

a customs union. The transactions cost savings in the long run associated with EMU will provide minor gains for both EU and foreign firms in Europe.

- Other major distinguishing features of FDI are that it is often motivated by a desire for strategic relationships among firms (vertical or horizontal integration), and that it conveys or provides access to technology. Neither of these are directly related to EMU.

EMU will likely have little if any direct effect on FDI flows. In fact, in the short run since FDI is very sensitive to the stability of the policy regime, EMU could lead some investors to adopt a wait and see attitude, and so reduce FDI into Europe.

There could be indirect effects from two sources. If EMU provides an impetus to other regulatory and market reforms in Europe which raise growth rates and profitability, then perhaps FDI would be attracted as a secondary effect. This situation (a more prosperous Europe with rising incomes and output) should on balance be good for Canada. Another possibility is that even though EMU has no concrete impact on profitability and market access for FDI, the perception of Europe as one market might be enhanced, which might attract FDI for a time (this is more likely to impact liquid portfolio investments first). These kinds of psychological impacts in financial markets can be important. However if the perceptions are not grounded in fact, they lead to "overshooting" and a consequent negative correction. In this case the Europe-bound FDI would not be sustained.

6. Conclusion: Summary of Implications

FOR EUROPE:

- The EMU will force Europeans to come to grips with internal market adjustment policies. National monetary policies and variable exchange rates among countries provided a means for countries to absorb economic shocks. Under EMU, there are no independent national monetary policies, and fiscal independence will be reduced by the recently concluded Stability Pact. Such adjustments will have to be made in national or regional goods and labour markets. Most economic observers agree that European labour markets do not currently have the flexibility for this, which could lead to greater dispersion in unemployment rates across regions and countries. However if EMU provides the impetus for the Europeans to tackle the difficult issues of legislative harmonization and deregulation in labour, goods, and services markets, potential growth, employment, and incomes would expand over the medium to long run.
- Much of the discussion surrounding EMU refers to the supposed investment and growth-creating aspects of the single market created by EMU. This appears