6. FDI Issues

Little attention has been given to the issue of FDI in Europe and the effects of the single currency on investment flows. Indeed, the European Commission expects that there will be no significant effects, so that the issue is generally being ignored by EU officialdom. The Commission's view is that if there are any effects then these will already have happened as part of the single market, and EMU will not have any significant impact on FDI, apart from determining locational preference. This view may have been orchestrated by recent, well-publicised decisions by Japanese MNEs as to where to locate incoming FDI in the EU, the decision being initially made apparently on the basis of likely Member State participation in the third stage of EMU.

Irrespective of the lack of any research in this area, a qualititative analysis will be attempted below. In the Canadian context, the issue of FDI in Europe can be characterised on two levels;

- it is largely undertaken by MNEs; and
- it is usually in the form of portfolio capital rather than physical capital.

Both these characterisations have economic implications for FDI flows. Each is dealt with in turn.

6.1 MNEs and FDI

The theory of the multinational (see Buckley and Clegg (1996), who summarise the so-called Dunning (1979) approach) states that there are three key motives for FDI - first, market-oriented FDI, where firms choose to invest in a market rather than alternative forms of foreign market servicing; the second is input-oriented FDI, where investment abroad is chosen as the best means of gaining access to key factors of production (raw materials, specific labour skills for example); and third, cost-oriented FDI where investment abroad is aimed at reducing costs of production. The form of FDI is also important - issues here include the ownership strategy (joint ventures or wholly-owned subsidiary) and the choice between takeovers and "greenfield" entry.

Other factors are also of importance in determining the level of FDI. First, cultural similarities help to reduce "psychic distance" - hence, given Canada's heritage, it would suggest that FDI between Canada and the UK, and Canada and France and Belgium should be particularly strong: to a certain extent this is borne out by the data. Second, FDI tends to take place between countries at similar levels of development - therefore it is likely that there should be a higher level of exchange of FDI between Northern Europe and Canada than Southern Europe. Lastly, FDI takes place in an environment of increasing regional integration in both North America and the EU.

In terms of general trends in Canada-EU FDI, the dominant trend from a sectoral point of view is the shift in the composition of national FDI from manufacturing industries to the services sector, where the leading investors in recent years have been the finance industry and the telecommunications industries. As far as the transatlantic FDI is concerned, the leading recipient of North American FDI has been the UK, and likewise, the prime origin of transatlantic FDI has also been the UK, with over 25 percent of US FDI, and just under 10 percent of total incoming Canadian FDI. This largely reflects the fact that the UK now possesses an extremely open economy and the largest EU sectors in both finance and telecommunications, due to the elimination of many trade barriers in the early 1980s and the extremely competitive environment that has transformed these two strategic industries.

The effects of EMU in this area are rather intangible and not easily quantifiable. The effects also largely depend on the dynamics of integration and the configuration of "insiders" and "outsiders" in the EU. Martin and Ottaviano (1995) raise concerns about the emerging integration dynamic for the EU, given that EMU goes ahead, and point to "agglomeration" effects, whereby those Member States that proceed in the first wave of EMU may benefit from the formation of a stronger but smaller "core" single