5. Canada-EU Foreign Direct Investment

While exports and imports appear on the current account of balance of payments, foreign direct investment appears on the capital account. Much of the world's foreign direct investment (FDI) is undertaken by multinational enterprises (MNEs), approximately 60 percent on average during the 1980s. The nature of FDI flows is very unlike merchandise trade flows, as FDI largely consists of equity and debt held by firms in affiliated corporations located in nations other than the home nation of the investor firm. The key defining characteristic of FDI is corporate control, which separately identifies FDI from foreign portfolio investment. The normal criterion for a foreign investment to be deemed a FDI is the ownership or control of 10 percent or more of an enterprise's voting securities.

The majority of the investment in the 1980s took place between the regional blocs of the EU, North America and Japan (see Graham and Krugman (1993)), but emerging trends in the 1990s suggest that much of the FDI being undertaken by MNEs is directed towards newly industrialised nations, especially in Asia. Much of the FDI flows in the 1980s replaced trade flows, as MNEs opened new subsidiary production facilities in North America and the EU. In contrast, the rapid growth in the Asian economies, and in particular China, suggests that much of the FDI flows in the 1990s created trade flows. The question, though, as to whether FDI is on balance a trade complement or substitute remains a largely unanswered question (see Graham (1996)), and in any case is clearly state-dependent.

5.1 Canada-EU FDI Flows

The subject of Canada-EU FDI flows has not been explored in any depth, although Buckley and Clegg (1996) provide an interesting statistical summary of transatlantic FDI flows (including Canada), and Canzoneri, Ethier and Grilli (1996) also provide some useful insights into the nature of transatlantic FDI flows.

Table 5.1 provides some statistics on FDI flows between Canada and the EU. The first column represents the balance of net flow of Canadian FDI in the EU, and it is almost uniformly negative, representing a net increase in assets held by Canadians in the EU. As expected, the second column which records EU FDI in Canada shows largely positive numbers, indicating an increase in EU holdings of Canadian assets. The third column represents the balance of these net FDI flows, a positive figure indicating greater FDI by EU entities in Canada than Canadian entities have invested in the EU. None of the figures show any discernable trend, with erratic changes in the statistics year on year. This is usual for FDI data, which can vary greatly according to the international strategies adopted by various MNEs or groups of MNEs. It is apparent from the table, though, that during the 1980s, a large amount of EU FDI arrived in Canada, particularly from the UK, which largely confirms the anecdotal evidence at the time, when many British MNEs reportedly decided to initiate some kind of market presence in the North America. This surge in FDI to Canada has not continued apace in the 1990s, as media reports suggest that many EU MNEs have decided to use the US as their principal North American base for production and distribution to the NAFTA member countries. In the 1990s the data also suggests that Canadian MNEs have sought to exploit the advantages of the single market, the opportunities that have arisen in a unified Germany and the favourable trading agreements that have been established for EU companies to trade with the newly emerging Eastern European economies (see Greenaway (1993) for an analysis of the effects of the single market on EU incoming FDI).

The final column in the table shows that the net flows in FDI between Canada and the EU seem to be largely in the same direction as the total transatlantic capital flows (in simple terms net FDI plus changes in Canadian and EU capital market portfolios plus net changes in official reserves). These figures might suggest that the return on capital market financial instruments largely reflects the return on FDI. Classical economic theory would tend to suggest that investment should flow to the nation with the highest marginal rate of return on physical capital, but in fact research by van Nieuwkirk and Sparling (1995) suggests that average rates of return on Dutch investment in the US or Japan during the period