



WMRC Country Report: Canada

18 December 2003

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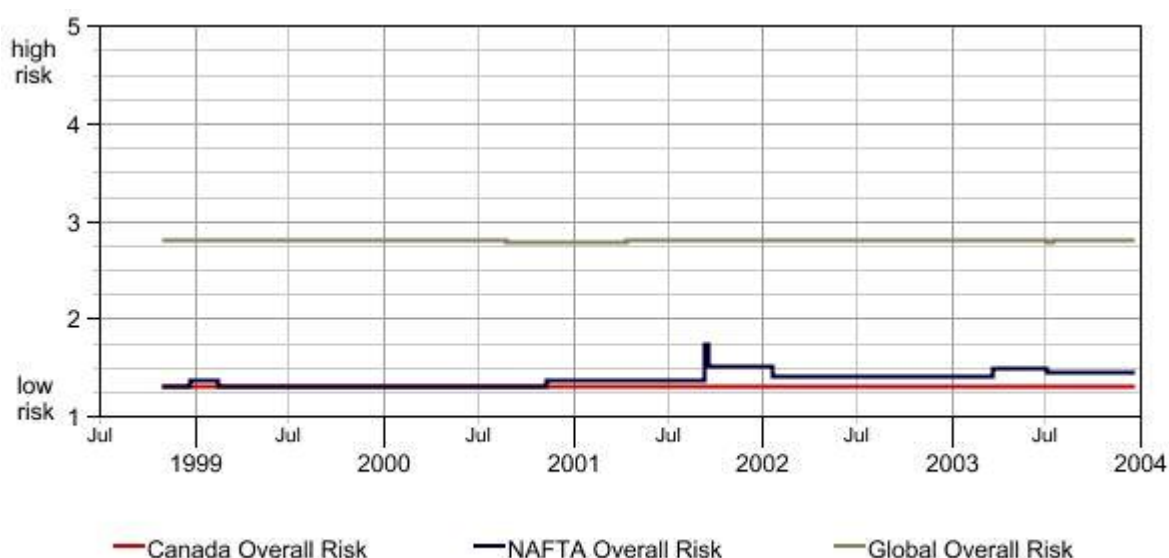
Overall

Canada - Country Risk Summary

Nature of risk	Rating	Summary
Political risks	1.50	The political environment in Canada is healthy and stable. The Liberal Party has been in power since 1993. It consolidated its parliamentary position during the November 2000 general election to an absolute majority and can therefore expect to govern comfortably through to 2005. Although charges of complacency are inevitably launched at the Liberals, the one-party consensus of the last nine years has not undermined the workings of the political system. The main opposition party, the Canadian Alliance, elected Stephen Harper as its new leader in March 2002, but he faces a tough challenge making inroads into Liberal support and differentiating the Alliance's agenda. The only potentially divisive issue is that of Quebecois separatism, but this has receded with the landmark victory of the Liberals in the 2003 provincial election.
Economic risks	1.50	The Canadian economy has generally performed strongly despite the recent economic downturn. It rode alongside the US's economic boom in the 1990s. While having many similarities to Australia in terms of economic size, living standards, 'dollar bloc' linkages, continuing importance of primary product exports, these similarities have begun to diverge on external balances and external debt. Unlike Australia, since the earlier build-up in the 1980s of a significant external debt burden, primarily from recurring current-account deficits, with the federal debt problem compounded by increasing provincial indebtedness, Canada has been able to first stabilise and then reduce external debts ratios significantly. The current account has been brought much closer to balance and the fiscal position into a broad, comfortable, albeit small, surplus. In addition, NAFTA has been a net positive for Canada's external finances. Productivity remains lower than in the US, which is a primary reason why capital tends to shy away. However, the impressive recent recovery, which meant that Canada was the first of the G7 countries to raise interest rates in the current cycle, has added to steadily advancing productivity to enhance Canada's strong investment prospects and performance.
Legal risks	1.00	The legal system is mature and well-defined. Foreign investment is given equal treatment and incorporation processes are simple. A foreign investment act, introduced in 1985, has been reinforced by Canada's entry into NAFTA.
Tax risks	1.00	The tax system is complex but well-defined. There are a number of taxes at federal and provincial levels. The tax burden on personal and corporate income tax is quite high as a result of commitment from the government and public to use it to enact social and economic policies. For example, Canada maintains a national publicly-funded health system that has more in common with Europe than the US.
Operational risks	1.50	In early 2003 there was considerable disruption to the operational environment after an outbreak of Severe Acute Respiratory Syndrome (SARS) in the Ontario province. This prompted the World Health Organization (WHO) to warn against travel to Toronto, Canada's main business centre. Otherwise, the operational environment is very good. Canada has a highly developed infrastructure. Union activity is quite high, but not restrictively so. Environmental awareness is high and protection is well-enforced by legislation. The increased focus on cross-border trade and security since the 11 September 2001 terror attacks in the US should enhance the speed and efficiency of the US/Canada border crossing.

Security risks	1.00	The security environment in Canada has inevitably suffered the consequences of the September 2001 terrorist attacks in the US, and there has been heavy US pressure to enhance anti-terrorism measures. The 2002 budget increased defence and security spending, in response to US criticisms that the Canadian border provides a major entry route for terrorists. Airport and border security is now much tighter. Aside from the new terrorist threats, the security environment is stable, with low crime rates and little organised crime. Some argue that the military is under-funded, with out-of-date, inadequate equipment.
Overall risks	1.32 NEGLIGIBLE	There are no serious overall risks for foreign investment. Canada is one of the most developed countries in the world. Present economic concerns should prove to be only temporary problems. The most important issue concerns the future of Quebec within the federation. However, the federalists will prevail over the sovereigntists.

Comparative Historical Risk



Risk Change History

Canada

	Overall Risk	Date Changed	Risk Change Article	Pol 25%	Eco 25%	Leg 15%	Tax 15%	Ope 10%	Sec 10%
1	1.32 NEGLIGIBLE	01-Nov-98	-	1.50	1.50	1.00	1.00	1.50	1.00

Canada - Key Country Facts

Area (sq km)	9220970
Capital	Ottawa
Languages	English (official), French (official)
Ethnic Diversity	British Isles Origin (40%), French Origin (27%), other European (20%), Amerindian (1.5%), Other (mostly Asian - 11.5%)

Religions	Roman Catholic (45%), United Church (12%), Anglican (8%), Other (35%)
Currency	Canadian dollars (Can\$)

Canada - Demographic Data (sourced from World Markets Healthcare)

	1990	1997	1998	1999	2000
Demographics					
Total population (m)	27.8	30.0	30.2	30.5	30.8
Population density (per sq km)	3.0	3.3	3.3	3.3	3.3
Total population under 15 years (m)	5.8	5.9	5.9	5.9	5.9
Total population 15-65 years (m)	18.9	20.4	20.7	21.0	21.0
Total population over 65 years (m)	3.1	3.7	3.7	3.8	3.9
Annual population growth (%)	1.5	1.1	0.9	0.8	0.8
Total rural population (m)	6.5	6.9	7.0	7.0	7.0
Total urban population (m)	21.3	23.0	23.3	23.5	23.7
Crude birth rate (per 1,000)	15.0	11.5	11.2	11.1	10.9
Crude death rate (per 1,000)	7.3	7.2	7.3	7.1	7.5
Total life expectancy at birth (years)	77.2	78.9	..	79.0	78.9
Total male life expectancy at birth (years)	74.0	76.0	..	76.1	76.0
Total female life expectancy at birth (years)	80.6	82.0	..	82.1	82.0

Source: World Bank, *World Development Indicators 2001*; IMF, *World Economic Outlook September 2001*; World Health Organisation, *WHO Estimates of Health Personnel*

Canada - Key Macro-economic Data (sourced from World Markets Country Analysis and Forecast)

	1999	2000	2001	2002e	2003f
Domestic Data					
A - GDP Growth %	5.5	5.3	1.9	3.3	2.3
J - Inflation %	1.7	2.7	2.5	2.2	2.9
N - GDP \$bn	861.6	907	924.4	954.7	976.8
Q - GDP Per Capita \$	21665	23335	22730	23114	23561
External Data					
AM - Foreign Direct Investment \$m	24488	66017	27438	24667	28960

Country Report - Canada (Country Analysis)

Political Environment

Current as of Mon 08 Dec 2003

Political risks: 1.50

The political environment in Canada is healthy and stable. The Liberal Party has been in power since 1993. It consolidated its parliamentary position during the November 2000 general election to an absolute majority and can therefore expect to govern comfortably through to 2005. Although charges of complacency are inevitably launched at the Liberals, the one-party consensus of the last nine years has not undermined the workings of the political system. The main opposition party, the Canadian Alliance, elected Stephen Harper as its new leader in March 2002, but he faces a tough challenge making inroads into Liberal support and differentiating

the Alliance's agenda. The only potentially divisive issue is that of Quebecois separatism, but this has receded with the landmark victory of the Liberals in the 2003 provincial election.

Current Highlights

- **The ruling Liberal Party remains reasonably secure** after a solid victory in the November 2000 election. Previous efforts to reduce the federal debt have paid off, leaving Canada in a good position to weather the economic downturn. The December 2001 budget was wise and prudent, fulfilling previous promises, boosting security but placing firm limits on excessive spending. The opposition remains disorganised and divided.
- **Prime Minister Jean Chrétien has finally announced that he will stand down as party leader in February 2004.** Jean Chrétien has been prime minister for ten years, and is approaching 70. Even loyalists were starting to argue that it might be beneficial for him to step down and hand the reins to a new leader.
- **Former Finance Minister Paul Martin will succeed Chrétien** following the withdrawal of current Deputy Prime Minister and Chretien's appointed successor, John Manley. Manley stated that Martin was too far out in front and could not be defeated.
- **The Quebec issue is receding**, confirmed by the landmark victory of the Liberal Party in the provincial elections of early 2003. The events of 11 September 2001 have increased national unity and dampened the public's appetite for secession. The economic viability of Quebec's independence also seems more questionable in the face of a downturn.
- **The Opposition remains weak** with no party able to mount a credible challenge to the Liberals for the foreseeable future. The Canadian Alliance is wavering on where to place itself to secure electoral advantage. Unpopular leader Stockwell Day resigned, but insisted on standing again in the March 2002 leadership election. However, he was beaten decisively by relative unknown Stephen Harper, who now faces a considerable challenge in mounting a credible opposition to the Liberals. Co-operation with the other main opposition party, the Progressive Conservatives, has been ruled out for the 2004 election. Peter MacKay became leader of the latter in mid-2003.
- **However, recent charges of corruption are weakening the government's position** and provide the opposition's best hope of making a dent in Liberal support. In May 2002, prime minister Jean Chrétien forced the resignation of two members of his Cabinet over sleaze charges. The opposition immediately accused him of hypocrisy and double standards, and said that at least eight other ministers, including Chrétien himself, should have been dismissed under the same standards.
- **Greater co-operation with the US, but Iraq Conflict proved divisive:** The 11 September 2001 terror attacks in the US fostered much closer security, defence, customs and immigration co-operation between Canada and its larger neighbour. North American economic integration is increasing at a rapid pace, and an active trade policy will continue to bind the two countries more closely. However, trade disputes will continue to surface. In early 2003 relations were dominated by Canada's refusal to join the attack on Iraq. This led to charges of disloyalty among some sections of the Bush administration, but tempers have since cooled.

Division of Power

Federal Government

Canada is a constitutional monarchy, parliamentary democracy and federal state. The head of state is the monarch - currently Queen Elizabeth II, who is represented within Canada by the governor general. The governor general is appointed by the Queen on the advice of the prime minister. The head of government is the prime minister, who is the leader of the party with most seats in the House of Commons. There are 301 seats in the House of Commons, who head the legislature through the parliamentary system. Seats are allotted for each province based on population - Ontario dominates with 101 seats of its own. In addition, there is a 105-member Senate, created by the 1867 Constitution Act to represent regional, provincial and minority interests against the potential tyranny of the Ontario majority. Senators are appointed by the governor general on the advice of the prime minister, and may have a political affiliation. They serve in the Upper House until the age of 75.

The last election was in 2000.

