadian High Commission



Haut Commissariat du Canada

BF 42

LONDON, January 25, 1989

Handwritten in red: An opinion proposal

Dear Mr. Chancellor,

I am looking forward to the opportunity to meet with you on Wednesday, February 8. I thought it might be helpful if I forwarded prior to the meeting a memorandum which I have prepared with respect to a possible Canada-U.K. scholarship fund.

As you will note from the proposal, it would be intended to finance the fund by directing payments to it from the deferred payments payable by the U.K. to Canada under the 1946 Canada-U.K. loan. In the normal course these deferred payments would not become due and payable for a number of years but the proposal is that a portion of the payments be directed for scholarship purposes to enable British students to study in Canada, and Canadian students to study in this country.

Later this year we will mark the 50th Anniversary of the arrival in the U.K. of Canadian forces in World War II and the 75th Anniversary of the first contingent of Canadians that came in World War I. A positive way to remember those events would be through the scholarship proposal.

I should make it clear that this suggestion is my own initiative. I am writing to Michael Wilson today to put the suggestion to him as well.

Yours truly,

Donald S. Macdonald

Donald S. Macdonald
High Commissioner

The Rt. Hon. Nigel Lawson, M.P.
Chancellor of the Exchequer
12 Downing Street
London, S.W.1

CH/EXCHEQUER	
REC.	26 JAN 1989
ACTION	MR FARMING
COPIES TO	CST, EST
	SIR P MIDDLETON
	MR ANSON
	MR SCHWAR, MR PHILLIPS
	MR PERETE
	MISS O'MARA

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The Canada-U.K. Scholarship Fund would in a certain sense resemble the Fulbright programme which has been operative between the United States and some of the European countries whereby repayment of Marshall Plan loans is deferred to pay for scholarships enabling American university students to study in the foreign countries.

The scholarship programme could be administered in the same way as the Rhodes Trust with scholarship candidates being chosen by a qualified committee. Unlike the Rhodes scholarship, the scholarships would not be confined to a single institution. The admitting institutions in each country would of course have to make the initial decision as to whether a place would be offered to a particular student.

Donald S. Macdonald

High Commissioner

dsm/ams

25th January 1989

MEMORANDUM

CANADA-UNITED KINGDOM FINANCIAL AGREEMENT 1946 -
POTENTIAL SCHOLARSHIP FUND

As part of the post-war reconstruction in 1946 Canada extended to the United Kingdom a credit of \$1.25 billion bearing interest at the rate of 2%, and to be repaid in fifty annual installments beginning on 31st December 1951. By a subsequent agreement in 1957 the interest payable in respect of the year 1956 and both principal and interest payments for seven years after 1956 were deferred with repayment to commence on 31st December 2001 and continuing until 31st December 2006. The deferred principal amounts to \$94,990,863.00.

This memorandum proposes that Britain commence partial repayment of the deferred amounts in the current year, but rather than the payments being made to the Government of Canada, they be paid into a scholarship fund for the purpose of assisting Canadian and British students to study in each others' country. The endowment fund would permit 200 Canadian students in each year to study in the United Kingdom, and 200 British students to study in Canada.

One of the historic links over the years between Canada and the United Kingdom has been university study, but in recent years because of fiscal restraints both in Canada and in the United Kingdom, the financial ability of foreign students to study in Canadian and British universities has been much reduced. There have been private sector efforts to augment the funds to study abroad, for example the Cambridge Canadian Trust Fund, but the success of those campaigns has been relatively modest. There have been suggestions in recent months that the Athlone Fellowships which were operative after the end of the Second World War to permit Canadian engineering students to study at British universities might be revived.

The endowment fund proposed by this memorandum would in effect provide a substantial endowment that would far exceed anything that could be achieved at the private level.

Both the British and Canadian Governments would be contributing to the endowment fund. The British Government would be required to make payments twelve years before actually due, while the Government of Canada would be forgoing receipt of the principal and interest. The benefit to both countries would be the building of a further bond between nations arising from the exchange of students.

...../continued

Folder for meeting 7/2



FROM: J M G TAYLOR

DATE: 27 January 1989

[Handwritten signatures and initials]

MR FARTHING

cc PS/Chief Secretary
PS/Economic Secretary
Sir P Middleton
Mr Anson
Mr Scholar
Mr Phillips
Mr Peretz
Miss O'Mara

CANADA-UK SCHOLARSHIP FUND: LETTER FROM HIGH COMMISSIONER

The Canadian High Commissioner's letter of 25 January has been sent to you for advice.

2. The Chancellor has commented that the High Commissioner's proposal is an ingenious one.

[Handwritten signature]

J M G TAYLOR

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FM OTTAWA
TO IMMEDIATE FCO
TELNO 55
OF 302030Z JANUARY 89
INFO IMMEDIATE MINISTRY OF DEFENCE
INFO ROUTINE WASHINGTON, UKREP BRUSSELS, UKDEL NATO

MIPT: NEW CANADIAN GOVERNMENT

1. FOLLOWING IS NEW CANADIAN GOVERNMENT (IN ORDER OF PRECEDENCE):

BRIAN MULRONEY
PRIME MINISTER

JOE CLARK
SECRETARY OF STATE FOR EXTERNAL AFFAIRS

JOHN CROSBIE
MINISTER FOR INTERNATIONAL TRADE

DON MAZANKOWSKI
DEPUTY PRIME MINISTER, PRESIDENT OF THE QUEEN'S PRIVY
COUNCIL FOR CANADA AND MINISTER OF AGRICULTURE

ELMER MACKAY
MINISTER OF PUBLIC WORKS AND MINISTER FOR THE PURPOSES
OF THE ATLANTIC CANADA OPPORTUNITIES AGENCY ACT (VICE MCINNES)

MINISTER OF ENERGY, MINES AND RESOURCES (VICE MASSE)

ROBERT R. DE COTRET
PRESIDENT OF THE TREASURY BOARD (VICE CARNEY)

PERRIN BEATTY
MINISTER OF NATIONAL HEALTH AND WELFARE (VICE EPP)

MICHAEL WILSON
MINISTER OF FINANCE

HARVIE ANDRE
MINISTER OF REGIONAL INDUSTRIAL EXPANSION AND
MINISTER OF STATE FOR SCIENCE AND TECHNOLOGY (VICE DE COTRET)

PAGE 1
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OTTO JELINEK
MINISTER OF NATIONAL REVENUE (VICE MACKAY)

