

principal back in euros. The federal government has no such securities outstanding at the moment, but crown corporations, provinces, and corporations have a considerable amount.

International Portfolio Diversification and the Canadian Dollar

It has been suggested that EMU will provide international investors with fewer currencies to choose from in building a diversified portfolio, and so more funds might flow into Canadian dollar denominated assets. While market turbulence elsewhere occasionally has had and will continue to have impacts on Canada, it will be hard to discern a sustained impact from the demand for diversification.¹³

- Canada is perceived by global investors as closely integrated with the USA. The Canadian dollar tracks the US dollar more closely than other major currencies do, and so provides little added diversification value for global investors.
- Although there are $\pm 15\%$ margins for European currency fluctuations, in practice European authorities try to keep fluctuations within a much narrower range. As a result, Europe is perceived already as a fixed exchange rate regime. EMU will merely confirm this perception.
- By the time EMU is completed (2002 or later), the world will continue to be multi-polar, providing new opportunity for diversification and currency speculation. While much of the European continent may be under a single currency, other parts of the globe will be emerging as large economic and financial centres - China, other parts of Asia, and Russia.

Foreign Direct Investment (FDI)

It has been suggested that EMU will attract a greater share of global FDI flows into Europe, to Canada's detriment. To examine this argument, we need to look at the distinguishing features of FDI and see how these relate to EMU.

- FDI is patient, long-term, illiquid equity capital. Equity investors accept high risk and, in compensation, expect high returns. Short-run exchange rate volatility (or the lack of it, which EMU will guarantee) should not matter very much to FDI.
- A major traditional use of FDI by firms is to gain market access behind tariff and non-tariff barriers. EMU will not change market access; Europe already is

¹³Some would argue that the presumed motive for the capital flows - to achieve diversification - is not as important as speculative motives based on active currency management principles.