Provincial Government

Canada's provincial government is comprised of ten provinces and three territories. Each has its own capital city and is headed by a lieutenant governor (provinces) or commissioner (territories), under the advice of a premier (provinces) or government leader (territories). The federal government has a little more control over territory affairs, and only provinces are allowed to vote when a Constitutional change is proposed. In general, provincial and territorial responsibilities include property and civil rights, administration of justice, natural resources, education, health and welfare. In recent years, the strength of provincial governments has increased relative to the centre. The province of Quebec holds 15.5% of Canada's total population, including a majority of Canada's French speakers. It is home to an active separatist movement with its own political party.

Main Political Parties

- **Liberal Party:** The Liberals have held power since 1993, moving to a more centrist, tax-cutting position in recent years. The Liberal Party focused on its economic successes during the 2000 election. In general, the party favours a balance of tax cuts, debt reduction, social spending and aid to disadvantaged regions. It favours strong central government, and seeks to establish tough ground rules for any future separatist referendum. Socially, the Liberals oppose capital punishment, support the right to abortion and are seeking the introduction of a national firearms registry.
- **Canadian Alliance (formerly Reform Party):** The Canadian Alliance was formed through the defection of several Progressive Conservatives, including former leader Stockwell Day, to the Reform Party. The Alliance has struggled to differentiate its policies from the Liberals as they have gradually moved to the right. It fought the 2000 election on a platform of tax cuts, doubling debt payments, and gradually increasing healthcare spending. It is now most notable for being socially conservative, and has called for re-introduction of the death penalty, and tougher sentences for juvenile offenders. The Alliance became the subject of popular ridicule during the 2000 election due to its support for referenda on all issues that receive support from more than 3% of the electorate. It has since backed away from this stance. In March 2002 it elected a new leader, Stephen Harper, who is in favour of fiscally conservative policies and more power for provincial governments.
- **Bloc Quebecois:** The Bloc Quebecois was formed in 1990 to push for Quebec's 'sovereignty' (secession). It was expecting this to occur during the 1990s but has now fought three elections. It pushes for the rights of provinces during the election as a short-term goal, since independence remains elusive. The local version of the Bloc Quebecois, which contests provincial elections, is known as the Parti Quebecois.
- **Conservative Party:** The oldest rival to the Liberal Party, the Conservatives have lost ground in recent years. The party now focuses on aggressive free market economic policies, such as eliminating capital gains tax on personal incomes. In an attempt to pacify public concern, it has also pledged to show compassion and find funds to maintain Canada's extensive social security system.
- **New Democratic Party:** Founded in 1961, the NDP has its roots in socialist movements. It focuses on what it sees as Liberal policy failures on health, education and the environment. It fought the 2000 election on a platform of full employment, a balanced budget, selective tax cuts for lower income families, and higher taxes for the rich.

Key Political Players

Government Figures

Prime Minister	Jean Chrétien has been Prime Minister since 1993. He secured his third term in office in 2000, largely due to his sound macroeconomic policy and an inadequate opposition. Chrétien has had a prolific political career, running unsuccessfully for the leadership of the Liberal Party in 1984, but subsequently building up his support to be elected leader in 1990. He has generally been a popular leader (outside Quebec), but his support began to decline in the late 1990s as the public grew tired of Liberal rule. However, Chrétien was comfortably
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	re-elected to a historic third term in 2000, dispelling criticisms that he was arrogant and out of touch with the public. In August 2002 he finally announced his intention to step down as leader in 2004.	
	Finance Minister	John Manley , the deputy prime minister, became finance minister in June 2002 after Paul Martin was sacked. Martin was very popular and highly regarded, and widely tipped as the most likely successor to Jean Chretien. He is also credited with turning the Canadian economy around since the early 1990s. Manley is relatively inexperienced in comparison, but is also seen as pro-business and should have little trouble gaining the trust of the financial markets.
Premier of Quebec	Jean Charest of the Liberals achieved a remarkable victory in the 2003 Quebec elections, finally turving the separatists out of power in the province. Charest replaced the Bloc Quebecois' Bernard Landry. Charest is bilingual and was born close to the Quebecois city of Montreal, but is a strong supporter of federalism. He faces difficulty casting off his image as a stooge of the federal government, and showing that he can fight for Quebec's interests.	
Governor General	Adrienne Clarkson was appointed Governor General in 1999. She was born in Hong Kong and came to Canada as a refugee during the war in 1942. Clarkson has a long and distinguished career in broadcasting, journalism, the arts and public service. She was appointed an Officer of the Order of Canada in 1992.	
Monarch	Queen Elizabeth II: As part of the Commonwealth of Nations, Canada recognises the British monarch as head of state. Her role is symbolic. She chooses the governor general of Canada (on the advice of the prime minister) to act as her representative in the country.	
Non-Government Figures		
Next Prime Minister	Paul Martin is firmly poised to succeed outgoing Prime Minister Jean Chrétien during the Liberal Party Convention in November 2003, having raised US\$4.3 million for the party and with an internal party poll showing that his nearest challenger, current Deputy Prime Minister and Chretien's appointed successor John Manley, has only about 15% of party members supporting him. A right-of-centre Liberal and shipping tycoon who was finance minister until he was ousted by Chrétien last year over a dispute, has said he would try to repair US-Canadian relations that deteriorated under Chretien, who chose not to join the United States and Britain in the war in Iraq. Since then, tensions between Canada and the United States have grown. A bitter political rival of Chretien's since he was defeated by him in a race for the party leadership in 1990, Martin is largely credited with cutting Canada's deficit and reviving its economy.	
Leader of the Opposition	Stephen Harper was elected leader of the Canadian Alliance after beating Stockwell Day in the March 2002 leadership election.	

	He is relatively unknown outside conservative political circles, but has considerable policy experience and is regarded as being more solid and dependable than Day. He is thought to be uninterested in an alliance with the increasingly marginalised Progressive Conservatives, led by Joe Clark. He is known to favour fiscal conservatism and increasing the power of the provinces, particularly in the west of Canada, where he comes from. Concerns remain that he will fail to garner sufficient support in Ontario and the east, and that the Liberals will adopt his best ideas and undermine his attempts to differentiate the position of the Alliance without moving further to the right.
Bloc Quebecois Leader	Gilles Duceppe first led the separatist Bloc Quebecois as Interim Leader in 1996, which also meant that he was Leader of the Opposition. He was subsequently officially elected Leader in February 1997. He has vowed to continue the fight for independence, despite losing ground during the 2000 election.
Leader of the National Democratic Party (NDP)	Alexa McDonough became Leader of the NDP in October 1995 at the party's national convention. She was previously the Leader of the Nova Scotia NDP - the first woman to lead a party at provincial level. As national leader of the NDP, she was initially without a seat in the House of Commons, but managed to win a seat along with 20 other NDP candidates in 1997 and won re-election in 2000.
Leader of the Progressive Conservatives	Peter MacKay was chosen as the Conservatives' leader in mid-2003. The Member of Parliament for Nova Scotia only won the contest after four rounds of voting. His appointment was mired in controversy given the deal he struck with rival David Orchard to review the party's traditional commitment to free trade.

Political Stability

Election 2000

In November 2000 the Liberal Party was re-elected to a third term in office, after Prime Minister Jean Chrétien called an early vote to cash in on a booming economy. Many people questioned his decision before the event, but it ultimately paid dividends. The party extended its parliamentary majority by securing 173 out of 301 seats, while the opposition Canadian Alliance performed less well than expected, managing to capture only 66 seats. Nevertheless, the party secured its position as the official opposition, with the separatist Bloc Quebecois dropping from 44 to 37 seats. The New Democrats took 13 seats, leaving the remaining 12 to the Progressive Conservatives. Much like the Labour Party in the UK, the Liberals currently face little coherent opposition, and - assuming no dramatic changes - are likely to win a fourth term in 2004 or 2005.

2000 Election Results		
	Seats	% of Vote
Liberal Party	173	40.85
Canadian Alliance	66	25.49
Bloc Quebecois	37	10.72
New Democrats	13	8.51
Progressive Conservatives	12	12.19

total 301 seats

The Liberal Party

The Liberal Party has dominated the policymaking process for so long that many Canadians joke they are members of a 'one party' state. The Prime Minister Jean Chrétien has been in power for ten years. In August 2002, Chrétien shocked his party and his political opponents by finally announcing that he would not stand for

a fourth term, but would step down at the end of February 2004. At 68 years old, and having been prime minister since 1993, speculation over when and whether he would step down has been rife for the last few years. Chrétien portrayed the decision as a statesmanlike attempt to heal the emerging divisions in the ruling party, and now has 18 months to carve out his legacy. The prime minister has resisted speculation over when his retirement would be for many years, but bitter party infighting has finally forced him to name a date. Recent polls have indicated that the electorate has grown tired of him, and he has faced increasingly intense criticism over his autocratic style and failure to stem political corruption. At least four senior ministers had announced that they planned to run for Liberal leadership, but all but one has subsequently withdrawn from the race in light of the overwhelming popularity enjoyed by former finance minister and chief political rival of Chrétien, Paul Martin. Even Chrétien's favourite, deputy prime minister John Manley, backed down from challenging the popular shipping tycoon. The only other minister that remains in the race is heritage minister Sheila Copps, who has no chance of defeating Martin at the party's convention in November 2003.

Perhaps inevitably for a party that has been in power for so long, questions of ethics and corruption have recently dogged the political environment, and particularly the Liberal Party. A recent poll revealed that 70% of Canadians believe that federal and provincial political systems suffer from corruption. Controversy over the prime minister's role in the sale of a golf course in his constituency dogged his 2000 general election campaign, but ultimately he was returned with an increased majority. The fundraising efforts of future leadership candidates have also drawn fire due to the heavy overlap between partisan political fundraisers and official government duties. There have been questions over the power of cabinet ministers and calls for greater checks and balances since the jobs-for-influence scandal of former Minister for Public Works Alfonso Gagliano, who was dismissed from his cabinet post in the January 2002 reshuffle. In May 2002, Chrétien was forced to dismiss two of his ministers from their posts over giving jobs to friends and taking bribes. This was followed by the sacking of popular finance minister Paul Martin due to the inability of the two men to control their personal animosity and work together any longer. These issues only encourage backbench unrest, which has been straining at the leash of party discipline for some time now. Liberal MPs have broken ranks over several bills in the last few years, though opposition has not so far been enough to derail government policy. However, with Chrétien's retirement date set, it is possible that divisions may break into open warfare.

Key policy positions of the Liberals are as follows:

- Sound economic and fiscal management.
- Support of publicly-funded healthcare, even as this increasingly conflicts with fiscal priorities and there remain many unanswered long-term questions.
- Increased economic and political co-operation with the US. This was dealt a heavy blow, however, by Canada's refusal to join the war on Iraq in early 2003. This provoked much anger in the US, but relations are now improving once more.
- Ambiguity over environmental policy, embodied by its hesitation over signing the Kyoto treaty on global warming in April 2002.
- A low focus on security, which has been given increased prominence since the 11 September attacks raised fears that the military was under-funded and out of date.

The Divided Opposition

In March 2000, leader of the opposition Preston Manning stepped down from his position as head of the Reform Party in order to stand for the leadership of the Canadian Alliance, a new group that would seek to merge the rightist opposition parties. Although in effect the Canadian Alliance is the Reform Party renamed, the image overhaul was intended to attract members of the Progressive Conservatives (Tories), in order to improve electoral success in key areas like Ontario. Tory leader at that time, Joe Clark, stated that he would not officially merge the party with the new alliance, but some party members did defect, including Alberta treasurer Stockwell Day who successfully campaigned to become leader of the Alliance.

A disappointing performance in the 2000 parliamentary elections left the Canadian Alliance dejected and searching for a way to make inroads into the Liberal majority. Frustration bred a revolt against the leadership and in May 2001 eight members of the Alliance formed a breakaway faction after calling for Day's resignation as party leader. He was accused of being inept and dishonest, and many felt that his ultra-conservative views were alienating potential voters. In December 2001, Day announced his resignation, paving the way for a fresh leadership contest in March 2002, won by Stephen Harper. The contest focused on whether co-operation with the Conservatives was the best way to ensure future electoral success, and Harper so far has been clear on his intentions to go it alone. The biggest problem with this is the regional variation in support, with the Progressive Conservatives (Tories) having substantial electoral strength in areas where the Alliance is weakest. However, the counter-argument is that the Tories are fading increasingly into irrelevance, and they will not help the Alliance form a fresh and credible alternative to the Liberals. The Tories change of leadership in 2003 was not promising for them. Peter MacKay struck a contentious deal with rival David Orchard that agreed to review the party's traditional free trade slant.

