Box D: International Direct Investment and Canada's Position in the NAFTA

Direct Investment Flows

FDI decisions are governed by firms' actions to locate production and related activities in plants that are most cost-effective. These decisions consider the advantages associated with labour costs, government incentives, liberalization of cross-border investment, potential economies of scale or scope, rationalization of plant facilities through cross-border mergers and acquisitions, and access to foreign markets by bypassing trade barriers.

FDI flows, whether inward or outward, are beneficial in a number of ways. Firstly, such investment flows tend to strengthen commercial links between the host and recipient countries, and raise the overall level of trade (and economic exchange more generally) between the two countries. Recent empirical work has confirmed that FDI plays an important role in fostering international spillovers of technological information for both developing and advanced economies.[21] FDI provides a mechanism for transferring technology that cannot be achieved through trade in goods and services and financial investments. FDI increases the flow of knowledge spillovers, both from and to the investing multinationals, and benefits both countries through gains in employee training and enhanced opportunities to exploit economies of scale in R&D and production. Growth theorists have introduced knowledge spillovers resulting from trade in goods and FDI, and the ability to imitate the products of foreign producers as engines of endogenous growth. In the host country, inward FDI tends to raise imports in the short-term and stimulate exports in the longer run, as exports will rise when new production facilities associated with the FDI come on line. International flows of capital can also reduce the risk of investment by providing regional diversification of portfolio. Another benefit of FDI flows is that they tend to reduce both the risk and magnitude of potential international financial crises, as such long-term flows cannot and tend not to be quickly reversed, unlike short-term capital flows.

Table D1: World FDI Inflows in US$ millions

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
World	200,612	203,812	157,773	175,841	219,421	255,988	331,844	377,516	473,052	680,082	865,487
NAFTA	75,928	58,322	29,502	28,055	54,998	64,275	77,555	103,277	130,080	218,259	311,827
Canada	5,018	7,855	2,740	4,777	4,749	8,207	9,257	9,636	11,761	21,705	25,061
United States	67,736	47,918	22,020	18,885	43,534	45,095	58,772	84,455	105,488	186,316	275,533
Mexico	3,174	2,549	4,742	4,393	6,715	10,973	9,526	9,186	12,831	10,238	11,233
Distribution of NAFTA FDI Inflows (percent)											
Canada	6.6	13.5	9.3	17.0	8.6	12.8	11.9	9.3	9.0	9.9	8.0
United States	89.2	82.2	74.6	67.3	79.2	70.2	75.8	81.8	81.1	85.4	88.4
Mexico	4.2	4.4	16.1	15.7	12.2	17.1	12.3	8.9	9.9	4.7	3.6

Source: UNCTAD World Investment Report, Annex Table B.1

[21] Lee Branstetter, Is Foreign Direct Investment a Channel of Knowledge Spillovers? Evidence from Japan's FDI in the United States, NBER Working Paper no. W8015, November 2000.