TOM SIDDON
MINISTER OF FISHERIES AND OCEANS

CHARLES JAMES MAYER
MINISTER OF WESTERN ECONOMIC DIVERSIFICATION (VICE MCKNIGHT)
AND MINISTER OF STATE (GRAINS AND OILSEEDS)

BILL MCKNIGHT
MINISTER OF NATIONAL DEFENCE (VICE BEATTY)

BENOIT BOUCHARD
MINISTER OF TRANSPORT

MARCEL MASSE
MINISTER OF COMMUNICATIONS (VICE MACDONALD)

BARBARA MCDUGALL
MINISTER OF EMPLOYMENT AND IMMIGRATION

GERALD MERRITHEW
MINISTER OF VETERANS AFFAIRS

MONIQUE VEZINA
MINISTER OF STATE (EMPLOYMENT AND IMMIGRATION) AND
MINISTER OF STATE (SENIORS)

FRANK OBERLE
MINISTER OF STATE (FORESTRY) (VICE ST GERMAIN)

LOWELL MURRAY
LEADER OF THE GOVERNMENT IN THE SENATE AND MINISTER OF STATE
(FEDERAL-PROVINCIAL RELATIONS)

PAUL DICK
MINISTER OF SUPPLY AND SERVICES (VICE JELINEK)

PIERRE CADIEUX
MINISTER OF INDIAN AFFAIRS AND NORTHERN DEVELOPMENT
(VICE MCKNIGHT)

JEAN CHAREST

MINISTER OF STATE (YOUTH) AND MINISTER OF
STATE (FITNESS AND AMATEUR SPORT) AND (VICE LEWIS)
DEPUTY LEADER OF THE GOVERNMENT IN THE HOUSE OF COMMONS

TOM HOCKIN
MINISTER OF STATE (SMALL BUSINESSES AND TOURISM (VICE VALCOURT)

MONIQUE LANDRY
MINISTER FOR EXTERNAL RELATIONS

BERNARD VALCOURT
MINISTER OF CONSUMER AND CORPORATE AFFAIRS (VICE ANDRE)

GERRY WEINER
SECRETARY OF STATE OF CANADA (VICE LUCIEN BOUCHARD)
AND MINISTER OF STATE (MULTICULTURALISM AND CITIZENSHIP)

DOUG LEWIS
MINISTER OF JUSTICE AND ATTORNEY GENERAL OF CANADA (VICE HNATYSHYN)
AND LEADER OF THE GOVERNMENT IN THE HOUSE OF COMMONS
(VICE MAZANKOWSKI)

PIERRE BLAIS
SOLICITOR GENERAL OF CANADA (VICE KELLEHER)
AND MINISTER OF STATE (AGRICULTURE)

LUCIEN BOUCHARD
MINISTER OF THE ENVIRONMENT (VICE MCMILLAN)

JOHN MCDERMID
MINISTER OF STATE (PRIVATIZATION AND REGULATORY AFFAIRS)
(FUNCTIONS PREVIOUSLY OVERSEEN BY MAZANKOWSKI)

SHIRLEY MARTIN
MINISTER OF STATE (TRANSPORT)

MARY COLLINS
ASSOCIATE MINISTER OF NATIONAL DEFENCE (VICE DICK)

ALAN REDWAY
MINISTER OF STATE (HOUSING) (VICE MCDERMID)

WILLIAM CHARLES WINEGARD

MINISTER OF STATE (SCIENCE AND TECHNOLOGY) (VICE OBERLE)

KIM CAMPBELL
MINISTER OF STATE (INDIAN AFFAIRS AND NORTHERN DEVELOPMENT)
(VICE VALCOURT)

JEAN CORBEIL
MINISTER OF LABOUR (VICE ADIEUX)

GILLES LOISELLE
MINISTER OF STATE (FINANCE) (VICE HOCKIN).

2. NOTES. THE LAST SIX HAVE BEEN APPOINTED MINISTERS FOR THE FIRST TIME. THE PREVIOUS INCUMBANTS (IN BRACKETS) ARE THOSE HOLDING THE PORTFOLIOS BEFORE THE ELECTION I.E. THE TEMPORARY APPOINTMENTS MADE AFTER THE ELECTION (MY TELNO 834) HAVE BEEN DISREGARDED FOR THE SAKE OF CLARITY.

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INFO IMMEDIATE MINISTRY OF DEFENCE

INFO ROUTINE WASHINGTON, UKREP BRUSSELS, UKDEL NATO

NEW CANADIAN GOVERNMENT

SUMMARY

1. AS EXPECTED A FEW OF THE KEY PLAYERS RETAIN THEIR PREVIOUS PORTFOLIOS, BUT THE MANY OTHER CHANGES MAKE THIS A MAJOR RESTRUCTURING, WHICH, COMBINED WITH THE CREATION OF A PLETHORA OF NEW COMMITTEES, IS LIKELY TO HAVE A SUBSTANTIAL IMPACT ON THE PERFORMANCE OF THE CANADIAN GOVERNMENT. THE MANY CHANGES ARE SET OUT IN MIFT.

DETAIL

2. MR MULRONEY UNVEILED HIS NEW MINISTERIAL TEAM ON 30 JANUARY. AS EXPECTED WILSON, CLARK AND CROSBIE RETAIN THEIR PORTFOLIOS AND MAZANKOWSKI REMAINS DEPUTY PRIME MINISTER. BUT MOST OF THE OTHER MINISTERS OF IMPORTANCE TO US HAVE BEEN MOVED, NOTABLY PERRIN BEATTY, WHO IS REPLACED AS DEFENCE MINISTER BY BILL MCKNIGHT (EX INDIAN AND NORTHERN AFFAIRS).
3. MULRONEY HAS CLEARLY USED THE 2 1/2 MONTHS SINCE THE ELECTION TO PRODUCE A CABINET WHICH IS VERY CAREFULLY BALANCED. HE HAS ALSO INCREASED THE NUMBER OF CABINET COMMITTEES, EACH WITH A QUITE SMALL MEMBERSHIP. THE AIM IS CLEARLY TO SECURE BETTER DECISION-MAKING, BUT WHETHER IT WILL TURN OUT TO BE SO REMAINS TO BE SEEN. IT WILL PROBABLY BE SOME TIME BEFORE WE DISCOVER WHICH MINISTERS REALLY CALL THE SHOTS.
4. FULLER COMMENTS ON THE CHANGES AND RECOMMENDATIONS FOR MINISTERIAL MESSAGES WILL FOLLOW SHORTLY SEMI-COLON SEE MIFT FOR DETAILS OF THE NEW CABINET.