Harper is planning to focus on broadening the base of his party's regional support, and appears both resolute and principled. There are certainly some chinks in the Liberal armour, but whether these can be widened to a chasm remains to be seen. The Reform Party was originally a regionally-based party, and Harper acknowledges that many of these voters do not yet see the Alliance as ready to form a government and seeks to resolve this issue before the next election. In a recent interview, he argued 'I think you can have a principled conservative party without being doctrinaire.' However, differentiating the Alliance from the Liberals, who have straddled the middle ground effectively and incorporated opposition party policies when it suits them, is going to prove a challenge. Canada's cosy governmental consensus is set to continue for the foreseeable future unless the opposition can ram home charges of corruption and capitalise on the public's disillusion with government.

Regional Tension: The Quebec Question

The relationship between federal and provincial governments defines much political debate in Canada. The most divisive and heated issue is that of the status of the French-speaking province of Quebec. Otherwise, the western provinces tend to push for more control over their natural resources, including vast supplies of energy reserves. The central, and more industrialised, part of Canada likes to throw its weight around in relation to economic development issues. On the Atlantic side, provinces have focused on defending the rights to their offshore fishing and mineral activities. Chrétien has sought, with moderate success, to return some powers to the provinces, whilst enhancing the federal role in areas such as inter-provincial trade and the regulation of securities.

There were two referenda in the 1990s on the secession of Quebec, and political gains by the separatists kept the question alive during the mid-1990s. The separatists narrowly lost out in 1995, gaining 49.44% of the vote to the federalists 50.56% on the issue. In the 1998 provincial elections, the separatist Parti Québécois was returned for another term having won 43% of the vote. However, victory celebrations were dampened somewhat due to the failure to win enough votes to call a quick referendum. Bouchard had been keen to win over 50%, which would have enabled him to call a referendum within six months. Support for the Quebec separatist movement subsequently dwindled and the party fell into third place behind the Canadian Alliance during the 2000 election.

The question of Quebecois sovereignty was thrown back into the political limelight in March 2001 with the election of outspoken firebrand Bernard Landry to the leadership of the PQ and, by implication, to the premiership of the province. His election followed the surprise resignation of the popular Lucien Bouchard who stepped down believing that he had done all he could, and that the issue of sovereignty had run out of steam under his leadership. Landry immediately announced his intention to bring self-government back to the top of the agenda, suggesting preparations were under way for a referendum on the issue before 2003. However, this ultimately proved fruitless and the Parti Québécois suffered a humiliating defeat by the Liberals in the 2003 provincial elections. This was the first outright victory for the federalists since 1990 and should push talk of secession onto the political backburner for some years.

Nationally, the Bloc Québécois will remain a significant force, although their support base is not sufficient to mount a serious challenge. Unless there is a marked shift in opinion, the 2003 provincial election bodes ill for the party at the next federal election. Many voters for the Bloc Québécois do not appear to be voting for separatism, but instead are content with a government able to strongly defend the province's interest against the interests of the federal government.

Foreign Relations: The US and 'Continentalism'

Canada's relationship with the US is inevitably going to be both close and ambiguous. It is heavily economically dependent, with 86% of Canada's exports going to the US. However, it is also highly alert to cultural and political encroachment from its powerful southern neighbour. The creation of NAFTA in 1993 led to extensive relaxation of trade barriers during the 1990s, and the proposed Free Trade Association of the Americas could increase the geographic scope of the agreement. Currently, the number of trucks travelling through the Toronto-Detroit corridor is 4.7m a year, and this is set to increase to 12m by 2020. In general, Canada benefited greatly from the US economic boom in the 1990s, and then escaped relatively lightly from the fall-out of the subsequent US recession. It has also gradually begun to approach the US in one key area where it has always lagged behind - that of productivity.

Despite the economic benefits that Canada accrued from the US during the 1990s, many highlighted the fact that growth remained comparatively slow, and that Canada was losing more than it was gaining. A central issue was 'brain drain' - Canadian tax rates are some of the highest in the world, and the consequent flight to the US of some of its most talented citizens has been a media obsession for many years. However, Canada's high taxes are used to maintain social services, such as a comprehensive, publicly funded health system. All sides of the political spectrum agree that this should be maintained, and few would wish to invite what are regarded as America's worst free market excesses, such as violence and social inequality. In many respects, Canadian

attitudes to the role of government are closer to Europe than the US, and ultimately slower economic growth is seen as an acceptable price to pay.

Culturally, Canadians are keen to maintain a distinct identity from the US, and have moved to protect their media and banking industries from the encroachment of American big business. Politically, increasing fragmentation and stronger provincial power have been stronger tendencies than 'continentalism', or co-operation with the US. For a time following the September 2001 terror attacks there was a stronger sense of solidarity, and much closer national security co-operation was introduced. However, much of the goodwill subsequently evaporated with the Iraq conflict in early 2003. Canada refused to participate in the campaign and was fiercely attacked in the US. Bridges have been rebuilt subsequently, but suspicions will remain. Whatever the state of headline diplomatic relations, economic integration continues deepening and widening through NAFTA.

Indigenous Affairs

The issue of greater autonomy for the country's indigenous communities was once again raised in May 2001. The signing of an agreement between the government and the Mohawks of Kahnawake gave the 7,000-strong group greater powers of self-governance. The agreement, replacing the existing Indian Act, gives the community control over its own policing, education and administration of land, although it does not touch directly on the issue of sovereignty. It will nevertheless form the foundation for future agreements with indigenous groups.

The Mohawk agreement follows a similar pact agreed in early 1999, after 15 years of discussion with the federal government. This gave the Inuit people of north-western Canada their own territory, known as Nunavut. Although it will remain within the federation, it will enjoy a strong degree of autonomy and will have its own government and parliament. The inauguration of Nunavut is a landmark move in Canada's increasing recognition of native land rights, and will galvanise other indigenous groups throughout the country to move for greater concessions. Many groups push for compensation rather than reclaiming the land and instituting self-government. In April 2002, the Quebec government reached an agreement with the Cree Indians to pay over US\$2.2bn over 40 years to settle other disputed land claims. The payments include royalties from hydro projects already located on Cree land that supply over half of Quebec's electricity.

Outlook

Chrétien's absolute majority in the November 2000 election gave the Liberals a strong political base for the next five years. Campaign pledges to increase spending on healthcare and research and development, cut taxes, encourage the new economy and reduce the nation's federal debt have been partially fulfilled, and recent signs of an economic recovery should aid the completion of that task. In January 2002, Chrétien presided over the first major Cabinet reshuffle since before the 2000 election. This was an attempt to breathe new life into a cabinet that has become increasingly fractious and divided as speculation over his imminent retirement has increased. Chrétien also signalled that he favours John Manley as the next prime minister, by promoting him to deputy and giving him a greatly enhanced role in the day-to-day running of the government. However, the recent dismissal of Paul Martin, who was the heavy favourite to succeed Chrétien, has highlighted the growing divisions within the party. Chrétien repeatedly dismissed calls to resign and showed a disregard for the needs of party unity in comparison to his own ambitions. However, in August 2002 he finally bowed to political pressure and said he would step down at the end of his term. By setting a departure date, Chrétien has circumvented the potential humiliation of a leadership battle, but has risked appearing an ineffectual leader. He tried to influence the leadership battle, and do all in his power to ensure that John Manley would succeed him as prime minister, but to no avail. Paul Martin will take over as Liberal Party leader following the withdrawal of Manley from the race.

The Quebec question should continue to recede in importance, particularly since the Liberals' outright victory in the 2003 provincial election. The 2001 terrorist attacks in the US helped push the national psyche towards greater national and continental co-operation, and accelerated public disenchantment with the interminable separatism debate. More broadly, decentralisation of powers to the provinces is nonetheless likely.
















The main opposition party, the Canadian Alliance, will continue to flail around until a policy direction is agreed and clarified. The election of Stephen Harper brings this goal closer than it was under the divisive Stockwell Day, and Harper may increase support and interest from the electorate in the party. However, there remains a struggle with clarifying the party's direction. The Liberals have been very effective at moving into the political middle ground, and have left the Alliance with an unenviable choice. The party could try to move to the centre, but would have problems differentiating its policies. It could, on the other hand, move further to the right but might become isolated and alienate voters further. There has long been a consensus among critics of the government that the only hope of a credible national challenge to the Liberals is for an umbrella party to unite right-leaning opinion. However, attempts so far have failed decisively and fulfilling this goal seems

questionable. Stephen Harper has the resolve to lead the party and redefine its role, and has made it clear that he will not co-operate with the Progressive Conservatives simply in order to win votes. However, his main hope remains that the electorate will grow increasingly dissatisfied with the complacency of the government, and call for a new, fresh direction in 2004. In this spirit, the opposition is driving home charges of corruption and noisily accusing the Liberals of hypocrisy at every possible opportunity.

Useful Links

- Governor General of Canada: <http://www.gg.ca>
- Parliament: <http://www.parl.gc.ca>
- Prime Minister's Office: <http://www.pm.gc.ca>

Canada (Country Analysis) : Political - Recent Updates

1. 18/12/2003 -  **COUNTRY** **New Prime Minister to Make his Mark on Canada** (Special Report)
 2. 18/12/2003 -  **COUNTRY** **Government Freezes All Major Capital Spending Projects in Canada**(In Brief)
 3. 17/12/2003 -  **COUNTRY** **New Canadian Prime Minister Doing What He Does Best - Cutting Spending**(In Brief)
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 5. 16/12/2003 -  **COUNTRY** **Losing Candidate for Prime Minister of Canada Turns Down US Ambassadorship**(In Brief)
 6. 16/12/2003 -  **COUNTRY** **New Prime Minister Paul Martin Set to Make His Mark on Canada** (Top Story)
 7. 12/12/2003 -  **COUNTRY** **Paul Martin Sworn In as Canadian Prime Minister Today**(In Brief)
 8. 09/12/2003 -  **COUNTRY** **Muted Celebrations, Defections Mark Inauguration of Canadian Conservative Party**(Main Story)
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 11. 24/11/2003 -  **COUNTRY** **Conservative MPs in Canada File Lawsuit to Prevent Party Merger**(In Brief)
 12. 24/11/2003 -  **COUNTRY** **UN Resolution Condemning Human Rights Situation in Iran Pushed by Canada**(In Brief)
 13. 19/11/2003 -  **COUNTRY** **Retiring Canadian Prime Minister to Step Down on 12 December** (In Brief)
 14. 17/11/2003 -  **COUNTRY** **New Leader Endorsed at Canadian Liberal Party Convention** (In Brief)
 15. 10/11/2003 -  **COUNTRY** **Citizen of Canada Tortured by Saudis Accuses Canadian Government of Inaction**(In Brief)
-

Economic Environment

Current as of Tue 15 Jul 2003

Economic risks: 1.50

The Canadian economy has generally performed strongly despite the recent economic downturn. It rode alongside the US's economic boom in the 1990s. While having many similarities to Australia in terms of economic size, living standards, 'dollar bloc' linkages, continuing importance of primary product exports, these similarities have begun to diverge on external balances and external debt. Unlike Australia, since the earlier build-up in the 1980s of a significant external debt burden, primarily from recurring current-account deficits, with the federal debt problem compounded by increasing provincial indebtedness, Canada has been able to first stabilise and then reduce external debts ratios significantly. The current account has been brought much closer to balance and the fiscal position into a broad, comfortable, albeit small, surplus. In addition, NAFTA has been a net positive for Canada's external finances. Productivity remains lower than in the US, which is a primary reason why capital tends to shy away. However, the impressive recent recovery, which meant that Canada was the first of the G7 countries to raise interest rates in the current cycle, has added to steadily advancing productivity to enhance Canada's strong investment prospects and performance.

