This study examines probable changes in foreign direct investment within Canada by multinational enterprises (MNEs) in response to three separate choices for Canada's bilateral trade policy with the United States.[1] Our examination seeks answers to three questions about MNE responses to reductions in trade barriers that currently inhibit Canadian trade flows with the United States. First, will the level of foreign control over domestic industries change significantly? Second, will foreign-owned firms change their Canadian strategy by updating their Canadian production techniques, or mandating Canadian operations with exclusive rights for worldwide production of one output? Third, what is the impact on our trade with the United States of various economic determinants and policy determinants that are independent of foreign direct investment? Our answers assess key aspects of MNE responses to reduced bilateral trade barriers with the United States.

Clarification of the central concepts is necessary for the study. A MNE is a firm controlled by foreign residents with productive activities located in Canada. Foreign direct investment occurs through foreign residents' acquisition or enhancement of controlling interests in a corporation by purchases or augmentation of Canadian equity holdings. Hence, this study investigates how foreign-controlled domestic firms would respond to three separate options for our bilateral trade policy with the United States. The three policy options are:

- an unrestricted bilateral free trade agreement making Canada and the United States a free trade area;

- a bilateral free trade agreement restricted to either specific sectors or to sectors currently subject to trade restrictions defined in terms of functional areas; and