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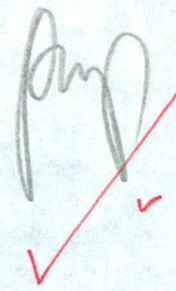
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INFO SAVING EDMONTON, MONTREAL, TORONTO, VANCOUVER



MY TELNOS 54 AND 55: NEW CANADIAN GOVERNMENT

SUMMARY

1. THE POSITION OF LEADING MINISTERS HAS BEEN REINFORCED BY CHANGES IN THE CABINET COMMITTEE STRUCTURE. MULRONEY HAS SAID THAT THE RESHUFFLE DOES NOT IMPLY POLICY CHANGES AND THAT THE REORGANISATION IS INTENDED TO IMPROVE FINANCIAL CONTROL. OVERALL, THE NEW TEAM LOOKS SOLID AND THE CHANGES SHOULD PROVE HELPFUL TO US. THERE IS BOUND TO BE SOME FURTHER DELAY IN THE DECISION ON SUBMARINES.

DETAIL

2. MULRONEY'S NEW CABINET SHOULD BE AN IMPROVEMENT ON ITS PREDECESSORS. IT STILL NUMBERS 39, ONLY ONE LESS THAN BEFORE. THE MINISTERS WHO HAVE BEEN PROMOTED ARE FOR THE MOST PART THOSE WHO HAVE PROVED THEIR WORTH IN ADMINISTRATIVE AS WELL AS POLITICAL TERMS. THE NEW RECRUITS TOO HAVE GOOD TRACK RECORDS. THE ESTABLISHED HEAVYWEIGHTS ALL NOW FIND A PLACE IN THE CABINET'S TWO KEY COMMITTEES, THE EXPENDITURE REVIEW COMMITTEE AND THE OPERATIONS COMMITTEE.

NEW COMMITTEE SYSTEM

3. MULRONEY IN HIS FIRST ADMINISTRATION TOOK OVER THE CABINET COMMITTEE STRUCTURE BEQUEATHED BY TRUDEAU IN WHICH THERE WERE HALF A DOZEN LARGE COMMITTEES COVERING BROADLY RELATED AREAS OF WORK PLUS THE CONSTITUTIONALLY ENTRENCHED TREASURY BOARD (TO APPROVE DEPARTMENTS' BASIC EXPENDITURE PROGRAMME AND THE PRIORITIES AND PLANNING COMMITTEE (INTENDED TO GIVE GENERAL POLICY DIRECTION). THIS SECOND GRADUALLY BECAME IN PRACTICE THE REAL CABINET. IN ADDITION, AN INFORMAL OPERATIONS COMMITTEE WAS SET UP AT THE END OF 1986 TO HANDLE PARLIAMENTARY AGENDA AND TACTICS. ITS INFORMALITY AND SMALL SIZE, MADE IT EXTREMELY EFFECTIVE SO THAT IT GRADUALLY PRE-EMPTED THE DECISIONS OF THE FORMAL COMMITTEE STRUCTURE.

4. MULRONEY HAS NOW FORMALISED THE EXISTENCE OF THE OPERATIONS COMMITTEE (OPS), ESTABLISHED NO LESS THAN 15 SMALL SECTORAL POLICY COMMITTEES AND SET UP A POWERFUL NEW COMMITTEE (EXPENDITURE REVIEW (ER)) TO VET ALL CALLS FOR NEW MONEY AND TO KEEP AN EYE ON AREAS WHERE CUTS IN EXISTING EXPENDITURE SHOULD FALL. IN SOME SENSES OPS AND ER, WHICH BETWEEN THEM CONTAIN THE DOZEN POLITICAL HEAVY-WEIGHTS IN THE GOVERNMENT CONSTITUTE THE REAL CABINET. MAZANKOWSKI, WILSON, CROSBIE AND DE COTRET ARE ON BOTH COMMITTEES.

5. MINISTERS NOW FALL INTO TWO DISTINCT CLASSES: THOSE WHO PARTICIPATE IN AUTHORISING EXPENDITURE AND THOSE WHO DO NOT. HITHERTO, PARTICULARLY UNDER ELECTORAL PRESSURE, INDIVIDUAL SPENDING MINISTERS WERE IN PRACTICE ABLE TO APPEAL TO THE PRIME MINISTER WHO WOULD INSTRUCT THE FINANCE MINISTER AND TREASURY BOARD TO MAKE FUNDS AVAILABLE, THUS PRE-EMPTING OTHER AND POSSIBLE WORTHIER CLAIMS. UNDER THE NEW SYSTEM CLAIMANTS WILL BE OBLIGED TO RUN THE GAUNTLET OF COLLEAGUES REPRESENTING MOST MAJOR POLICY AREAS AND ALMOST ALL REGIONS. IT IS EXPECTED THAT THEY WILL ALSO IN PRACTICE HAVE TO SQUARE THE OPS COMMITTEE AS WELL. THE MESSAGE WHICH EMERGES FROM THESE CHANGES IS THAT THE PRIME MINISTER AND DEPUTY PRIME MINISTER ARE AT ONE WITH THE MINISTER OF FINANCE IN WANTING TO RESTRAIN EXPENDITURE, BUT IT REMAINS TO BE SEEN WHETHER THIS STRUCTURE WILL SURVIVE SEVERE POLITICAL PRESSURES.

EXTERNAL AFFAIRS AND TRADE

6. REPORTS THAT THE EXTERNAL TRADE RESPONSIBILITIES OF DEA WOULD BE HIVED OFF HAVE SO FAR PROVED UNFOUNDED AND CLARK AND CROSBIE, ARE TO CONTINUE IN DOUBLE HARNESS AT LEAST FOR THE TIME BEING, WITH CROSBIE'S EQUAL STANDING NOW REFLECTED IN HIS MEMBERSHIP OF THE VARIOUS KEY CABINET COMMITTEES. HOWEVER, THE RETENTION OF MADAME LANDRY AS CLARK'S NO 2 MEANS THAT HE WILL BE AS OVER-BURDENED AS BEFORE: SHE IS A WEAK MINISTER WHO DISLIKES THE PROTOCOL SIDE OF HER RESPONSIBILITIES FOR MANAGING. ABLE PRESIDENT OF CIDA, MRS CATLEY-CARLSON, WHO IS A CIVIL SERVANT.