Canada - Economic Data

	1997	1998	1999	2000	2001	2002e	2003f
Domestic Data							
A - GDP Growth %	4.2	4.1	5.5	5.3	1.9	3.3	2.3
B - Household Con. % Change	..	..	3.8	4	2.6	3.4	3.4
C - Gross Fixed Cap. % Change	..	..	7.4	5.6	4.1	1	3
D - Gov. Consumption % Change	..	..	2.4	2.4	3	2.6	3.1
E - Exports (G+S) % Change	..	..	10.7	8.8	-3.1	-0.1	-2.1
I - Industrial Production % Change	..	..	5.5	5.1	-3.4	2	2.3
J - Inflation %	1.6	1	1.7	2.7	2.5	2.2	2.9
K - Budget Balance % GDP	0.8	0.5	0.1	1.6	3	1.4	0.8
L - Leading Interest Rate %	5	6.6	4.75	5.75	2.25	2.75	3.25
M - Unemployment Rate %	9.2	8.3	7.6	6.8	7.2	7.6	7.4
N - GDP \$bn	637.5	616.8	861.6	907	924.4	954.7	976.8
O - GDP % of UK	48	43.3	59	62.95	64.97	62.07	59.33
P - GDP % of US	7.7	7	9.29	9.23	9.17	9.16	8.97
Q - GDP Per Capita \$	21290.9	20414.2	21665	23335	22730	23114	23561
R - GDP Per Capita % of UK	94.6	84.9	88.27	96.71	95.76	90.41	86.42
S - GDP Per Capita % of US	68.6	62.9	63.75	66.64	64.27	63.82	62.9
T - Population m	..	..	30.49	30.75	31.01	31.27	31.53
U - Stock Exchange Index	428	353	519	552	465	395	420
V - 10 Year Bond Yield %	..	..	6.26	5.4	5.36	4.79	4.57
External Data							
X - \$ to Currency	1.43	1.53	0.69	0.67	0.63	0.63	0.61
AA - Exports \$m	219063	220539	519050	551810	464660	395440	420000
AB - Export Growth %, y-on-y	6	0.7	30.66	6.31	-15.79	-14.9	6.21
AC - Imports \$m	-200498	-204617	-327000	-362200	-350600	-356500	-350500
AD - Import Growth %, y-on-y	15	2.1	7.78	10.76	-3.2	1.68	-1.68

AE - Trade Balance \$m	18565	15922	192050	189610	114060	38940	69500
AF - Total Export Earnings \$m	..	..	358700	390400	378300	378000	370000
AG - Current Account Balance \$m	-8233	-7839.4	7779	10765	-3203	1683	-1683
AH - Current Account % GDP	-1.3	-1.3	0.9	1.19	-0.35	0.18	-0.17
AJ - Capital Account Balance \$m	..	..	-6470	-14295	-15008	-7541	-2355
AK - Reserves (minus gold) \$m	17822.6	23307.5	28126	31924	33962	32760	31220
AL - Reserve Import Cover - Months	1.1	1.4	1.03	1.06	1.16	1.1	1.07
AM - Foreign Direct Investment \$m	11522.8	22742.5	24488	66017	27438	24667	28960
AN - Foreign Direct Investment % GDP	1.8	3.7	2.84	7.28	2.97	2.58	2.96

Notes: B-E Real Changes (Minus Inflation); L - Overnight Target Rate; U - TSE 100 Index; X - US\$: Canadian Dollar

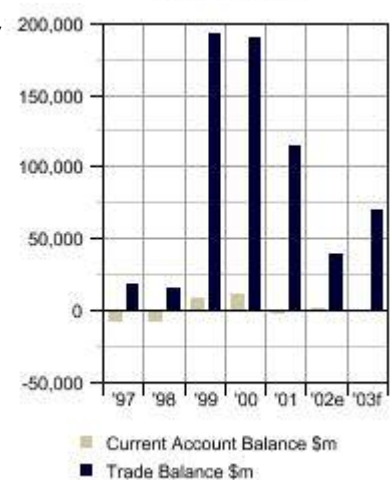
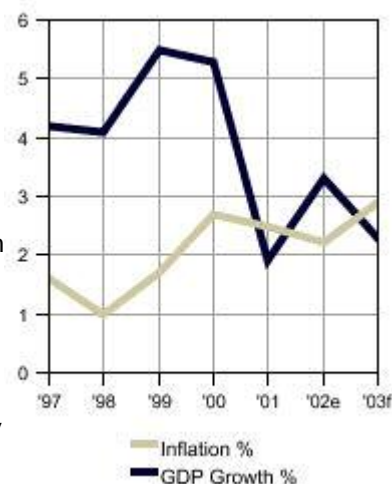
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[WMRC Forecasting Methodology](#)

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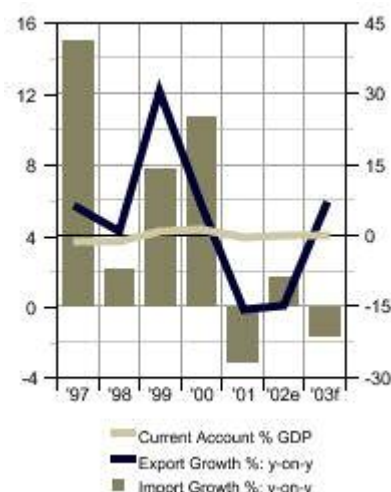
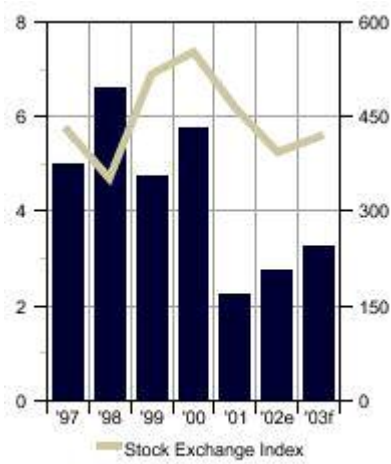
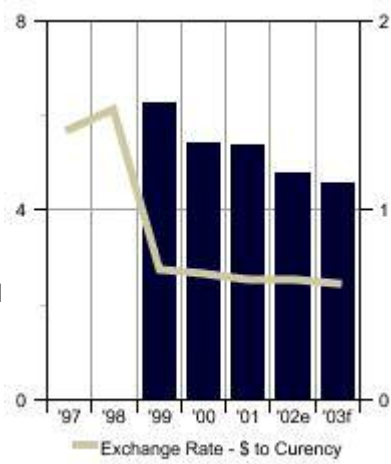
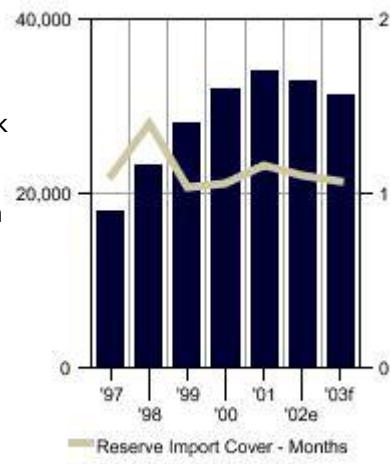
Current Highlights

- Canada Has Been the First of the G7 to Emerge from the Global Downturn:** During the current global economic slowdown, Canada only recorded one quarter of output decline. The Bank of Canada, going against a trend followed by other developed economies, increased interest rates on two separate occasions in mid-2003, citing a 'robust recovery' and a need to tame inflation. Although there is still some room for doubt over this decision, there is no doubt that the economy has performed exceptionally well in recent years, escaping the brunt of the US-led recession due to strong consumer spending and a healthy housing market.
- Business Investment and Household Spending Remain Relatively Strong, but External Shocks Still a Concern:** Despite concerns about stagnant business investment and household spending, heightened by the fear that the US economy would experience a 'double-dip' recession, both have remained fairly robust. However, it is still possible that the economic recovery will be hampered by oil price shocks and stock market uncertainty. Overall GDP growth is expected dip slightly to 2.8% this year due, in part, to losses stemming from the outbreak of Severe Acute Respiratory Syndrome (SARS) and subsequent downturn in tourism and business-related travel, and the US ban on Canadian beef after a case of mad cow disease was discovered.
- Strong Fiscal Consolidation at Federal and Provincial Levels Has Put Key Public Debt Ratios on a Steadily Declining Trend:** Both the so-called structural and overall budget balance have been in surplus since 1997. This has been achieved despite the recent slowdown, and has enabled the steady reduction in the key public debt ratio from a peak of 72% of GDP in 1993 (with the external debt ratio here at 48% of GDP) - to around 50% of GDP in 2003. This has greatly reduced the dangers of Canada suffering a reprise of the severe recessions in the



early 1990s.

- Interest Rates Rising:** Interest rates began a tentative climb in early 2002 to help stabilise inflation. This pattern continued in 2003. The Bank of Canada no longer sets interest rates in a copycat pattern to the US, instead deciding the rate at eight appointed dates during the year. Interest rates were cut by a total of 350 basis points during 2001, which was substantial but still less than the US Federal Reserve's 475 basis point cuts, and in 2002, Canada raised rates 75 basis points.
- Considerable Tax Cuts, But Within Prudential Limits:** In late 2002, several tax reductions and reforms were put into place. Marginal tax rates were lowered from 17% to 16% on lower incomes, from 26% to 22% for middle incomes, and from 29% to 26% for top incomes in 2002. The deficit-reduction surtax was eliminated altogether. Corporate taxes will be reduced from 28% to 21% over five years and capital gains taxes have been reduced. Finance Minister John Manley is credited for exercising appropriate prudence with these cuts and with keeping government spending in line with revenues, which still allowed for a surplus of 0.25% of GDP.
- Canadian Dollar Reaches a Three-Year High:** The Canadian dollar was trading at record levels in mid-2003, appreciating 8.2%, on average, since October 2002. Increases in value are due to the resilient domestic economy, favourably variable interest rates and strong commodity prices. The falling value of the US dollar has also contributed to this, as foreign currencies look for alternative safe havens.
- Export Markets Remain a Sensitive Area, Particularly Given the High Reliance on the US:** Trade co-operation were somewhat damaged by disputes over softwood and tomatoes. However, Canada has escaped the brunt of recent US steel protectionism, reflecting the benefits of the NAFTA trade bloc. Officials recently came to an agreement with the European Union on Canada's phasing out the use of European names for wine sold in Canada, which marks the opening of a broader dialogue on trade co-operation. Overall dependence on the US remains high and makes Canada somewhat more sensitive to economic fluctuations than its excellent fiscal and macroeconomic structure might otherwise indicate.



Economic Performance and Prospects

Recent Performance: Canada Shakes off US-Generated Recession

In contrast to the continuing doubts hanging over the US economy, Canada's performance in the current global context has been impressive. It was the first of the G7 group of economies to raise interest rates in early 2002, and will be one of the strongest performers out of the group both this year and next. The roots of this performance lie in economic structure, fiscal prudence and fortunate policy decisions. Canada's high production of both lumber and automobiles has enabled it to benefit from the few sectors that have remained buoyant within the US - consumer durables and homebuilding - although the 2003 outbreak of Severe Acute Respiratory Syndrome (SARS) stunted growth in the tourism sector. The government has repeatedly staked its reputation on fiscal prudence, and maintained a budget surplus through the last (albeit brief and mild) recession. Indeed, the 2002 budget surplus came in better than expected, at around US\$3bn. This comfortable performance looks likely to hold for the foreseeable future, barring any economic shocks. Canada invested less in technology during the late 1990s boom, so has suffered less from the recent slowdown. Canadians also invest less of their wealth in stocks than Americans, and so household net worth has fallen far less sharply.

Stellar Growth Leading Up to 2001

The Canadian economy ended the 1990s with a strong performance, underpinned by the sound macro-economic policies put in place during the decade. Real GDP grew at an average annualised rate of 5% between the last quarter of 1998 and the third quarter of 2000, broadly in line with growth in the US. The strong pace of economic growth pushed the economy to levels of resource utilisation that were not seen during the previous 25 years. The slowdown started to kick in in the final quarter of 2000, following in the US's wake. Canadian growth slipped into negative territory during the third quarter of 2001, but over the year growth was still 1.5%. Ultimately the economy was to escape relatively unscathed. Unemployment did rise from its historic low of 6.5% in June 2000, but at a slower pace than in the US.

External Balance

The external current account shifted from a deficit of 0.5% of GDP in 1999 to a surplus of 1.8% of GDP in 2000, reflecting strong US demand growth, together with some recovery in commodity prices. The surplus was maintained through 2001, though it fell slightly to 1.3% due to weaker US demand and a moderation in commodity prices. 2002 saw the account surplus rise, again, to 2%. In the capital account, direct investment inflows fell dramatically, turning negative in 2001. At the same time, net purchases of foreign stocks rose and capital outflows were up as a result. A sharp improvement in trade surplus has been mainly propelled by buoyant export growth to the US, particularly in non-automotive manufacturing exports. Furthermore, consumer spending and business investment have continued to grow, although a prolonged downturn in the US could begin to impact more significantly on these. The deficit in net investment income has also declined, partly reflecting the cumulative effects of lower interest rates and a more recent rebound in the foreign earnings of corporations.

