7. Policy Considerations

Some broad policy considerations can be addressed given the linkages between foreign direct investment and trade discussed above. In general terms, three broad categories can be identified for government policy. These include: Canada as a host country attracting foreign direct investment; Canada as an outward investing country; and Canada as a trading nation in world markets.

7.1 Canada as a Host Country Attracting FDI

Presently, the literature and current analysis have shown that FDI confers considerable benefits to host economies. FDI makes goods and services available at lower prices and/or larger amounts than was possible before the investment. It functions as a conduit for the flow of skills, information, technology and other know-how. FDI intensifies competition and accelerates the rate of innovation in local markets. Although all of the above benefits may not be present in each and every case of FDI, their absence does not mean the FDI should not be allowed.

With regard to host economies and trade policies, a number of factors become important when discussing potential trade policy options. First, the trade impact of FDI on the host economy cannot be predetermined, because FDI interacts with the host economy environment. The interaction of the FDI and the host economy will determine what will be the trade impacts. Although the characteristics of the host economy and the firms are important, they will not solely responsible for determining the trade impacts.

Second, the trade policy environment of the host economy can influence the export performance of multinationals investing and operating in the host economy. Trade orientation is low in economies which promote import substitution such that exports are penalized, either directly or indirectly. Conversely, studies have shown that open economies tend to attract trade-oriented FDI. As noted earlier, the potential exists for FDI into tariff-protected sectors of the host economy to result in a misallocation of resources and suboptimal welfare levels. Thus, the benefits of an open trading environment cannot be overemphasized, especially when one is considering the impacts of FDI on host economies.

Third, government domestic policies have an important role in attracting FDI. The domestic policy environment should be one of neutrality or non-discrimination. More specifically, the neutrality condition implies the equal treatment of foreign and domestic firms, prohibiting such practices as special reporting requirements for foreign owned firms and local content requirements. In addition, there should be neutrality between trade and investment policies. Trade and investment policies should be evaluated on the basis of the potential introduction of distortions which would affect investment or trade.