DEFENCE

7. THE REPLACEMENT OF BEATTY AND DICK BY MCKNIGHT AND MS COLLINS AT FIRST SIGHT SEEMS TO REPRESENT A SLIGHT WEAKENING OF THE DEFENCE TEAM. MCKNIGHT IS A LIKEABLE MAN, WHOSE MAIN POLITICAL ASSET IS HIS CLOSE FRIENDSHIP WITH MAZANKOWSKI (THEIR SASKATCHEWAN AND ALBERTAN CONSTITUENCIES MEET AT THE PROVINCIAL BORDER AND THEY SHARE DIGS IN OTTAWA). HE HAS BEEN, CONTRARY TO INITIAL EXPECTATIONS, AN EFFECTIVE MINISTER FOR INDIAN AND NORTHERN AFFAIRS WHO HAS GAINED THE CONFIDENCE OF THE LEADERS OF THE INDIGENOUS PEOPLES. HE

CAN BE EXPECTED TO WIN THE TRUST OF THE CANADIAN FORCES THOUGH HE MAY ADOPT A LOWER PROFILE THAN BEATTY IN ARTICULATING DND'S REQUIREMENTS. MARY COLLINS IS A PROTEGE OF JOE CLARK AND PERHAPS TOO GENTLE A PERSON FOR THE HURLY BURLY OF DEFENCE PROCUREMENT (THOUGH SHE STUCK UP VIGOROUSLY FOR FREE TRADE IN THE ELECTION CAMPAIGN). THE MEDIA HAVE INTERPRETED THESE APPOINTMENTS AS MARKING THE END OF THE SSN PROGRAMME. THIS CONCLUSION IS CERTAINLY PREMATURE AND COULD WELL PROVE WRONG: MCKNIGHT MAY PLAY HIS POLITICAL HAND WITH GREATER FINESSE THAN THE OVER-EAGER BEATTY. ON THE OTHER HAND HE WILL NEED TO REAL HIMSELF IN AND DECIDE WHERE ANY REDUCTIONS IN THE DEFENCE BUDGET SHOULD FALL. THIS POINTS FURTHER DELAY IN DECIDING BETWEEN THE BRITISH AND FRENCH SSN DESIGNS, BUT NOT NECESSARILY THE ABANDONMENT OF THE PROGRAMME. PAUL DICK WILL STILL BE A MAJOR PLAYER IN DEFENCE PROCUREMENT, SINCE IT IS HIS NEW DEPARTMENT OF SUPPLY AND SERVICES WHICH ACTUALLY SIGNS THE CONTRACTS.

OTHER MAJOR CHANGES

8. IN RECENT WEEKS THERE HAS BEEN MUCH TALK OF THE GOVERNMENT'S INTENTION TO GIVE ENVIRONMENTAL ISSUES INCREASED ATTENTION AND TO ENSURE THAT ENVIRONMENTAL CONSIDERATIONS ARE FULLY TAKEN INTO ACCOUNT IN OTHER AREAS OF POLICY. LUCIEN BOUCHARD'S EAGERNESS TO HOLD ON TO THE ENVIRONMENTAL PORTFOLIO ALLOCATED TO HIM ON A TEMPORARY BASIS HAS BEEN EQUALLY CLEAR: HE COULD IN ANY CASE HARDLY HAVE CONTINUED AS THE SECRETARY OF STATE WITH RESPONSIBILITY FOR LANGUAGE POLICY AFTER HIS SHARP PUBLIC DIFFERENCES WITH MULRONEY ON THIS ISSUE.

9. THE CHANGE OF MINISTER RESPONSIBLE FOR ENERGY SHOULD BE ON BALANCE HELPFUL TO US AND THE THE DEPARTMENT OF ENERGY, MINES AND RESOURCES: EPP IS A GOOD MANAGER AND VERY FAIR-MINDED. HIS PREDOMINANTLY ANGLOPHONE DEPARTMENT AND THE WESTERN OIL INDUSTRY, WILL FIND HIM A WELCOME CHANGE FROM HIS PREDECESSOR WHO OPENLY FAVOURED QUEBEC INTERESTS AND BLOCKED FOREIGN TAKEOVERS OF HEALTHY COMPANIES THE THE ENERGY SECTOR. AS A WESTERNER, EPP CAN BE EXPECTED TO FIGHT HARD FOR THE IMPLEMENTATION OF AT LEAST SOME OF THE ENERGY MEGA-PROJECTS ANNOUNCED DURING THE ELECTION CAMPAIGN. THE PROMINENCE OF JOHN CROSBIE ON THE MAJOR COMMITTEES WILL PROBABLY ENSURE THAT HIBERNIA GOES AHEAD.

10. MAZANKOWSKI BRINGS TO THE AGRICULTURAL PORTFOLIO BOTH REALISM AND THE POLITICAL AUTHORITY HE HAS ESTABLISHED AS DEPUTY PRIME MINISTER. AS A WESTERNER FROM ALBERTA, HE WILL DEFEND CANADIAN GRAIN INTERESTS WHERE HE THINKS IT IS JUSTIFIABLE IN FORTHRIGHT

TERMS, BUT IN OTHER AREAS HE MAY PROVE WILLING TO ACCEPT THE NEED FOR GRADUAL LIMITATION OF CANADIAN AGRICULTURAL SUBSIDIES. HE IS LIKELY TO PROVE PARTICULARLY KEEN TO SEE THE AGRICULTURAL CHAPTER OF THE MTNS SUCCEED: IT WAS NOTABLE THAT AT THE AGRICULTURAL OUTLOOK CONFERENCE HELD IN OTTAWA IN DECEMBER MAZANKOWSKI DID NOT ASCRIBE BLAME TO EITHER THE EC OR THE US FOR FAILURE TO REACH AGREEMENT AT MONTREAL.

11. DETAILS OF THE NEW COMMITTEE STRUCTURE AND MEMBERSHIP FOLLOW BY BAG.

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folder for meeting

FROM: D RAMSDEN

DATE: 6 February 1989

- 1. MR MELLISS
- 2. CHANCELLOR

cm 6/2

Handwritten signature/initials in red ink

- cc PS/Economic Secretary
- Mr N Wicks
- Mr Lankester
- Mr Evans
- Mr Edmonds

NEW CANADIAN HIGH COMMISSIONER: COURTESY CALL

The new Canadian High Commissioner, Mr Donald MacDonald is paying you a courtesy call at 3.30 pm on Wednesday 8 February. The attached briefing notes are effectively the same as you had for your dinner with the Prime Minister of Quebec with the exception of the points covered in paragraphs 2-6 below. The notes cover:-

- the Canadian economy, including the Canada/US free trade agreement (FTA) - annex 1;
- personality notes on the High Commissioner and the new Minister (Commercial and Economic), Mr Berlet - annex 2.