Currency

The Canadian dollar has risen to its highest value in three years, but is still widely regarded as being undervalued at 5% below its average in the mid-1990s. It weakened during 2001, from a high of C\$0.67:US\$1 at the beginning of the year, sinking to C\$0.63:US\$1 by the end. 2001 mirrored a longer-term depreciation, with the Canadian dollar falling at an average of -3% a year between 1991 and 2000. Canadian productivity levels remain 0.4% below those in the US, but are still stronger than other G7 countries such as France, Italy and Japan. However, with the Canadian economy currently more robust than its neighbour and the value of the currency actually well in line with its fundamental determinants, the Canadian dollar should benefit in the medium term. The recent interest rate decisions have driven up its value against the US dollar, though this trend has recently been reversed. Overall, Canada's flexible exchange rate continues to benefit the country, reflecting cyclical conditions and helping to cushion the impact of the US slowdown. Strong macroeconomic fundamentals should continue to support the currency, though the exchange rate will remain heavily influenced by fluctuations in non-oil commodity prices. There has been some discussion in the past of an EU-style monetary union with the US, which would have the benefits of a common currency and harmonisation of standards. However, the present flexible exchange rate system has the advantage of a high degree of freedom for short-term macroeconomic management.

Macro-Economic Policies

Monetary Policy

Monetary policy has traditionally been closely allied to the US, and it has been normal practice for the Bank of Canada to toe the US Federal Reserves line. However, the Bank began to take a more independent line in 2001 by scheduling eight set dates during the year on which to discuss interest rates, freeing it from a copycat attitude to US rates. The announcement of set dates has also helped the authorities to operate monetary policy effectively and keep inflation within the target rate of

between 1% and 3%. This has helped to reduce uncertainty in financial markets, and to highlight the significance of domestic economic conditions in settling monetary policy. Since setting the dates, the Bank has taken action outside them only once. A slight divergence in policy from the US has resulted from the new system.

In April 2002, the Bank of Canada, citing a 'robust recovery' perhaps prematurely, raised interest rates for the first time since March 2000, and followed this with a further 0.25% rate rise in July. Rates were again raised by 25 basis points on two separate occasions in the spring of 2003, raising the overnight target rate to 3.25%. The decisions are highly significant for two reasons. Firstly, Canada is the first of the G7 countries to raise rates in the current cycle, with no other country yet committed to monetary tightening. Secondly, Canada's interest rate decisions until April 2002 closely mirrored those in the US.

Fiscal Policy

The commitment of the Canadian authorities to fiscal discipline is reflected in the reversal of the budget balance since the Liberals took power in 1993. Almost three decades of chronic deficits were turned around, and by 2000/1 there was a surplus amounting to 1.5% of GDP (from a 5.75% deficit in 1993/4). This improvement has mainly been due to targeted cuts in spending and has resulted in a substantial reduction in net federal government debt. This was at over 70% of GDP in 1995/6, but is now down to around 50% of GDP. It has also raised the rate of gross national saving and reduced the reliance on foreign saving. Along with an increase in corporate saving, this has helped offset the fall in personal saving. Personal and corporate sector balance sheets remained generally sound during the recession, unlike in the US where they increased still further from already (arguably) unsustainable levels. Automatic fiscal stabilisers have also been put in place, which provided fiscal stimulus during the recession and removed the need for further fiscal easing in the December 2001 budget.

Former Finance Minister Paul Martin's budget proposals for the financial year ending 31 March 2001 painted an upbeat picture of the recovering Canadian economy, with cautious tax cut and spending proposals. This picture had somewhat shifted by the budget of December 2001, where caution was the dominant theme. The budget stood by the C\$100bn in tax cuts promised before the election, and also awarded the C\$23bn in extra spending promised to the healthcare system. Other social spending plans were abandoned in favour of enhancements to defence and domestic security that were necessary in the wake of the 11 September 2001 terrorist attacks in the US. The tax breaks will help stimulate the economy by encouraging the business sector, which has suffered from comparatively high taxes compared to the US. And, as Martin stressed, the measures introduced allowed the budget to remain in surplus (just) during 2002.

The Canadian government is one of the few major industrial countries to have taken action to deal with the long-term financing problems of its public pension plan. The future liabilities of the Canada Pension Plan (CPP) have been partially prefunded by the government to meet benefit payments without increasing payroll tax rates. A formal review of the financial condition of the CPP is also required every three years. The CPP is also the only public pension plan in the G7 countries to invest directly in private securities. However, the long-term future of the health system remains far more problematic. Both the federal and provincial governments are committed to improvements in healthcare, but the ageing of the population will continue to increase the burden on the system.

Financial Markets

Yield Curve Resumes a Normal, Positive Slope, on Bond Markets' Recovery Expectations

The Canadian yield curve has steepened considerably, with yields at the long end rising to roughly 6% and further interest rate cuts by the Central Bank factored in at the short end. The rise is the result of both a positive economic outlook and higher inflation expectations by bond markets. It mirrors the reversion of the US bond yield curve from inversion in mid-2000 to a reversion back to a normal, positively sloping yield curve following successive interest rate cuts at the short end in H1 2001. After an earlier period over 1997-2000 involving a negative interest rate spread over equivalent US treasuries at the short end of the yield curve, a small positive interest rate spread has since resumed of between 20-50 basis points. This is expected to remain the case over the medium term.

After a Consolidation Period, Banking Sector is One of the Soundest in the World

Stock prices have fallen recently as a result of the slowdown, but personal and corporate sector balance sheets remain generally sound. Similarly, although Canadian banks and financial institutions have undoubtedly suffered recently, major loan problems have not emerged, and the overall capitalisation and earnings levels of the sector remain high. Banks have managed their exposure very well throughout the mild recession, applying appropriate provisions against potential bad loans, tighter lending standards and diversifications of business lines. More broadly, Canada has a highly advanced financial system that is among the soundest in the world. The profitability, asset quality and capitalisation levels of Canada's financial institutions remain very high, enabling them to further strengthen their capitalisation levels. There has been recent legislation to reform the financial sector by reducing barriers to entry, such as required capitalisation levels, and make it easier for non-banking institutions to engage in banking activities. This will not have much effect in the short term but should help increase efficiency in the long term. Finally, there are some concerns that a recent rise in asset prices appears to be limited to equity. A sharp decline in real estate prices in the early 1990s suggests that current equity market valuations are primarily a hi-tech phenomenon. Household equity wealth and personal disposable income has risen and financial institutions must be on guard against a drop in equity prices, which would result in a deterioration in equity wealth.

Economic Development

Fundamental Improvements in the Economy Set Against Improved Macro-Economic Stability.

Canada is a federation of ten provinces and three territories and is a member of the G7, OECD and NAFTA. Canada's economy tends to register as the seventh-largest in the world at just under half the size of the UK and more than twice the size of Belgium. Per capita incomes are among the highest in the world and very similar to Australia's. The economy has tended to enjoy fairly robust growth, averaging annual GDP increases of 3.3.% during the 1980s and 2.7% during the 1990s. Apart from 2001 GDP growth has been stronger still in recent years. The country rode alongside the US's 'Clinton Boom' during the late 1990s. The recent US slowdown was always going to hurt Canada as the US accounts for almost 85% of its exports and 73% of its imports (2001 figures), although the impact was not as severe as it might have been.

While having many similarities to Australia in terms of economic size, living standards, 'dollar bloc' linkages and the continuing importance of primary product exports, these similarities have begun to diverge on external balances and external debt. Unlike Australia, since the earlier build-up in the 1980s of a significant external debt burden primarily from recurring current-account deficits, with the

	Public Debt	
	Total Public Debt % GDP	General Govt Gross Debt
1997	64	117.4
1998	60	116.2

federal debt problem compounded by increasing provincial indebtedness, Canada has been able to first stabilise then reduce external debt ratios significantly, as the current account has been brought much closer to balance and the fiscal position into a broad, comfortable, albeit small, surplus. In addition, NAFTA has been a net positive for Canada's external finances. Most significant has been the attraction of much higher levels of foreign direct investment over the last few years.

1999	55	111.6
2000	50	110.0
2001	52	112.0
2002	49	108.0
2003f	43	106.0

Source: Ministry of Finance, Forecast WMRC

A Fundamental Change in the External Sector from the North American Free Trade Agreement (NAFTA)

The Canada-United States Free Trade Agreement (FTA) came into effect on 1 January 1989. The FTA provided for the gradual elimination of tariffs and reductions in non-tariff trade barriers on goods by 1 January 1998. The FTA was incorporated into an improved instrument, the North American Free Trade Agreement (NAFTA) on 1 January 1994 by including Mexico and extending free trade to other important sectors, such as investment, trade in services, intellectual property, competition, the cross-border movement of business persons and government procurement.

NAFTA has therefore made Canada an attractive prospect for investors seeking to export to the US market tariff-free. Trade between Canada and the US has doubled subsequent to NAFTA coming into effect and the two make up the largest bilateral trading partnership in the world. NAFTA eliminates restrictions on the flow of goods, services and investments in North America. In addition to phasing out tariffs, NAFTA eliminates, as far as possible, non-tariff barriers and promotes safeguards for intellectual property rights - patents, copyrights and trademarks. The pact also includes provisions on trade rules and dispute settlement, and its parallel labour agreement seeks to ensure full protection of worker rights.

Regional Economic Integration - the Free Trade Area of the Americas (FTAA)

The Free Trade Area of the Americas (FTAA)

The FTAA will encapsulate 34 countries throughout North and South America, covering an area stretching from Alaska in the north to Cape Horn in the south. The only exceptions are Cuba, for political reasons, and French Guiana, which is technically a part of France. The FTAA aims for the eventual elimination of trade tariffs between all participating countries.

It will link 825m people (15% of the world's population). It was first touted as an idea by then-US President George Bush Snr. The region produced more than US\$11.4trn in goods and services in 1999 and about US\$2.7trn in cross-border trade.

The Free Trade Area of the Americas (FTAA) is an ambitious plan for regional integration that proposes the most extensive changes to the economic make-up of the continent through the biggest free trade area in the world. The tariff-free bloc, comprising all countries in the Americas - bar Cuba and French Guiana - has been scheduled for implementation in December 2005. The project - touted as a launchpad for the 'century of the Americas' - is to be overseen by the Organization of American States (OAS).

The following points were included in the Quebec Agreement, drafted in April 2001, as the basis of the FTAA:

- FTAA talks to conclude by January 2005, with the agreement to take

- effect by December 2005.
- Consultation on whether countries that suffer a 'disruption' to their democratic process should be allowed to participate in the process.
- Role of OAS reinforced as defender of representative democracy.
- Commitment to reaching international development goals, in particular the reduction by 50% of the proportion of people living in extreme poverty by 2015.
- Promotion of compliance with International Labour Organization (ILO) standards.
- Commitment to anti-drug strategy in the hemisphere.
- Support for the strengthening and enhancing of the Inter-American human rights system.
- Pledge to reinvigorate the fight against corruption.
- To welcome the contributions of civil society, including business and labour organisations, to the summit's Plan of Action.
- Preliminary draft negotiating texts to be released to public.

Keen to take on board the concerns of labour, environmental and human rights groups, the agreement contains concessions to these groups, including a clause obliging signatories to observe democratic norms, 'making [democracy] an essential precondition for participating in the process of the Summit of the Americas'. Countries that fail to live up to such standards could be suspended from future summits or even kicked out of the FTAA. The OAS has been set up as the institutional body selected to defend representative democracy in the region. In an extension of the spirit of transparency and inclusion, the text of the agreement will be made public for the first time. Preliminary draft negotiating texts will be released as part of a commitment to 'transparency and to increasing and sustained communication with civil society'.

