

It still remains unclear as to what will happen to floating rate notes - it may be that Member State central banks will specify how financial instruments with floating rates are to be converted into euro floating rate instruments, as current national differences in specification may cause adverse effects in these markets. As for derivatives, it is likely that as these instruments are to a large extent traded as "risky" instruments, then contractual provision will be issued to specify that the introduction of the euro will not "of itself" permit termination of the contract.

Canadian financial institutions are no doubt aware of some of the technical issues surrounding the introduction of the euro, and will make appropriate changes to their contracts with clients both in Canada and abroad.

After the transition phase, the most important consideration for services exports and imports will be the exchange rate policy and associated monetary policy of the ESCB and the ECB in particular. There have been some suggestions that the ECB will target monetary policy on maintaining a relatively stable exchange rate against the US dollar, and if this is the case, then this may enhance the prospect of transatlantic trade in services.

## **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