Mr Berlet will be accompanying Mr MacDonald.

2. Mr MacDonald was Liberal Minister of Finance between 1975 and 1977 and has a thorough grasp of economic issues. Though a Liberal (the Liberals opposed the FTA in last November's federal election) the High Commissioner is a supporter of the FTA. From 1982 to 1985 he chaired the Royal Commission on the future of the Canadian economy which recommended negotiation of the FTA along with many other proposals for structural reform including tax reform. The High Commissioner has stressed that the FTA should not be seen as creating a "fortress North America" and he may ask how the UK views the FTA. In principle we welcome the FTA but we will obviously be keeping an eye on its effects on UK interests. (See paragraphs 16-17 of annex 1).

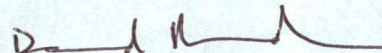
3. There is one outstanding bilateral issue relating to the FTA which you should be aware of. This is an issue of reciprocity: should UK financial institutions in Canada receive the same treatment granted to US financial institutions under the FTA? US banks are now exempt from the limitation on overseas banks in Canada that they may grow only as fast as the market as a whole - UK banks remain subject to this constraint. However, since the existing arrangements are not currently adversely affecting any UK banks in Canada, we recommend that you do not raise this issue with the High Commissioner at this stage.

4. The issue of the discriminatory treatment of UK exports of whisky and beer by some Provincial liquor boards has been largely resolved (see paragraph 20 of annex 1).

5. You may like to enquire of Mr McDonald as to the Federal government's plans for reducing the budget deficit (see paragraphs 11-15 of annex 1). The Federal budget for FY 1989 will be announced in February. Prime Minister Mulroney has reaffirmed his commitment to further reducing the deficit and in the recent Cabinet reshuffle he set up a new Expenditure Review Committee to vet and oversee all expenditure policy.

6. The High Commissioner may raise his own idea (not cleared with Ottawa) for some of the payments on the UK's outstanding debt to Canada (see paragraph 21 of annex 1) to be used to sponsor an exchange of students between the UK and Canada. HE2 are preparing a brief on this subject.

Separate brief on this behind.



D RAMSDEN

ANNEX 1:

CANADIAN ECONOMY

Background figures

	Canada (1987)
GDP*	US \$440 bn
Population	25.65m
GDP per capita*	US \$17,200

* using purchasing power parities.

Canada has the smallest GDP of the major 7 countries, though only the US has a higher level of GDP per capita.

Recent Economic Developments

2. The following table gives summary statistics including latest OECD estimates for Canada.

	(Percentage change on a year earlier)		
	1987	1988	1989
Real GDP	4.0	4 $\frac{1}{4}$	3
Business Investment	8.8	19 $\frac{1}{2}$	7 $\frac{3}{4}$
Consumer prices*	3.7	3 $\frac{1}{2}$	3 $\frac{3}{4}$
Unemployment rate	8.9	7 $\frac{3}{4}$	7 $\frac{3}{4}$
Current Account (US \$bn)	-8	-8	-10

* deflator of private consumption

Source: OECD, Conference Board of Canada

3. As in other major 7 countries, activity in Canada was more buoyant than originally expected in 1988. Business investment was particularly strong.

4. Inflation picked up a little during 1988 and inflationary pressures remain. The unemployment rate is at its lowest level for six years, and capacity utilisation rates in manufacturing are close to previous peaks.

5. Canada is the only major industrial country other than the UK to include mortgage interest payments in its consumer price index. However, because of the prevalence of fixed rate mortgages in Canada, changes in mortgage rates have little impact on the inflation rate. In December the 12-month inflation rates including and excluding mortgage interest payments were both 4.0 per cent.

6. The Canadian dollar reached a 7 year peak against the US dollar on 1 February. Its strength has helped to keep import prices down.

7. Canada moved into deficit on current account in 1985, and has remained so since. The visible surplus has fallen since 1984 partly as a result of loss of export market share, particularly in the US automobile market, and more recently because of strong growth of imports of manufactures related to the investment boom.

8. Canada's net external debt rose from 25 per cent of GDP in 1975 to 40 per cent in 1986.

Policy

9. Monetary policy has been tightened considerably since the beginning of 1988; short-term interest rates have risen by almost 3 percentage points since January 1988 and stood at 11.4 per cent on February 1. Current real short term rates at 7 per cent are the highest of the major 7 countries.

10. The Federal government's policies are set out in the Agenda for Economic Renewal (begun in 1984). This proposes better budgetary balance, tax reform, the freeing of trade with the US and other structural reforms.

11. The following table shows figures for the general government deficit and net public debt as a percentage of GDP.

(As percentage of GDP)

	1985	1987	1988
Net public debt	30.6	36.2	36.7
General Government deficit	-7.0	-4.6	-3¼

Source: OECD estimates, on national accounts basis.

12. The general government deficit fell as a percentage of GDP in 1988 to about 3¼ per cent.

13. Measures to further reduce the federal deficit are expected to be included in the 1989 Budget to be announced in February. Federal spending programmes which might be reduced are unemployment insurance and agricultural support spending.

14. The OECD estimate that net public debt as a percentage of GDP has risen from under 11 per cent to over 40 per cent in 1988. Interest payments on the public debt were considerably more than the total general government deficit in 1987.

15. The first stage of the tax reform programme came into effect on 1 January 1988, simplifying the personal tax system and reducing marginal rates. The second stage will see the replacement of the manufactures' sales tax with a more broadly based sales tax similar to VAT.

Canada/US Free Trade Agreement (FTA)

16. The Agreement was implemented on January 1 1989. Its main provisions are for the elimination of all tariffs between the two countries, the reduction of non-tariff barriers to trade, and the liberalisation of investment flows. Road haulage, air and rail transport are not covered by the Agreement, neither are government subsidies to industry.

17. The Agreement will almost certainly benefit Canada. Points to note are:-

- as the US takes about 75 per cent of Canada's exports, the macro-economic effects are potentially large;
- tariffs between the US and Canada fell considerably in the 1960s and 1970s. For example, trade in automobiles, the main Canadian manufactured export, was liberalised through the US - Canada Auto Pact of 1965. The elimination of remaining tariffs is in comparison small though the elimination of other trade barriers will have a substantial effect;
- the FTA contains no provisions relating to trade with third countries.

Canada's role in G7

18. Canada has played an active role in the G7 cooperation process, at Summit, Finance Minister and Deputy level. The G7 deputies meeting of 3 June 1988 was held in Toronto prior to the Toronto Economic Summit of 19-21 June.