The FTAA Timetable	
Begin negotiations	May 2002
End negotiations	January 2005
Implementation	December 2005

While the North American Free Trade Agreement (NAFTA) remains the most logical blueprint for the FTAA, a free trade treaty between Canada and Costa Rica - the region's first trade pact between a big developing country and a smaller less developed one - has been hailed as a potential model for the FTAA. It allows Costa Rica to lower its tariff barriers at a slower rate than Canada, in order to prepare for the greater competition. Minimum labour and environmental standards - opposed by poorer countries as non-tariff barriers - have been excluded from the treaty and, unlike NAFTA, there will no sanctions or fines for breaches of the pact. The agreement has been celebrated as a positive example of the way in which smaller economies can feel comfortable in a big free trade pact with some concessionary clauses in place.

Proponents of the FTAA argue that it will lower prices for consumers and provide new markets for the strongest industries in each member country. It will eliminate tariffs on goods moving between countries, streamline customs regulations, and remove quotas and subsidies as impediments to regional trade, creating the largest free trade area in the world. Opponents, meanwhile, insist that globalisation will ease the exploitation of cheap labour and encourage more lax environmental standards. They also point to the NAFTA precedent, arguing that investor protection provisions allow foreign companies to sue member states if they believe the government has taken harmful action to reduce the value of their investment. There are also persistent doubts as to whether such a disparate group of nations with such differing political ideologies can find common ground.

Private Investment

Since the mid-1980s, the size of the public sector has been substantially reduced and the economy has become increasingly open to foreign participation. Consistent levels of growth have been recorded since the recession of 1990-1991.

The falling cost of capital equipment has pushed levels of real private investment significantly higher than those seen in the last three decades. Gross private investment, measured in nominal terms, has hovered at around 18% of GDP since 1997, below average when compared with the 1970s and 1980s. However, the rate is well above its average in real terms, with the price of capital equipment falling quicker than in comparison with any other G7 country, at an annual rate of around 1.5% since 1994.

Significant Sectors

Canada: Structure 2001				International Trade 2001			
(1) Economy		(2) Export Profile		(3) Export To...		(4) Import From...	
%	Sector	%	Item	%	Country	%	Country
71	Services	10	Mining and Oil & Gas Extraction	85	US	73	US
27	Industry	46	Manufacturing	2	European Union	3	European Union
2	Agriculture	10	Information & cultural activities	2	Japan	3	Japan
		14	Finance & Insurance	2	United Kingdom	3	United Kingdom
		9	Services	3	Other countries	8	Other countries

Source: Statistics Canada

Useful Links

- Bank of Canada: (www.bank-banque-canada.ca/)
- Canada Investment and Savings: (www.cis-pec.gc.ca)
- Department of Industry: (www.ic.gc.ca)
- Statistics Canada: (www.statcan.ca)

Canada (Country Analysis) : Economic - Recent Updates

1. 18/12/2003 -  **COUNTRY** **Government Freezes All Major Capital Spending Projects in Canada**(In Brief)
2. 16/12/2003 -  **COUNTRY** **New Prime Minister Paul Martin Set to Make His Mark on Canada** (Top Story)
3. 07/11/2003 -  **COUNTRY** **Supreme Court of Canada Endorses Landmark 'Polluter Pays' Law** (Main Story)
4. 05/11/2003 -  **COUNTRY** **Opposition Parties Grill Canadian Finance Minister Over Budget**(In Brief)
5. 03/11/2003 -  **COUNTRY** **Study Highlights Growth of Canada's Knowledge Economy** (In Brief)
6. 29/10/2003 -  **COUNTRY** **Poll Shows Canadians Want Improved Ties to US** (In Brief)
7. 16/10/2003 -  **COUNTRY** **Labour Unions in Canada on the Decline** (In Brief)
8. 19/09/2003 -  **COUNTRY** **Canadian Prime Minister's Heir Apparent Lays Out Economic Proposals**(In Brief)
9. 08/09/2003 -  **COUNTRY** **US Reauthorises Limited Beef Imports from Canada** (In Brief)
10. 01/09/2003 -  **COUNTRY** **Canadian GDP Slips as Diseases Hit** (Main Story)

11. 12/08/2003 -  **COUNTRY** **Airline Unions in Canada Granted Access to Investors**(In Brief)

12. 11/08/2003 -  **COUNTRY** **Beef Flowing from Canada to US Again Following Mad Cow Scare** (In Brief)

13. 01/08/2003 -  **COUNTRY** **Proposed Agreement Between Canada and the US Over Lumber Fails**(In Brief)

14. 25/07/2003 -  **COUNTRY** **Government Sponsors Aircraft Purchase Loan Programme in Canada** (In Brief)

15. 23/07/2003 -  **COUNTRY** **Union and Canada Post Agree on Settlement**(In Brief)

Legal Environment

Current as of Thu 18 Dec 2003

Legal risks: 1.00

The legal system is mature and well-defined. Foreign investment is given equal treatment and incorporation processes are simple. A foreign investment act, introduced in 1985, has been reinforced by Canada's entry into NAFTA.

Overview

The legal system in Canada is derived from English common law and prevails throughout Canada, with the exception of Quebec, where civil law is based on French law. Judicial law is similar to that of England. Canada has a Charter of Rights and Freedoms, which guarantees basic precepts of equality and is generally not affected by legislation.

All investment is governed by the Investment Canada Act (ICA) of 1985. The ICA was enacted in order to promote investment by both Canadian and foreign investors. Initially, a government entity known as Investment Canada was set up in order to assist investors in identifying and exploiting investment potential. However, in 1994, Investment Canada was disbanded and its activities were divided up between the Department of Foreign Affairs and International Trade and the Department of Industry. The latter handles notifications of new investments and applications for foreign investment approval.

Through its entry into the North American Free Trade Association (NAFTA) with the US and Mexico, Canada has a commitment to maintain an open trade policy.

The ICA imposed a requirement that investment be of net benefit to Canada. Foreign investors generally need only notify the Canadian government of their investment when establishing new businesses.

Canadian federal and provincial laws recognise both the right of a government to expropriate private property for a public purpose and the obligation to pay compensation. There has been no nationalisation of any foreign firm since the Second World War. Federal and provincial governments have, on occasions, taken over businesses in financial distress.

Canada is a member of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958). Canada accepts binding arbitration of investment disputes, to which it is a party only when it has specifically agreed to do so through a bilateral or multilateral agreement such as a Foreign Investment Protection Agreement. The resolution of investment disputes between the United States and Canada is guided by the provisions of the North American Free Trade Agreement (NAFTA).

Company Law

The following forms of business entity are used in Canada:

- sole proprietorships
- corporations
- partnerships
- joint ventures
- trusts

Foreign corporations operate in the following ways:

- no formal presence
- branch operations
- corporate subsidiary

The preferred option is to establish a corporate subsidiary. Permanent branch operations tend to result in extra taxation and corporate law considerations. In a province, a branch will also be subject to 'extra-provincial' licensing requirements.

Applications for incorporation must be filed with the Corporations Directorate of Industry Canada. The following information must be provided: name and location of registered office; capital structure; the attributes of each class of shares and any restrictions on share transfer; size of the board of directors; restrictions on the type of business to be carried out.

When conducting business in another province, a licence must be obtained by the company.

Corporations are usually established in a matter of days, with a cost of C\$500 for a certificate of incorporation.

In July 2002 Canadian securities regulators and accountants announced a new body to address investor concerns over the reliability of financial statements. The new Canadian Public Accountability Board plans to spend C\$6m a year on monitoring public company audits, which is double the amount currently assigned. The new inspections unit will undertake more frequent and thorough reviews of auditors, and publicly report the results. If problems arise, the board will also have the power to discipline firms, though ultimately enforcement power will continue to rest with provincial chartered accounting associations. The initiative does not change auditing rules, but strengthens the judgment of the auditor.

Competition Law

The relevant legislation is the Competition Act, enforced by the Canadian Competition Bureau - <http://strategis.ic.gc.ca/SSG/ct01250e.html>). The bureau has announced an overhaul of the country's competition laws, but there are several areas of ongoing debate. Konrad von Finkenstein, the competition commissioner, said in May 2002 that modernising section 45 of the Competition Act will be the centrepiece of this round of amendments, but some question whether the section needs changing at all. Section 45 concerns the law that makes anti-competitive conspiracy a criminal offence. At present, section 45 incorporates a market-effect test for all agreements, and does not have a *per se* cartel offence such as that in the US.

Environmental Law

Canada has a strong record of environmental protection and has instituted some of the more progressive policies among developed countries. It is also a signatory of the Kyoto Protocol that addresses global climate change. Environmental regulations are, in principle, shared by the provincial and federal authorities. In practice, provinces take responsibility for environmental regulations, such as pollution control, and garbage and sewage disposal. The federal authority generally controls broader areas, such as shipping, public works and inland fishing. Failure to comply with environmental regulations may result in prosecutions and heavy fines.

In November 2003, the Canadian Supreme Court upheld a federal government policy that requires businesses responsible for polluting the environment to pay for the clean-up of the area, known as the 'polluter pays' policy. Federal and state agencies will now be able to legally require companies that are found to have polluted the environment to cover all of the costs associated with the clean-up and restoration of the contaminated area, which could end up costing businesses across Canada millions or even billions of dollars.

In 1999, the Canadian Environmental Protection Act (CEPA) was passed, establishing a broad-reaching methodology for controlling and managing toxic substances in Canada and creating a stronger, more effective enforcement role for the federal environmental agency. The 'Compliance and Enforcement Policy' laid the groundwork for some of the most aggressive enforcement policies of any government. Canada has also instituted 'creative sentencing', granting enforcement agencies more flexibility and creativity when handing down penalties for environmental violations. The government has also dedicated a large amount of resources to the cause, having budgeted C\$5.3bn for environmental protection efforts between 1997 and 2007. However, a recent poll of Canadian executives found that environmental compliance had become so complex that only 30% of respondents believed the full compliance was even possible.

Foreign Exchange and Profit Repatriation

There are no exchange controls. Currency is fully convertible and there are no restrictions on the repatriation of capital or on transfers of profits and dividends.

Intellectual Property Law

Canada has comprehensive intellectual property laws that offer protection for patents, copyrights, trademarks and industrial designs.

Investment Restrictions

There are few restrictions on foreign investment in Canada.

The extent of foreign ownership is restricted in certain industries including banking, media, airlines, insurance, trust and loan industries.

At a provincial level, foreign investment policy has few differences from federal policy. However, some states prohibit foreign investment in real estate. Ontario and Quebec impose some limitations through a special land-transfer tax on the acquisition of real estate by foreigners.

An investment review is required if:

- The Canadian business is being acquired directly and the assets are valued at C\$5 million or more; or
- The Canadian business is being acquired indirectly with assets valued at C\$50 million or more.

In establishing whether or not the investment is of 'net benefit' to Canada, the following factors are taken into consideration:

- The effect on the level of economic activity in Canada.
- The significance of Canadian participation in the business.
- The effects on Canadian productivity, efficiency, technology, and product innovation and variety.
- The effects on competition within Canadian industries.
- The compatibility of the investment within the scope of economic activity and policy throughout Canada.
- The effect on Canada's competitiveness in a global context.

Investments that may have implications with regard to the cultural heritage and national identity of Canada are subject to review, regardless of size.

Assessment

Canada's open foreign investment policy is unlikely to change. To a large extent, economic progress has been made possible by a sustained inflow of foreign capital. The legal system offers an environment where foreigners are granted equal and fair treatment. The judicial system is transparent, offering foreign investors the necessary protection for their business interests in Canada.