19. Canada recently hosted the GATT mid-term-meeting held in Montreal.

UK/Canada Trade Issues

20. In Canada, each state has a liquor board which is responsible for the sale of alcohol in the state. Some states, notably Ontario have levied substantial excise duties on imported products affecting UK and EC exports of spirits, wine and beer. The dispute was taken to a GATT adjudication panel and appears to have been resolved satisfactorily from the UK stand point.

Canada - UK Loan

21. In 1946 Canada loaned the UK C\$1½ billion under authority of the United Kingdom Financial Agreement Act at an interest rate of 2 per cent. The loan was last rescheduled in 1976. C\$522 million is currently outstanding to be repaid by 2006.

ANNEX 2

THE HONORABLE DONALD (STOVEL) MACDONALD

56 years old. Distinguished legal and political career. Liberal Minister of Finance, 1975-77. Resigned from Parliament in 1978. From 1982-85 he chaired a major commission on the economy which in 1985 recommended that Canada negotiate a Free Trade Agreement with the US.

Macdonald is an able and effective operator who could have become Liberal party Leader. He was a good Minister of Finance and, although his spell as Minister of Defence was short, he reportedly took a real interest in Canadian defence problems and should prove helpful to us over nuclear submarines and other defence sales prospects. As Energy Minister during the first oil price shock he tried to insulate Canada from worldwide price levels. His chairmanship of the Royal Commission on the future of the Canadian economy seems likely to prove a more enduring monument. It showed him to have a thorough grasp of complex economic issues. His recommendation that Canada should negotiate a Free Trade Agreement with the US was in the Liberal party's tradition, but was in the event taken up by Mulroney's Conservative government. If the Mulroney government is re-elected on 21 November, he may well enjoy the confidence of his Prime Minister and should prove authoritative generally for explaining Canadian policy. Although himself a Liberal, his position would be much less comfortable if the Liberals were to triumph at the next election.

Macdonald is lively and interesting. He is reputed to have a formidable temper which, together with his protruding front teeth, account for his nickname "Thumper". Macdonald's first wife, by whom he had 4 children, died some years ago. Lately he has lived with Adrian, the estranged wife of Otto Lang, a former Liberal Ministerial colleague: they were married in September. She is reputed to make up in vitality what she lacks in height, and to be a social live-wire. She has 7 children by her first marriage.

Born on 1 March 1932 in Ottawa, where he went to school. He obtained a BA from the University of Toronto in 1951, a Masters degree in Law from Harvard in 1956 and a Diploma in International Law at Trinity Hall, Cambridge in 1957. He was elected MP for the Toronto constituency of Rosedale in 1962 and remained an MP until his resignation in 1978.

He served as Parliamentary Secretary to a number of Ministers between 1965 and 1968, when he became President of the Privy Council and government House Leader. In 1970 he became Minister of National Defence, in 1972 Minister of Energy, Mines and Resources and in 1975 Minister of Finance.

Between 1957 and 1962 he practiced Law with the leading Toronto firm of McCarthy & McCarthy; he has been a senior partner since 1977. He holds a number of banking and industrial directorships; from 1980-84 he was Chairman of the International Development Research Centre.

CURRICULUM VITAE

Ronald J.L. Barlet

PERSONAL

Date of Birth: July 17, 1936
West Monkton, Ontario

Marital Status: Married, three children

EDUCATION

Primary: Ontario

Secondary and Junior College: Fort Wayne, Indiana
pre-theological studies

University: University of Toronto, B.A. Sc. (1960)

London School of Economics: Business Administration and Economics (1962)

BUSINESS EXPERIENCE

1962 General Electric Company of England, London
Market Research

1963-1964: Canadian Westinghouse Limited
Marketing/Sales Engineer

GOVERNMENT OF CANADA

Industry, Trade & Commerce/External Affairs

1964 Trade Commissioner Service, London

1965-1968: Canadian Embassy, Vienna, Second Secretary
Trade development reporting and negotiating
trade agreements in Eastern European States,
viz., Bulgaria, Romania, Hungary, Yugoslavia
and Czechoslovakia.

1968-1970: Canadian Embassy, Prague, Czechoslovakia,
First Secretary. Similar activity to
Vienna.

1970-1973: United Nations, New York; Canadian
Permanent Mission, Counsellor aid and
economic matters -U.N.D.P., Ecosoc

1973-1975: Treasury Board of Canada, Ottawa
Programs Branch analyst for RCMP,
Penitentiaries and Parole Board

1976 External Affairs, Ottawa, Operational Audit

1976-1980: Canadian High Commission, London, England
Counsellor: development in high technology
and defence equipment sectors in United
Kingdom

1980-1984: Canadian Consulate General, Hamburg, West
Germany
Consul General

1984 External Affairs, Ottawa
Director, Operational Resource Planning
(CMA)

1985-1988: External Affairs, Ottawa
Director General, Technology and Investment
Development Bureau

1988-Present Canadian High Commission, London, England
Minister (Commercial/Economic)

HOBBIES

Sportsman: tennis, golf, skiing, sailing (skippered yacht on Trans-Atlantic trip), travel

EXTRA CURRICULAR ACTIVITIES

Former president of Tradex Mutual Fund, Ottawa, Canada
Former Chairman, International School of Hamburg, Germany

CANADIAN ECONOMY

1. Following a pause in the second half of 1986, Canada is probably now the strongest-growing major country. During the first half of 1987 (from 1986Q4 to 1987Q2), real GNP increased at a rate of 6 per cent a year. However, reflecting the earlier pause, the increase for the year as a whole (between 1986 and 1987) will be much lower than this - the IMF estimates 3½ per cent which is below the Autumn Statement forecast of 4 per cent for the UK.

2. Employment is expanding fast, and at 8.6 per cent in August the unemployment rate is at its lowest for five years.

3. Partly because of indirect tax increases, Canada did not experience a decline in inflation in 1986 unlike the US and most other countries. At the end of 1986 its inflation rate of around 4 per cent was the highest of the G7 countries except Italy. However so far this year inflation has remained almost steady in Canada while it has been rising elsewhere. The differential between Canadian and US inflation rates (3 per cent at the end of 1986) has now largely disappeared.

4. As a large energy producer, Canada suffered a terms of trade loss from the oil price fall in 1986 which threw its balance of payments into deficit. Last year's deficit on current account of \$US 7 billion (1½ per cent of GNP) is likely to be repeated in 1987.

5. The budget deficit has been substantially reduced since 1985, but it remains relatively high. The February budget calls for a C\$ 29.3 billion deficit in FY1987 (5.3 per cent of GNP); the medium term plan published in June would see this decline to C\$ 23.5 billion in FY1991.

6. Between close on 15 October (before share prices started to fall sharply) and close on 6 November, share prices on the Toronto exchange dropped 21 per cent. This is slightly more than the fall on Wall Street (about 19 per cent), but equities are a smaller share of wealth in Canada than in the US and, the direct impact of the share price fall on domestic demand might be less important than the impact on Canada's exports (three quarters of which go to the US) if the US economy should falter.

7. Canadian interest rates have fallen sharply as the authorities have sought to stabilise the stock market and maintain confidence. 3-month rates, close to 10 per cent a month ago, are now down to around 8½ per cent.

8. One effect of the share price fall has been to cause the Canadian Government to suspend its privatisation programme. Air Canada and Petro-Canada will not now be sold before the 1989 election.

9. Table 1 shows some economic and financial indicators.

Table 1: Canada: Summary Statistics*

	1985	1986	1987
Real GNP*	4.3	3.3	3.5**
Industrial production*	5.2	1.3	6.5(Aug)
Unemployment rate (%)	10.5	9.6	8.6(Sep)
Consumer prices*	4.0	4.1	4.5(Sep)
Current deficit (\$US bn)	-0.9	-6.7	-7.4**
General government financial deficit (% of GNP)	7.0	5.5	4.5**
Interest rates (3-month %)	9.5	9.2	8.6(6 Nov)
Share prices (Toronto; 1980=100)	128	142	143(6 Nov)
Canadian dollar (effective index 1980=100)	85.6	84.1	76.7(6 Nov)

* Percentage change on year before.

** IMF estimate (World Economic Outlook, October).

SECRET

FROM: S BOWDEN
DATE: 7 FEBRUARY 1989

1. MR FARTHING
2. CHANCELLOR

cc: PS/Chief Secretary
PS/Economic
Secretary
Sir P Middleton
Mr Anson
Mr Wicks
Mr Scholar
Mr Monck
Mr Peretz
Miss O'Mara
Mr Watts
Mr Perfect
Mr Williams

Chancellor,

*The points in §6 and 7
look sufficiently strong to
block the proposal, especially
since as I understand from
Alex, Wilson is opposed to the
scheme.*

MEETING WITH THE CANADIAN HIGH COMMISSIONER

*N.C.U.
7.2.*

1. You are meeting the Canadian High Commissioner, Donald S Macdonald, on 8 February. He will want to discuss his proposal for a possible Canada-UK scholarship fund.

Letter attached, behind!

Background

2. Under the terms of the Canada-United Kingdom Financial Agreement 1946 Canada extended to the UK a credit of CAN \$1.25 billion at an interest rate of 2 per cent, to be repaid in fifty annual installments beginning on 31 December 1951. By subsequent agreement in 1957 the UK was given the option of deferring annual payments of interest and principal on up to seven occasions - deferred payments would take place in 2001 and subsequent years. We have exercised five such options. According to the High Commissioner's memorandum the deferred principal amounts to CAN \$94,990,863.

3. The High Commissioner proposes that the UK should commence partial repayment of the deferred amount this year. He suggests that these payments should go into a scholarship fund, for the purpose of assisting Canadian and British students to study in each others' country. The proposed fund would permit 200 Canadian students a year to study in the UK, and 200 British students to study in Canada.

Implications

4. We have consulted the FCO, and they believe that the idea has merits. They are looking for ways to create a new generation of Anglo-Canadian ties to replace war-time links. They see the High Commissioner's proposal as a potential element in this process, with future benefit for UK trade. The proposal would also benefit other Government bodies such as the British Council and the DES, who will both tend to favour it. But they would not have to pay for it - the money would come from the official foreign exchange reserves under the present proposal. The FCO's view is that if the Canadian Government were to support the High Commissioner's initiative strongly, it would be difficult for us to oppose it. They would, however, like more time to canvass opinion widely among interested parties.

5. You should also be aware that the Canadian Prime Minister is to call on the Prime Minister on 13 March. The Canadians have asked that the meeting should be kept secret at least for the present, as they may want to discuss the sale of British nuclear submarines to Canada. Number 10 have asked that you should not disclose knowledge of this meeting unless the High Commissioner mentions it himself.

Propriety

6. T.Sol have advised that the High Commissioner's proposal is not ultra vires the National Loans Act or the Exchange Equalisation Account Act. However it entails both an unconventional use of the official foreign exchange reserves and a cost to the EEA (since the interest rate of 2% is substantially less than we can earn by reinvesting the proceeds). These both raise problems of propriety. The Accounting Officers of both the National Loans Fund and the Exchange Equalisation Account - since the borrowing is a liability of the NLF and the proceeds are invested in the EEA - could have to account to the PAC for using in this way the future interest benefit, which we would otherwise receive, on a loan made explicitly for balance of payment purposes. Neither Accounting Officer has yet been consulted, and it would be quite wrong to contemplate a scheme of doubtful propriety when the NAO are at present enquiring into the NLF/CF and the EEA. MG and Accounts also have strong reservations about

the undesirable precedents that the High Commissioner's proposal could set. Schemes of dubious propriety involving the reserves have been rejected in the past (eg lending from the EEA to the IMF to finance a UK contribution to the IMF's enhanced Structural Adjustment Facility.)

7. If we were to adopt the route suggested, the Treasury could be criticised for making a payment to the proposed fund without proper authority. If something akin to the High Commissioner's proposal is eventually agreed, TOA and Accounts advise that the correct procedure would be for the UK and Canada to negotiate a new loan agreement, discounting the early repayments to match the interest forgone by the UK. The purpose of this would be to leave the EEA no better or worse off. The UK contribution would then be voted by Parliament, presumably on the DES Vote. But MG would still have strong reservations about directing loans made for balance of payments and reserves purposes for a different purpose. An alternative and simpler procedure would involve Parliament voting the funds without recourse to the reserves. In either case the resulting sum would, of course, represent an increase in public expenditure to the extent that it could not be offset in the DES budget.

Conclusion

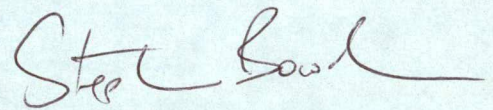
8. MG and Accounts are strongly opposed to the High Commissioner's proposal, on the grounds of propriety, and the potential precedents it might set. FCO on the other hand are strongly in favour, for the reasons given in paragraphs 4 and 5. DES and the British Council are to likely favour it also. Unless the Canadian Government have already rejected the initiative therefore you should aim to keep it on the table for the time being - though without, at this stage, giving a firm commitment either way.