Canada (Country Analysis) : Legal - Recent Updates

1. 25/11/2003 -  **COUNTRY Mutual Fund Firms in Canada Under Similar Scrutiny to US Counterparts**(In Brief)

2. 24/11/2003 -  **COUNTRY Conservative MPs in Canada File Lawsuit to Prevent Party Merger**(In Brief)

3. 13/11/2003 -  **COUNTRY Banking Regulators in Canada Target Offshore Accounts**(In Brief)

4. 07/11/2003 -  **COUNTRY Supreme Court of Canada Endorses Landmark 'Polluter Pays' Law** (Main Story)

5. 07/08/2003 -  **COUNTRY US Government Rules Against Patent Claim of Canadian Technology Firm** (In Brief)

6. 01/08/2003 -  **COUNTRY Proposed Agreement Between Canada and the US Over Lumber Fails**(In Brief)

7. 23/07/2003 -  **COUNTRY Competition Panel Rules Air Canada Engaged in Anti-Competitive Behaviour**(In Brief)

8. 20/06/2003 -  **COUNTRY Police Raid 13 Investment Firms in Toronto, Canada** (In Brief)

9. 12/06/2003 -  **COUNTRY** **Major Victory for Canadian PM as Vote Passes on Election Financing Reform**(In Brief)

10. 28/05/2003 -  **COUNTRY** **Partial Decriminalisation of Marijuana Stirs Deep Political Controversy in Canada**(In Brief)

11. 13/05/2003 -  **COUNTRY** **Canadian PM in Hot Water over Hotel Deal** (In Brief)

12. 04/09/2002 -  **COUNTRY** **Province Vows to Battle Federal Government Over Kyoto Ratification**(In Brief)

13. 24/07/2002 -  **COUNTRY** **Two Big Banks Caught Up in Enron Wall Street Web**(In Brief)

14. 18/07/2002 -  **COUNTRY** **New Regulatory Board Formed to Restore Investor Confidence**(In Brief)

15. 28/05/2002 -  **COUNTRY** **Debate Over Competition Law Reform** (In Brief)

Tax Environment

Current as of Thu 18 Dec 2003

Tax risks: 1.00

The tax system is complex but well-defined. There are a number of taxes at federal and provincial levels. The tax burden on personal and corporate income tax is quite high as a result of commitment from the government and public to use it to enact social and economic policies. For example, Canada maintains a national publicly-funded health system that has more in common with Europe than the US.

Tax Snap-Shot		
Corporate	%	Notes
Corporate Income Tax Rate (%)	28.12	Applies to all income not eligible for manufacturing, processing or small business deductions.
Capital Gains Tax Rate (%)	14.06	50% of all capital gains are subject to tax.
Branch Rate Tax (%)	35	
Withholding Tax (%)		Rates may be reduced by treaty.
Dividends	25	
Interest	25	
Royalties from Patents, Know-how etc.	25	
Branch Remittance Tax	25	This is imposed in addition to the regular corporate income tax.
Net Operating Losses (Years)		
Carryback	3	
Carryforward	7	
Personal	%	Notes
Top Rate: Earnings above C\$59,180	C\$12,724 on lower amount, plus additional 29% on excess	Since there is no definition of the term 'resident', it is often necessary to consult judicial decisions to determine whether an individual is resident for tax purposes.
Earnings between C\$29,590 and C\$59,180	C\$5,030 on lower amount, plus additional 26% on excess	
Earnings between C\$0 and C\$29,590	17%	

Tax Environment

Canada's tax rules are highly complex and reflect the desire of the federal and provincial governments to raise revenues as well as to effect social and economic policies. The level of federal and provincial taxes, as well as surcharges, make the tax burden quite high on personal and corporate income. Accounting advice should be sought by businesses operating in Canada.

For disclosure purposes, financial statements in Canada should include a balance sheet, an income statement, a statement of retained earnings and a statement of changes in financial position. Annual financial statements should be presented to the company's shareholders at an annual meeting. Public companies must file audited financial statements with the appropriate securities commission (federal or provincial). The tax year for individuals is the calendar year. The tax year for business need not correspond to the calendar year but may not exceed a period of 53 weeks.

The sources of accounting principles and practices are to be found in the Canadian Institute of Chartered Accountants (CICA) Handbook. The CICA is a member of the International Accounting Standards Committee (IASC) and therefore involved in the process of setting international standards. However, Canadian accounting practice does not always conform to international standards (and vice versa).

Tax and Duty Rates

Direct

Canada's sources of tax law include the Income Tax Act (1971), income tax treaties with other countries, provincial income tax acts and case law. The federal government is fully authorised to raise taxes, while provincial taxing is subject to more limitations. Both federal and provincial governments impose corporate and personal taxes on income, including capital gains and excise taxes. Residents of Canada are subject to tax on their international income, and non-residents are taxed only on income derived from inside Canada. In addition to collecting federal income tax, the federal government collects tax levied by the provinces.

Basic federal income tax is levied on the taxable income of corporations at the rate of 38%, which is generally reduced to 28% to compensate for provincial tax also imposed. Taxable income is allotted to each province in which the corporation has a permanent establishment, under a formula that provides equal weight to revenue received and wages paid.

Corporations resident in Canada, whether owned by Canadians or not, are taxed on their worldwide income. Non-resident corporations are taxable only on Canadian income. If incorporated in Canada after 1965, a company is usually deemed to be resident in Canada, though this can be changed if the corporation is incorporated and taxed as resident elsewhere.

Many foreign companies prefer to operate as a subsidiary rather than a branch. Subsidiaries are subject to tax in Canada on their worldwide income. Foreign corporations carrying on business at a branch or partnership are taxed at the corporate rate on their net business earnings in Canada. Branches must also pay an additional tax of 25% on after-tax income that is not reinvested in the business, though some tax treaties provide a C\$500,000 cumulative exemption from this.

Foreign tax credits are generally allowed if they do not exceed Canadian tax on foreign source income. The non-business tax credit from property is limited to 15% of gross foreign income from property. Tax credits may be carried forward for seven years or back for three years.

Indirect

The federal government levies a goods and services tax and all but one of the provincial governments levy a retail sales tax. The goods and services tax (GST) is a consumption tax similar to European VAT. It is levied at a rate of 7% on goods and services, collected by businesses or vendors, and passed onto the government. There is no GST on food, prescribed drugs, medical equipment and goods or services for export.

Excise taxes are levied by the federal government on various goods, including jewellery, automobiles, clocks and watches, gasoline, and certain other fuels, cigarettes, tobacco and wine. Excise duties are also imposed at various rates on the production of beer, spirits and tobacco.

Deductions and Exemptions

Significantly reduced federal tax rates apply to the first C\$200,000 of Canadian active-business earnings of companies not listed on the stock market which are at least 50% Canadian-controlled. This generally reduces the combined federal and provincial tax rate on small corporate earnings to between 18.12% and 22.62%, depending on the province in which income is earned. The credit is reduced for corporations with taxable capital of more than C\$10m and eliminated entirely for those with over C\$15m in income.

Corporations with manufacturing and processing activities are eligible for federal and provincial tax credits on manufacturing and processing profits. This reduces federal tax rates by 7%. It excludes activities such as farming and fishing, logging and construction.

Investment tax credits are available for certain qualified expenditures, and on property acquired for the use of the taxpayer for designated activities. ITCs may be used to offset federal income tax. They are determined by multiplying the capital cost of qualified property or the amount of qualified expenditures by a specified percentage. No limitations apply to the amount that can be claimed, which can be carried back ten years or forward up to three years. The ITC rate for current and capital expenditures on scientific research and

experimental development is generally 20%.

Canada (Country Analysis) : Tax - Recent Updates

1. 06/04/2001 -  **COUNTRY** Cigarette Tax Goes Up to Curb Youth Smoking (In Brief)

2. 29/02/2000 -  **COUNTRY** Budget 2000: National Debt and Tax Cuts Targeted (Main Story)

Operational Environment

Current as of Thu 18 Dec 2003

Operational risks: 1.50

In early 2003 there was considerable disruption to the operational environment after an outbreak of Severe Acute Respiratory Syndrome (SARS) in the Ontario province. This prompted the World Health Organization (WHO) to warn against travel to Toronto, Canada's main business centre. Otherwise, the operational environment is very good. Canada has a highly developed infrastructure. Union activity is quite high, but not restrictively so. Environmental awareness is high and protection is well-enforced by legislation. The increased focus on cross-border trade and security since the 11 September 2001 terror attacks in the US should enhance the speed and efficiency of the US/Canada border crossing.

Attitudes to Foreign Investment

Canada's economic development has depended heavily on foreign investment, and four of the top ten firms in Canada are foreign-owned. The Canadian government estimates that foreign investors control about one-quarter of non-financial corporate assets. Foreign direct investment in Canada has doubled since 1990. US investment in Canada grew an average of 6.9% a year, and is now 64% of total investment in Canada. The rationale for this investment is clear. The Canadian economic structure, business practices and development are more similar to the US than anywhere else in the world.

The US trades more with Canada than with all the EU countries combined, with trade between the two countries growing at an average annual rate of 10.4% between 1995 and 2000. The creation of NAFTA has speeded up this tendency by giving Canada long-term assured access to the US market by providing procedures for border facilitation, movement of personnel, investment and intellectual property protection and product certification. When added to existing geographical proximity, the increase in trade becomes unstoppable.

With a few exceptions, Canada offers full national treatment to foreign investors. Foreign investment activity is restricted only in strategic sectors including fisheries, energy, publishing, telecommunications, transportation and broadcasting. In addition, the Investment Canada Act requires federal regulatory approval for foreign investment in or acquisition of businesses over a certain size, those that are considered culturally sensitive, and any deemed to be in the 'national interest'. The investor must be notified of the progress of the review within 45 days. In the financial sector, the government has instituted a moratorium on mergers or acquisitions initiated by domestic or foreign firms while the parliament works on an overhaul of the financial services statutes that will eventually allow for more consolidation in the sector. In addition to these changes, the government is considering proposals to consolidate the nation's fragmented laws governing securities - which are currently defined primarily at the provincial level - so that the federal government establishes a uniform standard.

Labour

Canada has an advanced, affluent industrial economy that closely resembles the US in terms of per-capita output, market orientation and patterns of production. The Canadian labour force has certain advantages over the US. According to the US Bureau of Labor Statistics, labour costs in manufacturing are the lowest in the G-7 group of countries (US, UK, Japan, Germany, Italy, France and Canada). Occupational wages for knowledge workers are also lower than elsewhere. Statutory payments are also competitive - total payments for statutory benefits and Canadian employer-sponsored plans and time not worked are 27.1% of salary and wages, compared to 41.7% in the US. This is primarily due to lower medical insurance premiums.

Approximately 65% of the Canadian population over the age of 15 is in the labour force, which is comprised of 55% men and 45% women. Canada absorbs approximately 200,000 immigrants a year who are important as workers and investors. The federal minimum wage has been at C\$4 per hour since May 1986, although all provinces also have minimum wage laws for factory and service workers. Dismissed workers with over three months' service must be given at least two weeks' notice or two weeks' pay. Severance pay must be granted to workers with over five years' service, of at least two days' pay for each year worked. However, employers generally pay considerably more than this.

There are many substantial differences between employee benefit systems and labour market regulation in the US and Canada. The existence of a public healthcare system means that health benefits are not perceived as an employer cost, as they are in the US. Other differences are less stark, though significant nonetheless. For

example, public pension schemes are more generous in Canada, and private pension plans correspondingly less important. Compared to the US, Canada is more subject to centralised wage-setting processes, restrictive dismissal regulations, and high unemployment benefits. This means that the labour market lacks the flexibility of the US, with average unemployment rates in Canada more in line with European levels. Union action is not a major problem. However, a strike by Toronto municipal workers in July 2002 was the largest in Canadian history, involving 22,000 people and leaving garbage rotting in the streets for weeks.

According to the World Competitiveness Yearbook, Canada has the highest percentage of individuals achieving college-level education. It ranks fourth in the world in terms of the availability of skilled labour, whereas the US ranks 24th.

Bureaucracy

There are no significant bureaucratic obstacles to doing business in Canada. The Canadian bureaucracy is regarded as one of the best in the world, with several institutions safeguarding its credibility and efficiency. The Public Service Commission is responsible for merit and political neutrality, while the Treasury Board has formal responsibility for fairness, responsiveness and representation.

Corruption

In general, corruption is not a threat to business interests in Canada, and is very unlikely to affect the day-to-day lives of foreign investors in Canada. Transparency International ranks Canada as the seventh-least corrupt country in the world. The infrequency of major corruption scandals is demonstrated by the public and media furore over the current prime minister Jean Chretien's sale of a golf course in his parliamentary constituency. Weeks of parliamentary questions and newspaper headlines eventually led to all four opposition parties calling for a public enquiry, but the prime minister was ultimately to escape unscathed. More recently, former minister of public works Alfonso Gagliano was stripped of his post for allegedly giving public service jobs to his friends. Although scandals of this nature are infrequent, there is a high level of public concern over political corruption, with a recent poll revealing that 70% of Canadians believe the federal and provincial political systems suffer from corruption to some degree. This may be partially a result of the fact that Liberals have held power since 1993, which inevitably leads to some entrenchment of interests. On the whole, the opinion poll does not reflect the reality of the political or operational environment in Canada, but rather the high level of public vigilance on the issue.

Infrastructure

In early 2003 an outbreak of Severe Acute Respiratory Syndrome (SARS) prompted the World Health Organization to warn against travel to Toronto. While the authorities disputed the risk level, the episode caused considerable operational disruption for firms operating in Canada's business capital.

Overall costs for land, telecommunications, construction and electricity are between 7% and 15% lower than the US after taxes, depending on the industry. Building construction costs are roughly 15% lower than those in the US, even after accounting for additional materials for climactic conditions. On average, land costs are 6% lower than in the US, and office lease costs are 75% of those in the US. Average annual electrical costs for manufacturers are 76% of those in the US, and telecommunications and infrastructure costs are the lowest in the G-7.

A 1997 report by the World Economic Forum reported that Canada had the best transportation infrastructure out of the G-7 countries. Transportation rates in Canada are approximately 13% lower than those in the US. Canada is also well placed for access to the US.

Canada has two major railways, Canadian National Railways (CNR) and the Canadian Pacific Railway Company (CPR). Both offer inter-modal services to shippers between the Atlantic and Pacific Oceans. Both are highly integrated with the US railways. In particular, the CNR owns the Illinois Central Railroad and the Wisconsin Central Railroad, which give it direct rail connections all the way to the Gulf of Mexico.

Canada has more than 500,000 miles of public road, with a Trans-Canada highway linking all ten provinces. The provinces have jurisdiction over the road network, and shippers will require operating authority from the relevant provincial Department of Transport or Highways. The road network includes a large number of crossing points with the US and 18 major trade gateways. Since 11 September 2001, the two countries have agreed a 30-point plan for a 'smart border' which aims to increase efficiency as well as security. A secure card will be developed for permanent residents of the US and Canada, and the 'smart card' system for frequent travellers will be extended. Pre-approved businesspeople and lorry (truck) drivers will find it easier to cross between the countries. Facilities may also be established so that manufactured goods can get clearance at

their source, then be packed in sealed trucks and driven straight across the border.

Canada has access to the Pacific, Atlantic and Arctic Oceans and contains the world's longest inland waterway open to ocean ships - the Great Lakes/St Lawrence Seaway system. Vancouver is the largest port and the main terminal for shipments to the Asia-Pacific region. Major ports on the east coast are Montreal, Halifax, St John and Quebec City. Foreign vessels need a licence to operate commercially within Canadian waters.

Canada has a highly developed air transport system, including eight airports with over one million passengers per year. Canada has a national airline, Air Canada, with a comprehensive international and domestic service, which is supplemented by various other national and regional carriers. As of July 2001, Air Canada had roughly 80% of the domestic market and no major national competition. This situation results in domestic air fares that, on a per-mile basis, are generally higher than fares in the United States. Connections with the US are excellent and unrestricted. Since the September 2001 terrorist attacks in the US, security measures at airports and on flights have been increased to mirror those in the US. There is now more information-sharing about passengers on flights between the two countries, and measures to prevent travel document forgery. A new Air Security Authority now places armed undercover police on Canadian aircraft, and provides new explosive-detections systems and better training for airport personnel.

The telecommunications system is highly sophisticated, with standards equivalent to the US. Canada is integrated with the US direct dial long-distance telephone system.

Natural Hazards

Canada's location means that it suffers from extremely cold winters. Continuous permafrost in the north is a serious obstacle to development. There are cyclones east of the Rocky Mountains due to mixing air masses from the Arctic, Pacific and North American interior, which produce most of Canada's rain and snow.

Activism

Canadians tend to be environmentally aware, due to the vast amount of natural land in the country. Environmental legislation offers significant protection, and companies are liable for hefty fines if they cause environmental damage. Native aboriginal groups have successfully argued against corporations in several cases. Unresolved land claims have delayed development of natural gas reserves in the Canadian Arctic for two decades. PetroCanada has delayed construction of a pipeline due to a blockade in British Columbia. Development of a pipeline by Westcoast Energy Inc. and Transcanada Pipelines has also stalled because of protests in the NorthWest Territories. The groups want a moratorium on development until the environmental impact is assessed. They also want to be consulted before the British Columbia government hands out permits for energy-related projects, in addition to a share of the benefits.

Anti-globalisation political activists are fairly active, and the US comes in for particular criticism for its alleged cultural and commercial imperialism. Recently, the government has acted against over-zealous protestors, removing the tax status of various anti-globalisation NGOs.

Practical Advice

Business customs in Canada closely resemble those in the US. However, visitors should pay close attention to the fact that Canada is officially bilingual, with English and French as the national languages. English is the first language of the geographical majority, and the accepted language of business. The province of Quebec is officially French-speaking, and New Brunswick is bilingual.

Canada (Country Analysis) : Operational - Recent Updates

1. 25/11/2003 -  **COUNTRY Mutual Fund Firms in Canada Under Similar Scrutiny to US Counterparts**(In Brief)

2. 24/11/2003 -  **COUNTRY UN Resolution Condemning Human Rights Situation in Iran Pushed by Canada**(In Brief)

3. 30/10/2003 -  **COUNTRY Report Criticises Canada's Coastal Defence** (In Brief)

4. 27/10/2003 -  **COUNTRY** **Two El Al Flights to Canada Diverted Over Terror Threats**(In Brief)

5. 21/10/2003 -  **COUNTRY** **Prime Minister of Canada Urges More Countries to Send Troops to Afghanistan**(In Brief)

6. 17/09/2003 -  **COUNTRY** **Efforts to Curb Greenhouse Gases in Canada Fall Short**(In Brief)

7. 13/08/2003 -  **COUNTRY** **Kyoto Protocol Programme in Canada to Receive Additional US\$721m**(In Brief)

8. 12/08/2003 -  **COUNTRY** **Airline Unions in Canada Granted Access to Investors**(In Brief)

9. 23/07/2003 -  **COUNTRY** **Union and Canada Post Agree on Settlement**(In Brief)

10. 22/07/2003 -  **COUNTRY** **New Government Fees Further Straining Canadian Airlines** (In Brief)

11. 18/07/2003 -  **COUNTRY** **Postal Workers' Strike in Canada Looms** (In Brief)

12. 03/07/2003 -  **COUNTRY** **Toronto Declared Free of SARS** (In Brief)

13. 30/06/2003 -  **COUNTRY** **Mad Cow Disease Still Poses a Threat to Canadian Beef**(In Brief)

14. 20/06/2003 -  **COUNTRY** **Police Raid 13 Investment Firms in Toronto, Canada** (In Brief)

15. 10/06/2003 -  **COUNTRY** **Mad Cow Fears Subside in Canada** (In Brief)

Security Environment

Current as of Thu 18 Dec 2003

Security risks: 1.00

The security environment in Canada has inevitably suffered the consequences of the September 2001 terrorist attacks in the US, and there has been heavy US pressure to enhance anti-terrorism measures. The 2002 budget increased defence and security spending, in response to US criticisms that the Canadian border provides a major entry route for terrorists. Airport and border security is now much tighter. Aside from the new terrorist threats, the security environment is stable, with low crime rates and little organised crime. Some argue that the military is under-funded, with out-of-date, inadequate equipment.

Key Security Issues

- Inevitably, the terrorist attacks in the US have greatly heightened security concerns in Canada. A series of revelations emerged in the wake of 11 September 2001 and led to allegations from the US that inadequate security in Canada had made the job of the terrorists easier.
- The Canadian government acted quickly to increase defence and security measures. The December 2001 budget assigned an additional C\$7.7bn (US\$4.9bn) to improve trade flows with the US and enhance Canada's intelligence and military capabilities. This included C\$1.2bn (US\$7,600m) to create a border that is 'open to trade but closed to terror', as Canada attempts to increase its economic ties with the US while it enhances security.
- The money allocated has speeded traffic at the congested border crossings, using hi-tech pre-screening equipment. Funds have also boosted existing border enforcement teams, and enhanced inspection for vehicles that do not have pre-allocated border clearance.
- There has also been a renewed focus on improving air travel safety, increasing defence spending and more rigorous screening for immigrants and refugees.
- In addition, a new anti-terrorism bill came into force in December 2001, which gave officials the ability to detain people for 72 hours without a warrant, collect DNA samples from terrorist suspects, deport immigrants suspected of terrorist links and declare military zones in areas where terrorist cells are suspected.
- The measures are more liberal than those passed in the US, but have still provoked concerns from civil rights groups and trade unions. Allegations that the government is pandering to the US have been given further weight by a sweeping new border security pact, and an increase in FBI presence in Canada.
- In April 2002, the US announced a reorganisation of the military with a new focus on domestic and continental defence. Canada is certain to be partially included in the continental security measures, but the defence minister has stressed that it will retain control of its sovereignty and armed forces. Canada is set to join the US's ambitious missile defence system.

Crime

Crime rates are relatively low, and have generally been falling over recent years. However, in 2001 came the first increase reported in 10 years. There were 7,747 incidents per 100,000 people that registered under the Criminal Code in 2001, 1% up on 2000. Levels of crime are higher in the major cities, such as Montreal and Toronto, and crime tends to be concentrated in the poorer neighbourhoods.

Organised Crime

Foreign investors are unlikely to be affected by organised crime. Although levels of organised crime are not particularly high, concerns have been raised about the activities of a number of criminal groups.

- Asia-based groups control a significant share of the importation and distribution of heroin from South-East Asia. They are also believed to play a major role in computer software piracy and in the theft and export of luxury automobiles. Russian organised crime groups are reported to be active in many parts of the country with relation to the smuggling of stolen commodities, including luxury automobiles, computer equipment and other consumer goods. Aboriginal street gangs appear to be growing and extending activities across the prairies and into Northern Ontario and are forging links with other organised crime groups.
- The smuggling of illegal migrants has grown over the past few years. This is a particularly lucrative enterprise for the smuggling groups involved, as large sums of money can be extracted from a vast pool of potential migrants, whilst the legal consequences are negligible.

Extortion

Extortion is uncommon and will not affect foreign investors.

Kidnapping

Kidnapping is not a relevant security concern for foreign investors.

Political Violence/Terrorism

Political violence is almost non-existent in Canada. There has been no violence directed at foreign investment in recent memory. There have been some violent incidents related to environmental disputes, but these were directed against Canadian-owned natural resource companies or against the Canadian government. The recent G8 meeting passed without major security incidents, partly because the summit itself was held in a remote, inaccessible mountain resort. However, demonstrations in nearby cities also caused minimal disruption and were conducted peacefully and without extensive crime.

Canada (Country Analysis) : Security - Recent Updates

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 2. 02/12/2003 -  **COUNTRY** **Canadian Prisoner Freed from US Detention Centre Was Trained by Al-Qaida**(In Brief)

 3. 24/11/2003 -  **COUNTRY** **Intelligence Assessment by Canadian Authorities Cites Terrorist Threat**(In Brief)

 4. 24/11/2003 -  **COUNTRY** **UN Resolution Condemning Human Rights Situation in Iran Pushed by Canada**(In Brief)

 5. 30/10/2003 -  **COUNTRY** **Report Criticises Canada's Coastal Defence** (In Brief)

 6. 27/10/2003 -  **COUNTRY** **Two El Al Flights to Canada Diverted Over Terror Threats**(In Brief)

 7. 23/10/2003 -  **COUNTRY** **New Fears That Terrorists Are Eyeing Canada** (In Brief)

 8. 07/10/2003 -  **COUNTRY** **New Technology Will Bring Emergency Workers in Canada Up to Date**(In Brief)

 9. 28/08/2003 -  **COUNTRY** **Canadian Officials Claim Arrested Suspects Are Al-Qaida Head's Agents**(Main Story)

 10. 16/07/2003 -  **COUNTRY** **Tensions Build over Death of Canadian Journalist in Iran** (In Brief)

 11. 30/04/2003 -  **COUNTRY** **WHO Lifts Travel Warning Against Canada, as Rescue Package Drawn Up**(In Brief)

 12. 22/04/2003 -  **COUNTRY** **SARS Disruption Continues to Mount in Canada** (In Brief)

 13. 04/09/2002 -  **COUNTRY** **Defence Committee Warns of Vulnerability to Terrorist Attacks** (In Brief)

 14. 28/06/2002 -  **COUNTRY** **G8 Summit Hailed as Security Success** (In Brief)

 15. 25/06/2002 -  **COUNTRY** **Security Setback for G8 Summit** (In Brief)
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