Line to take

9. You should first enquire whether the Canadian Government have expressed an opinion on the High Commissioner's proposal.

SECRET

- If they are opposed, you might sympathise, but state that you understand their position.
- If they are in favour, you should say that we will need to consider further the implications of the proposal, and offer to write to the High Commissioner shortly.
- If they have not yet expressed a view, you could offer to give the proposal further thought while awaiting their opinion.



STEPHEN BOWDEN

FROM: N L WICKS
DATE: 8 FEBRUARY 1989

CHANCELLOR OF THE EXCHEQUER

cc PS/CST
PS/EST
Sir P Middleton
Mr Anson
Mr Scholar
Mr Monck
Mr Beastall
Mr Farthing
Mr Peretz
Miss O'Mara
Mr Watts
Mr Perfect
Mr N Williams
Mr Bowden

Thank you.
PS JI/PS/EST

MEETING WITH THE CANADIAN HIGH COMMISSIONER

I minute, as Accounting Officer for the EEA, to reinforce the concerns expressed in paragraphs 6 and 7 of Mr Bowden's minute of 7 February about the propriety of using premature repayments of the Anglo-Canadian loan to finance the scholarship scheme suggested by the Canadian High Commissioner in his letter of 25 January. My concerns are as follows:

i. the scheme would, as I understand it, result in a cost to public funds, amounting to the difference between the 2 per cent interest rate on the loan and the interest rate that we can earn by investing its proceeds, since the proposal is that the deferred principal be repaid early. We have not calculated the figures involved - they depend crucially on estimates of future interest rates - but they would be significant in view of the size of the loan prepayments involved, some Can \$95 million. If you wanted to consider the proposal further, I would want to provide you with some estimates of possible costs. The cost to public funds would manifest itself by a reduction in the EEA returns.

ii. These costs would result from a most unconventional use of EEA funds. The purpose, the scholarship fund, has nothing to do with the purposes for which the Account was established (or the loans were made). It is a patent device to avoid Parliamentary control. The NAO would, I feel sure, query the

X | arrangements. They are already much interested in the operations of the EEA as you will see from a submission that I am putting to you today. You will see in that submission that we have a good story to tell about our stewardship of the \$50 billion or so taxpayers' funds tied up in the Account. It would be a great pity to blemish the record by adopting the sort of device suggested by the High Commission. It would be very difficult, if not impossible, to explain to the NAO why we were using EEA funds for educational and diplomatic purposes.

iii. There is the officials' argument of last resort - precedent! If we allowed this scheme through, however estimable its objectives, our defences against other less desirable schemes would be weakened - hard cases make bad law.

3. For all these reasons, I hope that you can tell the High Commissioner this afternoon that you do not wish to pursue his proposal. But if you were minded to favour it, I would recommend you not to tell the High Commissioner so but to give us the opportunity to consider it further.

N.L.W.

N L WICKS



FROM: J M G TAYLOR

DATE: 9 February 1989

PMP

MR WICKS

cc PS/Chief Secretary
PS/Economic Secretary
Sir P Middleton
Mr Anson
Mr Scholar
Mr Monck
Mr Beastall
Mr Farthing
Mr Peretz
Miss O'Mara
Mr Watts
Mr Perfect
Mr N Williams
Mr Bowden

MEETING WITH THE CANADIAN HIGH COMMISSIONER

The Chancellor was grateful for your note of 8 February, and Mr Bowden's note of 7 February, on the High Commissioner's proposal for a possible Canada-UK scholarship fund.

2. As you know, this was discussed briefly at the meeting yesterday. The High Commissioner said that he had yet to convince Ottawa of his proposal. The Chancellor said that he had also gained the impression from the Canadian Finance Minister that he had yet to be persuaded of the merits of this proposal. The Chancellor continued that, although the proposal was an imaginative one, with a worthy objective, the means proposed would create difficulties for us.

A handwritten signature, likely of J M G Taylor, consisting of stylized initials.

J M G TAYLOR



FROM: J M G TAYLOR
DATE: 9 February 1989

PHP

MR RAMSDEN

cc PS/Economic Secretary

Mr Wicks
Mr Lankester
Mr Evans
Mr Edmonds
Mr Melliss

Sir P Middleton

Mr Cassell (UKDEL)

NEW CANADIAN HIGH COMMISSIONER: COURTESY CALL

The Chancellor was grateful for the briefing you provided for his meeting with the Canadian High Commissioner yesterday. The High Commissioner was supported by Mr Berlet. Mr Wicks was also present.

2. Mr MacDonald asked whether US foreign economic policy would now be run from the State Department. The Chancellor said he thought that Secretary Baker would continue to take a close interest in debt. But for the rest, he would have enough to do without involving himself closely in economic policy. Secretary Brady was, also, close to President Bush himself. Mr MacDonald asked whether there would be a new US initiative on debt. The Chancellor said this was possible. Brady might be tempted to give some sort of hint when he made his report to Congress later this month.

3. Mr MacDonald asked whether the Japanese could be expected to carry on with their own debt initiative, following the departure of Miyazawa. The Chancellor said that Japan wanted, more generally, to play a bigger role on the international financial scene. Their banks were also not well provisioned. So we could expect the Japanese to continue to put forward ideas. Mr MacDonald asked about the Japanese wish to play a larger role at the Fund. The Chancellor said this would need to be wrapped up in the overall discussions on quota increases. It might not be settled until the annual meetings in September. Berlet asked



whether we thought the US were encouraging the Japanese in their ambitions. The Chancellor said that this was unclear.

4. Mr MacDonald asked about the Delors Committee and European Monetary Union. He noted that the existing US/Canada open capital markets had not required the pre-condition of Monetary Union. The Chancellor agreed that there was no inevitability in Monetary Union at all. The question was whether it was desirable. A pragmatic case for membership of the ERM could be made out, but he was not persuaded of the need for EMU. The Chancellor outlined the planned timetable for the report of the Delors Committee. He pointed out the difficulties which it posed. Mr MacDonald expressed puzzlement over why EMU was so strongly favoured by certain politicians in other Member States. The Chancellor described briefly the reasons why its supporters favoured EMU.

5. There was a brief exchange on the proposed Canada UK Scholarship Fund, which I have recorded separately. Closing, Mr MacDonald noted that the UK and Canada were together on most bilateral issues. He noted, in particular, that the UK's position on trade had been particularly helpful to Canada.

A handwritten signature in dark ink, appearing to be 'J M G Taylor'.

J M G TAYLOR